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Interpretative doubts in the context of regulations regarding the tax on the income of controlled foreign entities¹

**Wątpliwości interpretacyjne na tle regulacji
dotyczących podatku od dochodów
zagranicznych jednostek kontrolowanych**

Abstract. The main purpose of the publication is to determine the role and significance of the tax on income of the CFC generated by a taxable person as a taxation mechanism aimed to tax income earned by foreign entities controlled by Polish taxpayers, based in countries with more preferential tax regulations than

¹ From 1 January 2019, pursuant to the Act of 23 October 2018 amending the Personal Income Tax Act, the Corporate Income Tax Act, the Tax Law and certain other acts (Polish Journal of Laws, item 2193) there was a change of a name from “a controlled foreign company” to “a controlled foreign entity.” The name change was caused by the extension of the catalogue of entities which a Polish tax resident may be obliged to tax in Poland. Despite the name change, the author will refer to the term “CFC” in relation to both “a controlled foreign company” and “a controlled foreign entity.”

Poland. The article indicates the possible inaccuracies and doubts caused by the CFC regulations and their interpretation. The aim of the article is also an attempt to assess the effectiveness of the abovementioned regulations, taking into account the revenue of the state budget from the taxation of controlled foreign companies. The remarks included in the study were prepared using the analytical and dogmatic-exegetical methods, mainly based on the interpretation of the provisions of the PIT Act and the CIT Act, as well as views of the doctrine. The Operational reports are the source of empirical data on the implementation of the state budget in 2015–2018.

Keywords: controlled foreign entity; counteracting tax avoidance; tax on the income of a controlled foreign entity generate by a taxable person.

Streszczenie. Zasadniczym celem publikacji jest ustalenie roli i znaczenia podatku od dochodów zagranicznych jednostek kontrolowanych jako instrumentu prawopodatkowego stworzonego w celu opodatkowania dochodów osiąganych przez jednostki zależne od polskich podatników² podlegające opodatkowaniu w państwach o bardziej preferencyjnych systemach podatkowych niż obowiązujące w Polsce. W artykule wskazano najistotniejsze wątpliwości interpretacyjne, jakie wywołują przepisy dotyczące CFC. Autorka podejmuje także próbę oceny skuteczności wspomnianych regulacji, analizując wysokość wpływów do budżetu państwa z tytułu podatku od zagranicznych jednostek kontrolowanych. Uwagi zawarte w opracowaniu zostały sporządzone przy wykorzystaniu metody analitycznej oraz dogmatyczno-egzegetycznej przede wszystkim w oparciu o wykładnię przepisów ustawy z dnia 26 lipca 1991 r. o podatku dochodowym od osób fizycznych³ oraz ustawy z dnia 15 lutego 1992 r. o podatku dochodowym od osób prawnych⁴ jak również z uwzględnieniem poglądów doktryny. Źródłem danych empirycznych są sprawozdania operatywne z wykonania budżetu państwa w latach 2015–2018.

² The expression “a Polish taxpayer” in this study means a tax resident in Poland in accordance with Article 3, section 1 of the CIT Act and Article 3, section 1, and 1a of the PIT Act, i.e. a legal person or a natural person subject to Polish tax liability on all their income (revenue) regardless of the location of the sources of revenue (unlimited tax liability).

³ The Personal Income Tax Act of 26 July 1991 (Dz.U. [Polish Journal of Laws] of 2019, poz. [item] 1387, with subsequent amendments), hereinafter: the PIT Act.

⁴ The Corporate Income Tax Act of 15 February 1992 (Dz.U. of 2019, poz. 865, with subsequent amendments) hereinafter: the CIT Act.

Słowa kluczowe: zagraniczna jednostka kontrolowana; zapobieganie unikaniu opodatkowania; podatek od dochodów zagranicznej jednostki kontrolowanej.

1. Introduction

Provisions regarding the taxation in Poland of the income of Controlled Foreign Companies were added to the CIT Act and the PIT Act pursuant to the Act of 29 August 2014 amending the Corporate Income Tax Act, the Personal Income Tax Act, and certain other acts⁵, and entered into force on 1 January 2015. Since then, these provisions have been amended several times, including on 1 January 2018⁶ owing to the need to implement Council Directive (EU) 2016/1164 of 12 July 2016 establishing provisions to counteract tax avoidance practices that have a direct impact on the functioning of the internal market,⁷ and later from 1 January 2019⁸.

The obligation of the Member States to tighten the taxation rules of controlled foreign entities with the ATA Directive is consistent with actions taken internationally by the Organization for Economic Co-operation and Development (OECD) as a part of a project on counteracting tax base erosion and profit shifting (BEPS – *Base Erosion and Profit Shifting*). In the BEPS report of July 2013,⁹ and then in the final report published by the OECD on 5 October 2015, among 15 actions, the CFC institution was indicated as Action No 3, which was to prevent taxpayers from avoiding taxation through the use of foreign entities, with their seat or management board in countries, as a rule, with a lower level of taxation than the one in

⁵ The Act of 29 August 2014 amending the Corporate Income Tax Act, the Personal Income Tax Act, and some other acts (Dz.U. poz. 1328).

⁶ Pursuant to the Act of 27 October 2017 amending the Personal Income Tax Act, the Corporate Income Tax Act, and the Act on the flat-rate income tax on certain revenue generated by natural persons (Dz.U. poz. 2175); hereinafter: the 2018 amendment.

⁷ The Council Directive (EU) 2016/1164 of 23 July 2016 establishing provisions to counteract tax avoidance practices that have a direct impact on the functioning of the internal market [2016] OJ L 193/1, hereinafter: the ATA Directive.

⁸ Pursuant to the Act of 23 October 2018 amending the Personal Income Tax Act, the Corporate Income Tax Act, the Tax Law, and certain other acts (Dz.U. poz. 2193).

⁹ The OECD Report, *BEPS Action Plan, Action Plan on Base Erosion and Profit Shifting*, 2013 <https://www.oecd.org/ctp/BEPSActionPlan.pdf> (access on-line: 06.11.2019).

force in Poland¹⁰. The common goal of the above legal acts and the CFC concept was to ensure the efficiency of national tax systems and the taxation of an income generated by corporate enterprises in the countries where profits are generated¹¹. The doctrine formulated the right view, justifying the introduction of the CFC regulation, which was that the degree of erosion (reduction) of the tax base and profit shifting has already reached such a level that the effectiveness of preventive measures began to require consolidation of forces on an international scale¹².

It is pointed out that if it were not for regulations on foreign controlled entities, taxpayers could defer a tax liability or even avoid it through the artificial allocation of the so-called passive sources of an income to foreign entities not conducting actual economic activity¹³. By introducing the CFC into Polish legal order, the legislator aimed at sealing the national tax system in such a way as to prevent Polish taxpayers from shifting their profits to foreign entities they control¹⁴.

The purpose of this study is to determine the role and the significance of regulations related to the CFC institutions as an international tax law instrument created to prevent tax avoidance, as well as to assess the effectiveness of the CFC provisions from the perspective of the amount of a state budget revenue from tax on foreign controlled entities. The whole study ends with a summary and presentation of *de lege ferenda* conclusions.

¹⁰ Final Report on BEPS No 3 *Designing Effective Controlled Foreign Company Rules*, https://read.oecd-ilibrary.org/taxation/designing-effective-controlled-foreign-company-rules-action-3-2015-final-report_9789264241152-en#page1 (access on-line: 06.11.2019).

¹¹ B. Kuźniacki, F. Majdowski, *Kolejne zmiany w opodatkowaniu dochodu kontrolowanej spółki zagranicznej*, LEX/el. 2018, System Informacji Prawnej Lex.

¹² L. Mazur [in:] B. Brzeziński, K. Lasiński-Sulecki, W. Morawski, *Nowe narzędzia prawne w podatkach dochodowych i majątkowych. Poprawa efektywności systemu podatkowego*. Warszawa 2018, System Informacji Prawnej Lex.

¹³ F. Majdowski, *Czy stosowanie regulacji CFC stoi w sprzeczności z postanowieniami Dyrektywy o spółkach matkach i spółkach córkach?*, "Monitor Podatkowy" 2018, No 6, System Informacji Prawnej Legalis.

¹⁴ Explanatory statement to the government draft act amending the Corporate Income Tax Act, the Personal Income Tax, and amending certain acts, Sejm paper No 2330, <http://www.sejm.gov.pl/Sejm7.nsf/druk.xsp?nr=2330> (access on-line: 06.11.2019).

2. The essence of CFC concept

The essence of the CFC concept is that after fulfilling the conditions specified in the CIT Act or the PIT Act, Polish taxpayers are subject to taxation of the income obtained by controlled foreign entities owned by those taxpayers. The tax rate was specified in Article 24a, section 1 of the CIT Act, and Article 30f, section 1 of the PIT Act, and amounts to 19%. Polish taxpayers are additionally required to declare the income of controlled foreign entities in a separate CIT-CFC or PIT-CFC tax return. Furthermore, Polish taxpayers are obliged to keep a CFC register and a record of events in a controlled foreign entity in a manner ensuring determination of the amount of an income, a tax base, and the amount of a tax due for a tax year. Therefore, the CFC institution deviates from the general rule expressed in tax regulations, which assumes the legal separation of a foreign entity from the Polish persons controlling it¹⁵. At the same time, the tax imposed as a result of the application of the CFC provisions is not charged to the CFC, even if it is determined by a reference to the value of the economic profit of this entity and the size of the share held in it by Polish taxpayer. In this way, the provisions regarding the controlled foreign entity are in line with the provisions of double taxation conventions and therefore making a reservation as to the possibility of introducing this type of regulation into national legislation is not necessary in the content of a specific convention¹⁶.

¹⁵ A. Leconte, *Komentarz do art. 24a* [in:] K. Gil, A. Obońska, A. Waclawczyk, A. Walter (ed.), *Corporate income tax. Komentarz*, Warszawa 2019, System Informacji Prawnej Legalis.

¹⁶ Cf. P. Małecki, M. Mazurkiewicz, *CIT. Komentarz. Podatki i rachunkowość*, Warszawa 2019, System Informacji Prawnej Lex; B. Kuźniacki, *Polskie CFC rules w świetle międzynarodowego prawa podatkowego. Wybrane aspekty wystąpienia ryzyka niezgodności CFC rules z umowami o unikaniu podwójnego opodatkowania (1)*, "Przełęcz Podatkowy" 2015, No 1, pp. 37–48; B. Kuźniacki, *Polskie CFC rules w świetle międzynarodowego prawa podatkowego. Podstawy wykładni umów o unikaniu podwójnego opodatkowania oraz stanowisko Ministerstwa Finansów i OECD (2)*, "Przełęcz Podatkowy" 2015, No 2, pp. 39–50; B. Kuźniacki, *Polskie CFC rules w świetle międzynarodowego prawa podatkowego. Zagraniczna i polska praktyka legislacyjna w zakresie relacji między CFC rules a umowami o UPO*, "Przełęcz Podatkowy" 2015, No 3, pp. 44–55.

Foreign entities are those listed in Article 30f, section 2, point 1 of the PIT Act and in Article 24a, section 2, point 1 of the CIT Act, which do not have a registered office, a management board, or a registration in Poland, and the taxpayer alone or jointly with related entities has a direct or an indirect share in their capital, voting rights in controlling, constituting, or managing bodies, or has the right to participate in a profit, including their expectancy right, or in which in the future he or she will be entitled to acquire such rights, including as the founder or a beneficiary of a foundation, a trust, or other entity, or a legal relationship of a fiduciary nature, or over which the taxpayer exercises actual control.

The literature on the subject indicates that the main goal of the 2018 Amendment was “(...) to increase the effectiveness and precision of the CFC regulations, which can have positive effects for both the Treasury (increased efficiency) and for taxpayers (increased precision and, as a consequence, legal certainty)”¹⁷. At present, there are no data on a state budget revenue that would allow verification of the effectiveness. However, it can be stated with certainty that the provisions introduced more doubts than served to explain them. The CFC regulations contained in the CIT Act and the PIT Act seem to create the most complex legal norm of the already complicated tax law system in Poland, as evidenced by a significant number of individual interpretations issued by tax authorities, as well as extensive case law in the field of the CFC¹⁸.

A specific feature of the CFC concept is the imposition on the Polish tax resident of the obligation to tax the income of a controlled foreign entity, also in a situation where no actual distribution of a profit has occurred, which means that the Polish taxpayer will be liable for settlements of foreign entities also in the event of no actual property increment. Therefore, in practice, a Polish taxpayer may be obliged to tax the income even if no direct increment has taken place, because only the fact that the controlled foreign entity generates the income and the existence of conditions indicated in the provisions is significant.

¹⁷ B. Kuźniacki, F. Majdowski, *Kolejne zmiany...*

¹⁸ B. Kuźniacki, *Opodatkowanie zagranicznych spółek kontrolowanych (CFC). Konieczność reformy*, Warszawa 2017, p. 5.

Considering the above, it should be noted that the legislator imposed a tax obligation on Polish taxpayers in a situation when they acquire only the expectancy right to participate in a profit in the future. Owing to the lack of a sufficiently clear and precise reference of the legal definition of “the right to participate in profits” to the expectancy right to obtain profits of a foreign entity earned or generated in the future, there may be situations in which a Polish taxpayer will be obliged to pay the tax in the year in which he or she entered into a possession of an expectancy right to participate in profits of a foundation, despite the fact that this right will not be exercised before the lapse of a few or more years.

Another objection that can be formulated against the CFC regulations is that, with particularly complex structures of capital groups or entities taken over by investment funds, Polish taxpayers may not be aware of all their capital relations. As a consequence, the regulation, which was aimed at preventing the artificial division of foreign entities, may additionally cause difficulties in correctly qualifying foreign entities as CFCs owing to the requirement to examine the participation of not only the Polish taxpayer, but also the related entities of the taxpayer¹⁹.

In addition, the regulations do not contain tools that prevent the multiple taxation of the same income of a foreign entity controlled by different taxpayers. During the legislative process, the right proposal was made to specify the regulations in such a manner that they clearly state on whom and for what period the tax obligation from the foundation’s income is imposed, as well as an introduction of a mechanism eliminating the possible multiple taxation of the same CFC’s income by different taxpayers: however the legislator did not take into account these comments in the final wording of the regulations²⁰.

¹⁹ M. Piech, P. Janiak, M. Paprocki, *Zagraniczne spółki kontrolowane* [in:] A. Allen, Ł. Kupryjańczyk, M. Thedy (ed.), *“Praktyka stosowania zmian z 2018 r. w podatkach dochodowych”*, Warszawa 2019, System Informacji Prawnej Legalis.

²⁰ Detailed comments on the draft act on the amendment to the Personal Income Tax Act, the Corporate Income Tax Act, the Tax Law, and on the amendment of certain other acts in the field of taxation of controlled foreign companies’ income. Source: [https://krdp.pl/files/aktystanowiska/109\(4\).pdf](https://krdp.pl/files/aktystanowiska/109(4).pdf) (access on-line: 06.11.2019).

At the same time, it is worth noting that for taxing the income of a controlled foreign entity at the level of a participating Polish entity, it is not only formal relations that are crucial. The actual influence on decision-making at the highest level in matters concerning a foreign entity through control, which is the result of factual circumstances, e.g. resulting from contractual relations or court decisions, is also of a great importance. In 2019 the condition of “holding voting rights in management bodies” was introduced, whose independent fulfilment may result in the recognition of a foreign entity as a controlled foreign entity of a Polish taxpayer. Consequently, the lack of connection of this condition with any capital-ownership relationship may lead to a situation in which a natural person subject to the taxation on all his or her income in Poland will manage a foreign entity as a part of a professional activity, e.g. on the basis of a managerial contract, and at the same time it will be his or her only relationship with this entity, but owing to holding voting rights in the management bodies of this entity, the person will be required to fulfil additional administrative obligations related to the keeping of CFC registers and other records. In addition, in an extreme case, when an entity managed by a Polish taxpayer has its registered office or management board in the territory of a country recognised as a so-called tax haven, despite the lack of participation in the profits of this entity, the taxpayer may be required to pay tax in Poland.

3. The definition of a controlled foreign entity

A controlled foreign entity may be an entity having its registered office or management board in a country applying harmful tax competition²¹

²¹ These are the countries listed in the Regulation of the Minister of Finance of 28 March 2019 on determining the countries and territories that apply harmful tax competition in the field of corporate income tax (Dz.U. of 2019, poz. 600) and the Regulation of the Minister of Finance of 28 March 2019 on determining the countries and territories that apply harmful tax competition in the field of personal income tax (Dz.U. of 2019, poz. 599).

or having its registered office or management board in the territory of another country with which Poland or the European Union²² has not ratified an international agreement, such as e.g. a double taxation convention, or other agreement constituting the basis for exchanging tax information with this country. Therefore, if a given entity has its registered office or management board in a so-called tax haven, it is recognised as a CFC regardless of the low percentage or short-term participation in its capital²³. As a result, the legislator introduced a non-rebuttable legal presumption of a tax avoidance or an occurrence of harmful tax competition in the event that a Polish taxpayer has a share in a company having its registered office or management in the territory of a tax haven²⁴. In addition, a foreign entity may be considered a controlled foreign entity if all three criteria are met: the possession criterion, the passive income criterion, and the taxation criterion.

The first of these criteria requires that the taxpayer owns alone or jointly with related entities, directly or indirectly, over 50% of the shares, voting rights, participation in profits, or exercises actual control over a foreign entity. Owing to the fact that the regulations do not specify a minimum time of holding a 50% share, even if it is held for 1 day in a tax year, a Polish taxpayer may be obliged to tax the income of a controlled foreign entity in an amount proportional to the period in which the entity was controlled by the taxpayer.

Another criterion – the passive income one – is met if at least 33% of the foreign entity's revenue generated in the tax year comes from the so-called passive sources, whose closed catalogue can be found in Article 30f, section 3, point 3, letter b of the PIT Act and 24a, section 3, point 3, letter b of the CIT Act.

²² Hereinafter: the EU.

²³ W. Modzelewski, J. Bielawny, M. Słomka (ed.), *Komentarz do art. 30f, Komentarz do ustawy o podatku dochodowym od osób fizycznych*. Warszawa 2019, System Informacji Prawnej Legalis.

²⁴ B. Kuźniacki, *Wątpliwości związane z implementacją dyrektywy ATA. Nowe przepisy o CFC, spółki z rajów podatkowych oraz swoboda przepływu kapitału*, "Przegląd Podatkowy" 2018, No 3, System Informacji Prawnej Lex.

When determining the fulfilment of the last of the conditions, i.e. the taxation criterion, the value of the tax actually paid must be first determined, and then compared to the hypothetical tax due in Poland, and determined according to the CIT Act (taking into account tax deductions, exemptions, or refunds, as well as its proper rate). If the amount of an income tax paid by the entity in the country of its registered office, a management board, a registration, or a location is less than half of the hypothetical income tax that would have to be paid in Poland, the condition of recognising the foreign entity as a CFC is met. The tax base will be the generated excess of the sum of the revenue in the tax year over the costs of generating this revenue, determined in accordance with the CIT Act, regardless of the type of sources of revenue, and on the last day of the tax year of the controlled foreign entity.

By the end of 2017, the provisions of the CIT Act and the PIT Act had referred to the nominal tax rate in the CFC country of residence, and thus the taxation criterion should have been considered as met even if only one of the items of CFC passive income was exempted or excluded from taxation, or was taxed at a lower tax rate by at least 25% of the tax rate applicable to it, as specified in Article 19, section 1, point 1 of the CIT Act. At that time, identifying whether the condition regarding the level of taxation was met did not cause so much difficulty to Polish taxpayers, because it was sufficient to compare nominal tax rates without referring to internal tax preferences in the form of tax refunds and deductions. The current regulation requiring Polish residents to reclassify the accounts kept by subsidiaries in consideration of the CIT Act regulations in order to correctly calculate the hypothetical income tax is much more labour-intensive and expensive, because it often requires the involvement of tax advisers who will analyse economic events that took place in a foreign entity.

4. The risk of violating the principle of proportionality by the CFC regulations

The CFC structure imposes on the Polish taxpayer additional documentation obligations in the event of identifying a controlled foreign entity whose income is to be taxed in Poland. They are related to submitting separate tax returns, keeping CFC registers, as well as additional records of events occurring in CFCs that affect their income. As the Voivodeship Administrative Court in Warsaw rightly noticed in the judgment of 29 December 2016²⁵, the CFC regulations distinguish between a foreign entity and a controlled foreign entity, and impose obligations of keeping records on Polish taxpayers, the scope of which has been defined differently for a foreign entity and a CFC. If a taxpayer owns a foreign entity, he or she is obliged to keep only the register of foreign entities, while the ownership of a CFC requires the Polish taxpayer to keep additional records as well.

In Article 24a, section 13a of the CIT Act and Article 30f, section 15a of the PIT Act, the obligation to register events that have occurred in a controlled foreign entity in the records separate from the accounting records was regulated. They are to enable the determining of the amount of the income, the tax base, and the amount of tax due for a tax year, as well as to contain the information necessary to determine the amount of depreciation write-offs of fixed assets and intangible and legal assets in accordance with the provisions of the CIT Act or the PIT Act. In practice, this involves the need to keep two records – one required for a proper taxation in the country of the registered office of a foreign entity and the other only for the correct fulfilment of obligations arising from the CFC regulations.

It should be assumed that the obligation to keep separate accounting books for CFCs may violate the principle of proportionality expressed in

²⁵ A judgment of the Voivodeship Administrative Court in Warsaw of 29 December 2016, III SA/Wa 2624/15.

Article 31, section 3 of the Polish Constitution²⁶. Pursuant to this principle, the legal provisions should achieve their goal of protecting the public interest, which in this case is combating tax avoidance. At the same time, achieving the intended effect should be as minimally severe as possible for the taxpayers whose freedoms and rights are restricted²⁷. This view is also confirmed in the Communication of the European Commission²⁸, because the obligation to keep double records can be considered as an acute administrative restriction both in terms of finances and time.

It is worth noting that Polish taxpayers have been obliged to keep records and determine the income of CFCs on the basis of Polish regulations in a manner detached from the actual possibility of fulfilling this obligation. While it may be assumed that with 50% of shares in a controlled foreign entity, a Polish taxpayer has the possibility of obtaining CFC financial and accounting data, the fulfilment of the obligation to collect information on accounting events affecting the tax base in relation to controlled foreign entities from tax havens, regardless of whether the taxpayer controls it, what income it generates, and at what level it is taxed, may be particularly hindered. An example of a CFC from a tax haven is an investment fund run in the British Virgin Islands, which conducts thousands of transactions with entities from around the world during the year. Recording events occurring in this CFC will require considerable financial outlays and hours of work. Some authors present a position with which one should undoubtedly agree that the obligations of keeping records in CFCs constitute an excessive restriction on the free movement of capital²⁹.

²⁶ The Constitution of the Republic of Poland of 2 April 1997, Dz.U. of 1997 No 78, poz. 483.

²⁷ See more A. Stępkowski, *Zasada proporcjonalności w europejskiej kulturze prawnej. Sądowa kontrola władzy dyskrecyjnej w nowoczesnej Europie*, Warszawa 2010.

²⁸ Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, *The application of anti-abuse measures in the area of direct taxation – within the EU, and in relation to third countries*, p. 5, <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0785 :FIN:en:PDF> (access on-line: 06.11.2019).

²⁹ L. De Broe, *International Tax Planning and Prevention of Abuse: A Study under Domestic Tax Law, Tax Treaties, and EC Law in Relation to Conduit and Base Companies*, Doctoral Series IBFD – Academic Council, Vol. 14, Amsterdam: IBFD 2008, pp. 914–915; G. Meusen, *Cadbury Schweppes: The ECJ Significantly Limits the Ap-*

Attention should also be drawn to the fact that the income of a controlled foreign entity is not reduced by losses incurred in previous years, and thus the taxpayer will be each time assessed on the income generated in a given tax year by a CFC in complete isolation from the financial situation of this entity from previous years³⁰. In addition, the tax rate for CFC income is always 19%, even if the CFC meets the conditions for taxing it in Poland at a reduced rate of 9%. Shaping the regulations in this manner may indicate that the Polish legislator's goal was not to introduce uniform principles of CFC taxation in comparison to the income generated in Poland. Although the Polish legislator orders the calculation of the amount of the income of controlled foreign entities taking into account Polish laws and principles, this income is not treated in the same manner. This may also be indicated by the fact that the tax rate was set at 19% in the regulation governing the CFC institution, and the legislator decided not to refer in this respect to the proper application of Article 19 of the CIT Act stipulating the basic tax rate.

5. Provisions relating to the CFC institution and actual economic activity

Pursuant to Article 24a, section 16 of the CIT Act and Article 30f, section 18 of the PIT Act, if a controlled foreign entity is subject to the taxation on all its income in an EU Member State or in a country belonging to the European Economic Area³¹ and conducts significant actual economic activity in that country, then taxpayers are not obliged to pay tax on the income of the controlled foreign entity. Taxpayers are also exempt from keeping separate CFC accounting books or submitting annual tax returns,

plication of CFC Rules in the Member States, "European Taxation" 2007 No 1, pp. 17–18; J. Roels, *Thin Compatibility Rules and Compatibility with EC law*, in *Liber Amicorum Luc Hinnekens*, Brussels 2002, p. 477. [given after:] B. Kuźniacki, *Wątpliwości związane z implementacją dyrektywy ATA...*

³⁰ W. Modzelewski, J. Pyssa (ed.), *Komentarz do art.24a, Komentarz do ustawy o podatku dochodowym od osób prawnych.*, C.H. Beck, Warszawa 2019, System informacji prawnej Legalis.

³¹ Hereinafter: the EEA.

although, the obligation to keep a CFC register remains. It seems that it should be sufficient to include basic data in the register, such as: a name of the entity, a country of its residence, an amount of share (in the capital or voting rights in its bodies), or an indication of other nature of the relation, an address of the foreign entity, as well as a local or tax registration number³².

When assessing the significance of actual economic activity, in particular the ratio of a revenue generated by a controlled foreign entity from actual economic activity to its total revenue is taken into account. At the same time, the lack of a legal definition of the term: “significant actual activity,” as well as the lack of a statutory determination as to what proportion of CFC’s revenue indicates that its actual economic activity can be considered significant, create the risk of arbitrary decisions by the tax authorities as to the nature and the legitimacy of the business conducted by the controlled foreign entity.

The legislator indicates in Article 24a, section 18 of the CIT Act³³ and Article 30f, section 20 of the PIT Act the criteria that are considered when assessing whether a CFC conducts actual economic activity, but, these criteria do not take into account differences in the specifics of production or service activity, a financial activity consisting in the purchase and sale of receivables, or a holding activity. Nevertheless, the catalogue of criteria is open, and thus when assessing whether an entity is conducting actual economic activity, other conditions should also be taken into account³⁴. As a consequence, a situation may occur in which the conditions listed in the CIT Act and the PIT Act are not met, although all the circumstances will indicate that the entity conducts actual economic activity.

An additional difficulty may be the fact that the taxpayer is not able to submit an application for an individual interpretation to the Director of

³² Ł. Kupryjańczyk, *Regulacje dotyczące zagranicznych spółek kontrolowanych po zmianach w 2018 r.*, System Informacji Prawnej Legalis 2018.

³³ For more information: W. Dmoch, *Komentarz do art. 24a, Podatek dochodowy od osób prawnych. Komentarz*, Warszawa 2018, System Informacji Prawnej Legalis.

³⁴ Cf. a judgment of the Voivodeship Administrative Court in Warsaw of 15 September 2016, III SA/Wa 2201/15.

the National Tax Information to determine whether the entity he or she controls conducts a significant actual economic activity³⁵.

At the same time, it should be emphasised that e.g. Ukraine, Belarus, and Russia are not the EU Member States, nor do they belong to the EEA, and thus the fact of conducting a significant actual economic activity in those countries by controlled foreign entities does not preclude an application of the CFC regulations. Therefore, it may be necessary to tax professional entities in Poland conducting, e.g. insurance, banking, or other financial activities in countries outside the EU or the EEA, despite the fact that their income is generally realised in countries other than Poland and should be subject to the taxation there.

Such structure of the CFC regulations contradicts the rationality of the legislator and diverts them from their original goal, which was to prevent tax avoidance by taxpayers' artificial allocation of sources of revenue to controlled foreign entities. In shaping the taxation mechanism for the income of controlled foreign companies, the EU Member States operate within the framework set by the treaty freedoms in the interpretation given to them by the case law of the Court of Justice³⁶. As the Court's decisions from 2006 and 2008 indicate³⁷, the EU regulations oppose the inclusion in the tax base of a company which is resident with its registered office in a Member State of an income generated by a CFC in another Member State if this income is subject to a lower level of taxation there than in the first state, unless such inclusion refers to only purely artificial structures whose purpose is to avoid the national tax due. Accordingly, such a tax measure must not be applied where it is proved, on the basis of objective factors which are ascertainable by third parties that, despite the existence

³⁵ Article 14b § 2a, point 2, letter b of the Act of 29 August 1997 The Tax Law (Dz.U. of 2019 r., poz. 900 with subsequent amendments).

³⁶ A judgment of the Supreme Administrative Court of 6 March 2018, II FSK 1107/16.

³⁷ A judgment of the Court (Grand Chamber) of 12 September 2006 in the case of Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue, Case C-196/04, EU:C:2006:544; Decision of the Court (Fourth Chamber) of 23 April 2008, C-201/05 the Test Claimants in the CFC and Dividend Group Litigation v. Commissioners of Inland Revenue, EU:C:2008:239.

of tax motives, that controlled foreign company is actually seated in the host Member State and conducts genuine economic activities there³⁸.

The doctrine expresses the view that CFCs should be exempted from the taxation, not only in the case of entities seated in the Member States or states belonging to the EEA, but also in third countries, provided that they conduct an actual significant economic activity. This distinction causes an inconsistency of the CFC regulations with the best practices in the application of the CFC regulations in the light of EU law³⁹.

6. The state budget revenue from CFCs

Despite the fact that the CFC regulations are becoming more and more restrictive, numerous administrative obligations imposed on taxpayers related to the possession of CFCs, such as keeping a register, keeping an annual record of events occurring in a CFC, used to determine the income generated by this entity in accordance with the CIT Act, or submitting a separate tax return have no translation into the real effectiveness of CFC regulations, which is illustrated by the negligible revenue to the state budget from tax on controlled foreign entities.

Owing to the fact that Polish tax residents are required to submit tax returns and tax the income generated by CFCs by the end of the 9th month after the end of the tax year, it is necessary to clarify that the data shown in Table 1 for 2016 should be in fact referred to the first year of functioning of the CFC institution in the Polish tax system, i.e. 2015.

³⁸ For more information: F. Majdowski, *Stosowanie regulacji CFC do podmiotów z państw trzecich na kanwie wyroku Trybunału Sprawiedliwości w sprawie unijnej swobody przepływu kapitału*, „Przegląd Podatkowy” 2019, No 6, pp. 28–36.

³⁹ B. Kuźniacki, *Strengthening CFC Rules in a Compatible Way with EU Law under BEPS Action 3 in Light of the European Commission’s Proposal – A Critical Evaluation* [in:] R. Danon (ed.), *Base Erosion and Profit Shifting (BEPS): Impact for European and International Tax Policy*, Zurich 2016, pp. 162–164.

Table 1. Number of tax returns about the amount of income from a controlled foreign company submitted by Polish tax residents in 2016–2018.

Tax return	Number of submitted tax returns		
	2016	2017	2018
PIT-CFC	41	43	38
CIT-CFC	84	75	64

Source: data obtained from the Ministry of Finance in response to a request for providing information under the Act of 6 September 2001 on an access to public information.

Table 1 presents the number of PIT-CFC and CIT-CFC tax returns filed by Polish taxpayers obliged to pay tax on the income of controlled foreign companies. In the first three years after the introduction of the CFC institution into the Polish legal system, corporate income tax payers submitted a total of 223 tax returns, while personal income taxpayers only 122 tax returns.

Table 2. The amount of a state budget revenue from the corporate income tax⁴⁰ and personal income tax⁴¹ in total as well as from the tax on income of a controlled foreign company broken down by CIT and PIT in 2015–2018.

The amount of a state budget revenue from:	The amount of a state budget revenue [in PLN]			
	2015	2016	2017	2018
CIT in total	48,232,395,000	52,668,801,000	53,625,494,000	55,500,000,000
PIT from CFC	375,000	2,047,000	4,493,000	2,000,000
CIT in total	26,381,397,000	29,758,467,000	31,817,695,000	32,400,000,000
CIT from CFC	10,386,000	14,465,000	7,916,000	15,800,000

Source: basic information on the implementation of the state budget for individual months in 2016-2019⁴².

⁴⁰ Hereinafter referred to in the table as: CIT.

⁴¹ Hereinafter referred to in the table as: PIT.

Table 2 presented in the above contains information on the amount of the state budget revenue from the CFC tax. The total revenue from corporate income tax and personal income tax for individual years is also presented. The introduction of the CFC structure into Polish legal order resulted in a revenue to the state budget for the years 2015–2018 in an amount not exceeding one ten-thousandth of a percent of all revenue. The total amount of the tax paid for the years 2015–2018 by natural persons who are Polish tax residents on the income of controlled foreign companies is less than PLN 9 million and by taxpayers of corporate income tax slightly over PLN 48.5 million. Data for 2019 is not yet known, so it is not possible to fully and reliably assess the significance of the amendment from 2019 for the amount of revenue to the state budget, however, in my opinion, no significant increase in revenue should be expected.

7. Conclusions

To sum up, the tax on the income of controlled foreign entities is an international tax law instrument created to prevent a tax avoidance.

However, while it is necessary to assess positively the actions taken by the legislator aimed at combating tax fraud occurring in relations between related entities using the mechanism of income shifting to subsidiaries subject to the tax jurisdiction of countries applying more preferential taxation rules, the constant tightening of existing regulations concerning CFCs, which, however, does not bring satisfactory results in the form of revenue to the state budget, deserves criticism.

The regulations regarding CFCs did not achieve the intended fiscal effect in the form of an additional revenue to the state budget. The imposition of complex and costly obligations on taxpayers is not really reflected in the amount of a state revenue. The reasons for this phenomenon can be

⁴² <https://mf-arch2.mf.gov.pl/ministerstwo-finansow/dzialalnosc/finanse-publiczne/budzet-panstwa/wykonanie-budzetu-panstwa/sprawozdanie-operatywne-miesieczne-z-wykonania-budzetu-panstwa>; <https://www.gov.pl/web/finanse/sprawozdania-operatywne-miesieczne> (access on-line: 06.11.2019).

seen in the fact that with an entry into force of the CFC regulations, taxpayers have liquidated artificial structures created to avoid taxation, or simply the number of Polish foreign investments (e.i. *outbound investments*) compared to Western European countries is still small^{43, 44}.

Currently, the CFC regulations are more and more restrictive and in principle oblige Polish tax residents to tax almost all income of foreign entities in Poland with which the Polish taxpayer has any direct or indirect relationship regardless of receiving or not receiving remuneration from them, and regardless of their size.

In relation to the CFC regulations, objections can be made concerning excessive restrictions on the free movement of capital and its inconsistency with the CIT Act, and the PIT Act, and with the best practices of applying the provisions on CFCs in the light of EU law. Therefore, one should consider the need to amend the CIT Act and the PIT Act regulations in such a manner as to eliminate – inadequate for the purpose of the CFC regulations – administrative obligations in the form of: keeping a CFC register and records of events occurring in CFCs in relation to entities exempt from an income tax, e.g. investment funds. In addition, the legislator should consider eliminating the obligation to keep double records in relation to CFCs and exclude taxation of CFCs for all entities, and not only those residing in the EU or the EEA countries, provided that they conduct actual significant economic activity. It is worth noting that certainty in business transactions would also be ensured by clarification on how to determine a “significance” in relation to an actual economic activity. A significant simplification for taxpayers would also be the reintroduction of the EUR 250,000 limit of a CFC revenue removed from 1 January 2018, below which it would not be necessary to apply the CFC regulations. The removal of the limit undoubtedly affected taxpayers with small

⁴³ The Annual Report prepared by the Department of Statistics of the National Bank of Poland, “*Zagraniczne inwestycje bezpośrednie w Polsce i polskie inwestycje bezpośrednie za granicą w 2017 roku*”, Warszawa 2019, pp. 8–12, 28–37 https://www.nbp.pl/publikacje/ib_raporty/raport_ib_2017.pdf (access on-line: 06.11.2019).

⁴⁴ Cf. M. Kluzek, *Opodatkowanie dochodów zagranicznych spółek kontrolowanych*, “*Studia Ekonomiczne. Zeszyty Naukowe Uniwersytetu Ekonomicznego w Katowicach*” 2016, No 282, pp. 64.

investments abroad the most because they are currently obliged to examine the CFC status of foreign entities regardless of their revenue.

In conclusion, it should be emphasized that it is necessary for the legislator to make a comprehensive assessment of the CFC institution and consider how it can be ensured that the CFC regulation prevents abuses consisting of artificial profit shifting by Polish taxpayers to foreign entities controlled by them, and only leads to the neutralization of artificial allocation of sources of revenue to a foreign entity, and does not constitute another barrier in doing business.

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