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MEETING DOCUMENT

From:	General Secretariat of the Council
To:	Code of Conduct Group (Business Taxation)
Subject:	(Draft) 6-month Progress Report by the Code of Conduct Group (business taxation) to the ECOFIN Council – PL011

Delegations will find attached a document in view of the Code of Conduct Group (Business Taxation) on 14 November 2019.

Poland's notional interest deduction regime (PL011)

I/ AGREED DESCRIPTION

The following description was agreed by the Code of Conduct Group on 20 May 2019:

At the request of the Code of Conduct Group and in line with previous practice in relation to the notional interest regimes of other Member States the Commission sent a questionnaire to the Polish authorities to fill in and return to the Commission. On the basis of the replies to the questionnaire received from the Polish authorities the Commission put some additional questions to the authorities and received the responses. All the replies to the questionnaire and the additional questions are set out below:

Questionnaire on Notional Interest Deduction Rules

1. Name of the regime.

Notional Interest Deduction Rules.

2. Year of introduction / entry into force.

1st of January 2019.

3. Please attach (or provide a link to) the relevant legislation which introduced/amended your NID regime and any administrative guidance providing clarifications (if in a language other than English, please provide a translation).

Art. 15cb Corporate Income Tax Act of 15th February 1992 (see a courtesy translation of the provisions in annex).

Art. 15cb. 1. In a company as revenue earning costs are regarding also the amount corresponding to the product of the reference rate of the National Bank of Poland applicable in the last business day of the year preceding the tax year being increased by 1 percentage point and the amount:

- 1) additional payments brought into a company, if they are brought in according to the procedure and rules specified in separate provisions of law or,
- 2) the amount of the profit transferred to the reserve capital or the supplementary capital of the company.
2. The revenue earning cost referred to paragraph 1 shall be entitled in the year of bringing the additional payment or increasing the reserve capital or the supplementary capital in the subsequent directly following 2 tax years.
3. The total amount of revenue earning costs deducted in the tax year dues resulting from the reasons referred to in paragraph 1 may not be higher than the amount of 250.000PLN.

4. The paragraph 1 shall not apply to additional payments and transferred profits being designed on covering the balance-sheet loss.
 5. The paragraph 1 shall apply if the refund of the additional payment or the division and the payment of the profit occurred not earlier than 3 years counting from the end of the tax year for which this payment was brought to the company or the profit distribution resolution was taken.
 6. As the tax year for which the additional payment was brought to the company shall be considered the year for which the payment credited to the payment account of the company.
 7. If the additional payment referred in the paragraph 1 is refunded prior to the elapse of the time limit referred in paragraph 5, in the tax year for which the refund was made, the revenue is the amount in the part corresponding to revenue earning costs deducted pursuant to the paragraph 1.
 8. The paragraph 7 shall apply accordingly to the revenue of the company in the proportion corresponded to this part of revenue earning costs which corresponding to the refunded amount of the additional payment – in case of the refund of part of the additional payment referred in paragraph 1.
 9. In case of the company referred in the paragraph 1 is merged or divided or transformed in the company having no legal personality prior to the elapse of the time limit referred in paragraph 5, at the day preceding the day of the take-over or the transformation shall be determined the revenue in the amount
- 4. Please describe the scope of entities that can claim a NID deduction (companies based in your country / treatment of PE of foreign companies).**

- Resident companies
- Permanent establishments in Poland of non-resident companies

5. NID formula:

5.1 Reference Rate: please describe the formula to determine the deductible interest rate; provide the applicable rates for the previous years (since entry into force).

The reference rate of the National Bank of Poland – 1.5%, increased according to art. 15cb par. 1, by 1 percentage point.

5.2 Equity: is your regime stock-based or an incremental regime?

Incremental regime

5.3. Equity: please define the equity on which the interest can be deducted.

In order to determine equity increase the factors to consider include:

- additional payments - contributions in cash, starting from the payment date,
- net profits allocated to reserves (the reserve capital or the supplementary capital).

There are not considered as equity increase:

- additional payments and transferred profits being designed on covering the balance-sheet loss;
- if the refund of the additional payment or the division and the payment of the profit occurred earlier than 3 years counting from the end of the tax year for which this payment was brought to the company or the profit distribution resolution was taken

6. Limitations applicable to the amount of notional interest deduction:

6.1 Does your legislation provide for a maximum amount of taxable income against which the NID can be claimed? If so, please describe the mechanism and state the lowest effective tax rate that can be achieved by using the maximum amount of NID:

The Polish legislation does not provide for a maximum amount of taxable income against which the NID can be claimed.

However, the total amount of revenue earning costs deducted in the tax year dues resulting from NID regime may not be higher than the amount of 250.000PLN (approx. EUR 60.000).

6.2 Can the NID create losses? If so, please describe how those losses can be used by the taxpayers (carry-back, carry-forward, time and amount limitations):

The NID cannot create a loss. If the notional return exceeds the taxable income calculated for a given tax year, the excess may be rolled over to subsequent tax years.

7. The treatment of distributions made out of profits relieved from tax through a NID claim:

No specific provisions for distributions made out of profits relieved from tax through a NID claim.

7.1 Could you please provide an example of the treatment of distributions made out of profits relieved from tax through a NID claim?

7.2 Could you please explain in more detail how the taxation of the NID claim in the hands of a foreign shareholder/partner would work in practice?

8. Please describe any limitations of scope in your legislation (exclusion of some specific assets, participations, treatment of foreign PE of a domestic company).

See point 5.3. The Polish NID applies to permanent establishments in Poland of non-resident companies.

Concerning more specific issues such as exclusion of own shares, exclusion of shares held in other resident and non-resident legal persons, it can be clarified that there is no

relationship between applying Polish NID regime and changing of equity. Although, as a result of additional payments and net profits allocated to reserves determine equity increase, tax benefits under NID regime refer to the amount of additional payments and net profits allocated to reserves not to the equity increase itself.

9. Do you have specific anti-abuse provisions in your legislation that may apply in the following fields (if so, please explain the measure)?

There are no specific anti-abuse rules for the new Polish notional interest deduction regime. The general anti-abuse rule is applicable. Moreover, re-categorisation of old capital as new and acquisitions of business held by associated enterprises should have no impact on use Polish NID rules because, as outlined earlier, Polish NID regime not refers rightly to the equity increase.

As regards the creation of subsidiaries, there is no specific rule in Polish NID regime, which states that NID should be refused for actions or transactions carried out without any substantial economic or trading purpose but with the aim of receiving NID. However, such a principle arise directly from Polish general anti-abuse rule.

9.1 Intra-group loans and loans involving associated enterprises;

9.2 Cash contributions and contributions in kind;

9.3 Transfers of participations;

9.4 The re-categorisation of old capital as new capital through liquidations and the creation of start-ups;

9.5 The creation of subsidiaries;

9.6 Acquisitions of businesses held by associated enterprises;

9.7 Double-dipping structures combining interest deductibility and deductions under the AGI;

9.8 Increases in the amount of loan financing receivables towards associated enterprises as compared to the amount of such receivables at the reference date.

10. Do you have a general anti-abuse provision in your legislation?

The Polish GAAR was introduced by the amendment of the Tax Ordinance Act in July 2016.

The GAAR is considered as a sufficient tool which may apply to NID rules. Therefore, there are no specific anti-abuse provisions corresponding to NID rules.

The Polish NID regime is viewed as relatively immune to abuse, because of its framework, which ensures the limited scope of the regime. Particularly:

- the formula to determine the deductible interest rate is based on the reference rate of the National Bank of Poland i.e. 1,5%, increased by 1 percentage point;
- in order to determine equity increase the factors to consider include exclusively: additional payments - contributions in cash and net profits allocated to reserves (the reserve capital or the supplementary capital);
- the total amount of revenue earning costs deducted in the tax year dues resulting from NID regime may not be higher than the amount of 250.000PLN (approx. EUR 60.000).

11. Please describe the administrative procedures to benefit from the NID.

It is possible to benefit from the NID by filing the tax return.

Annex

Art. 15cb Corporate Income Tax Act of 15th February 1992

Art. 15cb. 1. In a company as revenue earning costs are regarding also the amount corresponding to the product of the reference rate of the National Bank of Poland applicable in the last business day of the year preceding the tax year being increased by 1 percentage point and the amount:

- 1) additional payments brought into a company, if they are brought in according to the procedure and rules specified in separate provisions of law or,*
- 2) the amount of the profit transferred to the reserve capital or the supplementary capital of the company.*

1. The revenue earning cost referred to paragraph 1 shall be entitled in the year of bringing the additional payment or increasing the reserve capital or the supplementary capital in the subsequent directly following 2 tax years.

2. The total amount of revenue earning costs deducted in the tax year dues resulting from the reasons referred to in paragraph 1 may not be higher than the amount of 250.000PLN.

3. The paragraph 1 shall not apply to additional payments and transferred profits being designed on covering the balance-sheet loss.

4. The paragraph 1 shall apply if the refund of the additional payment or the division and the payment of the profit occurred not earlier than 3 years counting from the end of the tax year for which this payment was brought to the company or the profit distribution resolution was taken.

5. As the tax year for which the additional payment was brought to the company shall be considered the year for which the payment credited to the payment account of the company.

6. If the additional payment referred in the paragraph 1 is refunded prior to the elapse of the time limit referred in paragraph 5, in the tax year for which the refund was made, the revenue is the amount in the part corresponding to revenue earning costs deducted pursuant to the paragraph 1.

7. The paragraph 7 shall apply accordingly to the revenue of the company in the proportion corresponded to this part of revenue earning costs which corresponding to the refunded amount of the additional payment – in case of the refund of part of the additional payment referred in paragraph 1.

8. In case of the company referred in the paragraph 1 is merged or divided or transformed in the company having no legal personality prior to the elapse of the time limit referred in paragraph 5, at the day preceding the day of the take-over or the transformation shall be determined the revenue in the amount.

II / FINAL ASSESSMENT

The following draft assessment was agreed by the Code of Conduct Group on 10 July 2019:

	1a	1b	2a	2b	3	4	5	OA
PL – Notional interest deduction rules	X	?	X	?	V	X	X	X

V = harmful

X = not harmful

Under the Standstill review for 2019 the COCG agreed on a description of the Polish notional interest regime at the meeting of 20 May 2019¹. The following assessment has been prepared with regard to paragraphs 1 to 5 under letter B of the Code, based on this agreed description. The measure is assessed against all Code criteria and relevant agreed guidance.

Explanation

Significantly lower level of taxation:

“Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code”

The Polish Notional Interest Rules were introduced on 1 January 2019. They are not yet applied and the Polish authorities have indicated that further implementing provisions will be adopted.

The general tax rate in Poland is 19%.

The Notional Interest Deductions Rules apply to:

- any resident company; and
- any permanent establishment in Poland of a non-resident company.

The interest deduction on equity is calculated as a percentage of a company's equity increase. In order to determine equity increase the factors to consider include:

- additional payments - contributions in cash, starting from the payment date,
- net profits allocated to reserves (the reserve capital or the supplementary capital).

The following are not considered as equity increase:

- additional payments and transferred profits being designed on covering the balance-sheet loss;
- if the refund of the additional payment or the division and the payment of the profit occurred earlier than 3 years counting from the end of the tax year for which this payment was brought to the company or the profit distribution resolution was taken.

¹ See above.

The Polish legislation does not provide for a maximum amount of taxable income against which the NID can be claimed. However, the total amount of revenue earning costs deducted in the tax year may not be higher than the amount of 250.000PLN (around 58.700 EUR).

The reference rate is the reference rate of the National Bank of Poland – currently 1.5%, increased (according to art. 15cb par. 1) by 1 percentage point.

This reduction of the tax base may lead to a significantly lower level of taxation in the meaning of the Gateway criterion of the Code of Conduct.

However, in view of the low maximum amount of revenue earning costs that can be deducted in the tax year the regime cannot in our view affect in a significant way the location of business activity in the EU, in the sense of paragraph A of the Code of conduct.

Therefore, we suggest considering this regime as being out of the Code of conduct scope.

The NID regime is therefore outside the scope of the Code of Conduct within the meaning of paragraph A of the Code.

Criterion 1:

“whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents”

Criterion 1 contains two elements. The first element is whether the measure is exclusively available to non-residents or transactions with non-residents (criterion 1a). The second element is whether it is only or mainly used by non-residents or for transactions with non-residents (criterion 1b).

1a) Criterion 1a) concerns the de jure application of the measure. The NID applies and is available to legal entities based in Poland without any restriction in terms of shareholding (resident or non-resident shareholders) or in terms of business sector.

1b) Criterion 1b) is used to complement the assessment under criterion 1a) which only looks at the literal interpretation of the measure. It takes account of the de facto effect of the measure. Where the majority of taxpayers (or counterparties to transactions) benefitting from the measure are in fact non-residents the measure will fall foul of criterion 1b). As the regime is not yet applied we do not have information to determine whether the NID is pre-dominantly used by non-residents, hence the question mark (“?”) for criterion 1b).

Criterion 2:

“whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base”

As regards criterion 2 the division between criteria 2a and 2b is done in the same way as in the case of criterion 1 (i.e. de jure interpretation and de facto analysis). In general, a measure is caught by criterion 2 if the advantages are ring-fenced from the domestic market so that they do not affect the national tax base. In most cases, the evaluation against criterion 2 follows closely that of criterion 1.

2a / 2b We refer to what is mentioned above under criteria 1a) and b).

Criterion 3:

“whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages”

According to the standard practice for the evaluation of the potentially harmful measures against criterion 3, a measure is caught by this criterion if there are no express requirements with regard to real economic activities and notably any requirement with respect to employment obligations.

Such express requirement aims at ensuring that the activities generating the income are undertaken by the taxpayer benefiting from the preferential tax regime.

Notional interest regimes such as the Polish Notional interest deduction rules are different from other preferential tax regimes in that their tax benefits are not based on income generated or the activity performed but on the policy goal to tackle the debt bias, making it difficult to expect a correlation between income-generating activities and benefits.

Such a regime should nonetheless be properly contained by appropriate anti-abuse measures in order to tackle tax planning opportunities, especially when associated with the windfall effect of a regime based on the stock of equity (as compared to an incremental system that rewards only the increase in equity).

Paragraph L of the Code of Conduct states that: "anti-abuse provisions or countermeasures contained in tax laws and in double taxation conventions play a fundamental role in counteracting tax avoidance and evasion". In past assessments, the Code Group has taken into account, in the overall assessment of various regimes, the existence of appropriate anti-abuse provisions or countermeasures.

In order to avoid tax planning and abuse connected to notional interest regimes, a number of limitations of the scope and anti-abuse measures have been identified in a previous assessment².

² Limitation of scope:

- Exclusion of own shares: this exclusion prevents the possibility for a company to increase its equity and simultaneously subscribe the new shares.
- Exclusion of shares held in other resident and non-resident legal persons: this exclusion tackles the possibility to cascade the ACE through chains of equity injection.
- The application of the allowance may not create nor increase tax losses. Consequently, a negative result due to this deduction does not generate a loss carry forward.
- Assets not necessary for conducting business: this is a classical exclusion in NID systems to avoid benefiting from NID on assets that do not generate taxable income (for instance, luxury goods, artwork, etc.).
- No deduction of NID with regard to capital which is allocated to a foreign permanent establishment. If the foreign PE was a legal person (a subsidiary), the parent company holding its capital would have to exclude those shares from the ACE base.

Anti-abuse rules targeting specifically transactions between related parties: The proposal for an EU Directive on a common consolidated tax base (CCCTB) contains an allowance for growth and investment (AGI). Art. 11(6) of the CCTB reads as follows:

“The Commission shall be empowered to adopt delegated acts in accordance with Article 66 to lay down more detailed rules against tax avoidance, and more particularly in the following fields relevant to the AGI:

- (a) intra-group loans and loans involving associated enterprises;*
- (b) cash contributions and contributions in kind;*
- (c) transfers of participations;*
- (d) the re-categorisation of old capital as new capital through liquidations and the creation of start-ups;*

The same structure and content will be used for the assessment of the Polish Notional interest deduction rules.

The Polish NID regime is viewed by the Polish authorities as relatively immune to abuse, because of its framework, which ensures the limited scope of the regime. Particularly:

- the formula to determine the deductible interest rate is based on the reference rate of the National Bank of Poland i.e. 1,5%, increased by 1 percentage point;
- in order to determine equity increase the factors to consider include exclusively: additional payments - contributions in cash and net profits allocated to reserves (the reserve capital or the supplementary capital);
- the total amount of revenue earning costs deducted in the tax year dues resulting from NID regime may not be higher than the amount of 250.000PLN.

Poland's Notional interest deduction rules include the following limitations of its scope:

- To compute the notional interest deduction the reference rate is applied to the "equity increase" (see definition under the Gateway criterion) of the company.
- Under the Polish provisions there is no connection between the application of the NID and the change of equity. Tax benefits under NID regime refer to the amount of additional payments and net profits allocated to reserves and not to the equity increase itself.

This is complemented by the fact that **the general anti-abuse provision** (Tax Ordinance Act of July 2016) **applies to Poland's Notional interest deduction rules.**

Under the Polish GAAR tax avoidance is considered to occur where a transaction/action is carried out primarily to obtain a tax benefit that, under the circumstances, is inconsistent with the subject and purpose of a provision in the tax legislation, and the transaction/action is carried out in an "artificial" manner. A tax benefit will be deemed to be obtained in the following cases:

- The taxpayer is able to defer, reduce or eliminate its tax liability;
- The taxpayer creates or overstates a tax loss; or
- The taxpayer creates an overpayment of tax or a right to a refund, or increases the amount of an overpayment or refund.

The transaction/action to which the GAAR refers includes a set of related transactions/actions, carried out by the same or different entities.

There are **no specific anti-abuse rules** for the Polish notional interest deduction regime. Only the general anti-abuse rule is applicable.

Re-categorisation of old capital as new and acquisitions of business held by associated enterprises should have no impact on the application of the Polish NID rules because the regime is not based on the equity increase.

(e) *the creation of subsidiaries;*

(f) *acquisitions of businesses held by associated enterprises;*

(g) *double-dipping structures combining interest deductibility and deductions under the AGI;*

(h) *increases in the amount of loan financing receivables towards associated enterprises as compared to the amount of such receivables at the reference date."*

As regards the creation of subsidiaries, there is no specific rule in the regime, which states that NID should be refused for actions or transactions carried out without any substantial economic or trading purpose but with the aim of receiving a NID. However, such a principle applies directly as a result of the Polish GAAR.

The Polish regime appears to lack some anti-abuse rules targeting specifically transactions between related parties that could give rise to abuse especially from:

- Intra-group loans and loans involving associated enterprises;
- Equity contribution in cash or in kind between related parties;
- Double dipping structures combining interests deductibility and the Notional interest rules;
- Acquisition of businesses held by associated enterprises;
- Intragroup transfer of participations.

On the basis of the available information and the currently applicable provisions the general anti-abuse provision does not seem to meet the requirements of the Code of Conduct for targeted provisions aimed at avoiding that a measure is being used for tax avoidance.

Criterion 4:

“whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD”

The measures do not contain such elements that would be relevant from the point of view of internationally accepted principles as referred to in criterion 4 of paragraph B of the Code.

Criterion 5:

“whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way”

All preconditions necessary for the granting of a tax benefit should be clearly laid down in publicly available laws, decrees, regulations etc. before a measure can be considered transparent.

Overall assessment (OA):

A NID regime such as the Polish regime at issue cannot affect in a significant way the location of business activity in the EU, in the sense of paragraph A of the Code of conduct.

This due to the modest benefits available through the regime – 58.000 EUR/year - and despite the absence of targeted anti-abuse provisions.

The regime will be subject to monitoring by the COCG with regard to its economic effects. If the allowed maximum amount should be raised in the future the COCG should be informed and carry out a new assessment.

It should also be noted that the Polish authorities have indicated that targeted anti-abuse provisions would be introduced through the regulations implementing the law and rendering it applicable.

