Torun Business Review

CALCULATION OF BANK TAX ALLOWANCE FOR INSURANCE COMPANIES — CASE LAW REVIEW

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Abstract

Since 1 February 2016, insurance companies in Poland are subject to a tax on certain financial institutions (Journal of Laws 2019, pos. 1836 — consolidated version). From the very beginning, the taxpayers subject to this act struggle with proper interpretation of its provisions. This paper aims to present one of the unclear provisions related to the appropriate allocation of tax allowance to insurance/reinsurance entities subject to taxation from the same capital group and decode its proper meaning based on many decisions delivered by administrative courts. To achieve this goal, the author gathered and analysed decisions delivered by administrative courts concerning the above provisions. The detailed analysis of pertinent regulations and case law leads to the conclusion that the most reasonable approach is to apply appropriate IFRS rules while allocation the tax allowance to taxpayers.

Keywords: tax law, bank tax, bank levy.

JEL Codes: H25, K34.
DOI: 10.19197/tbr.v19i1.323

1. Introduction

The idea to introduce a bank tax arose in 2010 and reappeared in 2011 and 2012 in bills drafted by various political parties (Gajewski, 2016, pp. 2–3). The previous bills were either rejected by the Parliament or not even discussed during Parliamentary proceeding.

The current bank tax has been introduced by the Act as of 15 January 2016 on tax on certain financial institutions ("Bank Tax Act") and was brought into force on 1 February 2016. The regulation aimed to introduce an additional source of funding for social programs planned by the government. Despite its common name — bank tax — and

original discussion focused rather on the banking sector, the tax was also levied on insurance and reinsurance institutions conducting their activity in the form of companies and branches of foreign companies (Marszelewski, 2016, p. 100).

From the very beginning, the new regulations raised some doubts about the proper interpretation of its provisions related, in particular, to taxable base calculation. This paper aims to present one of the unclear provisions and try to decode its proper meaning based on the number of decisions delivered by administrative courts.

2. The origins of the regulations

The second sentence of Article 5 sec. 2 of the Bank Tax Act was not included in the bill proceeded by the Sejm (Poselski Projekt Ustawy o Podatku Od Niektórych Instytucji Finansowych, VIII Kadencja, 2015); hence the justification for the bill does not contain any reasoning behind this provision. On 31 December 2015, the Senate passed a resolution amending the bill and introducing the pertinent provision along with other alteration of the bill. However, the only justification for this amendment is that Senate considered it fair to align the legal position of insurance companies with loan institutions (another group of bank tax taxpayers) (Uchwała Senatu z 31 Grudnia 2015 r. w Sprawie Ustawy o Podatku Od Niektórych Instytucji Finansowych, 2015) where such a provision was introduced during the first hearing of the bill before the Public Finance Committee (Kancelaria Sejmu, 2015).

3. General rules

Pursuant to Article 5 sec. 2 of the Bank Tax Act, insurance and reinsurance companies as well as branches of foreign insurance and reinsurance companies the taxable base is the excess of the total value of the taxpayer’s assets, resulting from the trial balance, determined on the last day of the month based on entries in the ledger accounts, according to the Accounting Act or accounting standards applied by the taxpayer pursuant to Article 2 sec. 3 of the Accounting Act — over PLN 2,000,000,000. This value is calculated jointly

for all taxpayers that are dependent or co-dependent directly or indirectly on one entity or group of related entities.

Although both sentences of the above provisions are rather vague and create problems with the proper interpretation, it is the second one that was thoroughly analysed by the Polish tax administration and administrative courts.

4. Review of standpoints presented by tax authorities and administrative courts

The main issue while construing the above provision is when and how to attribute the allowance to each taxpayer.

This issue was noticed for the first time by the Ministry of Finance. On 3 March 2016, the Minister of Finance issued a general tax ruling no. PK1.8201.1.2016, where he gave guidance on how to determine relations between insurance and reinsurance companies to correctly calculate bank tax allowance. In the general tax ruling, the Minister of Finance referred to appropriate provisions on related parties of Accounting Act or International Financial Reporting Standards (IFRS) — depending on which standards are applied by a given taxpayer. While determining the relations, the taxpayer should take into consideration all type of relations irrespective of any shareholding or voting rights thresholds. The total allowance amount — according to the Minister of Finance — might be attributed to each taxpayer based on the share of each taxpayer assets value to the total amount of group assets subject to taxation, although taxpayers can decide to allocate this amount in another way.

Having in mind interpretation presented in the general tax ruling, tax authorities — while issuing individual tax rulings — applied their own interpretation of the provision identifying two groups of entities: (1) taxpayers that are dependent or co-dependent directly or indirectly on one entity, and (2) group of related entities (see: individual tax rulings issued by Director of the National Fiscal Information: no. 0114-KDIP2-2.4016.3.2017.1.AZ as of 8 September 2017, no. 0114-KDIP2-2.4016.1.2017.1.AG as of

26 April 2017). The Supreme Administrative Court and Regional Administrative Courts contested this interpretation in several decisions.

For instance, the Regional Administrative Court in Warsaw in the decision delivered on 11 July 2018 no. III SA/Wa 3664/17[1] held that "the existence of only related entities if there is no dependency or co-dependence (direct or indirect) between them, excludes the calculation of the surplus of the sum of the value of assets resulting from the trial balance [for all related entities — Author] over PLN 2 billion, referred to in Article 5 sec. 2 of the Bank Tax Act".

The court also held that to apply the regulation on the division of bank tax allowance between taxpayers two prerequisites must occur:

- Existence of entities related to one another;
- Dependency or co-dependency between taxpayers (both direct and indirect).

The same standpoint was also presented in other decisions of the Regional Administrative Court in Warsaw decision delivered on 25 May 2018 (no. III SA/Wa 2664/17), on 8 April 2019 (no. III SA/Wa 2144/18), on 8 August 2019 (no. III SA/Wa 1403/19), or on 25 October 2019 (no. SA/Wa 514/19 and no. III SA/Wa 515/19) as well as the Supreme Administrative Court decisions delivered on 29 January 2019 (no. II FSK 3087/18 and no. II FSK 3243/18).

The Regional Administrative Court in Wrocław in the decision as of 25 October 2018, no. I SA/Wr 741/18[2] concurred with the above standpoint adding a detailed linguistic analysis of the provision. Namely, the court held that "If the legislator wanted to distinguish such a category of entities [group of related entities — Author] in the context of the tax obligation, they would use the preposition "for" before the expression "group of related entities". The relationship of the words "on one entity or group of related

1 The decision was upheld by the Supreme Administrative Court in the decision delivered on 2 July 2019, no. II FSK 134/19.

2 The decision was upheld by the Supreme Administrative Court in the decision delivered on 24 April 2019, no. II FSK 286/19. The same argumentation can be found in the decision delivered by the Regional Administrative Court in Wrocław on 25 October 2018, no. I SA/Wr 682/18, later upheld by the Supreme Administrative Court in the decision delivered on 24 April 2019, no. II FSK 285/19.

entities” cannot be read differently from the joint alternative in the form of the conjunction “or”, which refers to the feature of dependency or co-dependence, and not separately to the category of dependent (or co-dependent) taxpayers and the category of related entities with each other (in the context of the obligation to calculate the taxable base)”. Additionally, the legislator, while defining relations, refers to a group of entities, not to taxpayers determined in the Bank Tax Act. In consequence, the obligation to allocate the bank tax allowance does not lie with a group of related parties but with dependent or co-dependent taxpayers. Therefore, the only requirement set by the provision in question is to determine dependency and co-dependency between entities. However, the court did not explain how to determine those relations.

Similarly, on 29 January 2019, the Supreme Administrative Court delivered decisions no. II FSK 3087/18 and no. II FSK 3243/18 where the court only confirmed that to determine dependency and co-dependency, taxpayers have to refer to relevant regulations in the Accounting Act and IFRS. In both decisions, Mr Justice B. Dauter gave a concurring opinion holding that to decode the meaning of “group of related entities”, it is necessary to refer also to Article 3 point 12 of the Insurance and Reinsurance Activity Act. The Accounting Act should only indicate how the control over another entity is exercised, whereas the Insurance and Reinsurance Activity Act should indicate which entities should be considered. In consequence, the group of entities is a group:

- which includes an entity holding equity interests in other entities, subsidiaries of this entity and entities in which this entity or its subsidiaries hold equity interests, as well as a group of entities related to each other by the agreement referred to in Article 7 Sec. 1 of the Commercial Companies Code,
- based on the establishment, by contract or otherwise, of strong and durable financial relationships for group supervision, which may include mutual insurance companies, mutual reinsurance companies or other similar insurance undertakings, which meets the following conditions:

- one of the entities included in the group, recognised as the parent entity, is entitled to run the financial and operating policies of other entities in the group, recognised as subsidiaries,
- the establishment and dissolution of the financial relationship for regulatory supervision purposes is subject to the approval of the regulator.

According to Justice Dauter, basing solely on the accounting regulations leads to the situation where the taxpayer's status depends on whether an entity applies the Accounting Act or IFRS.

In the decision delivered on 25 September 2019 no. III SA/Wa 736/19, the Regional Administrative Court in Warsaw held that it is unacceptable to construe tax law that defines fundamental elements of the tax, such as a taxable base, by referring to rules outside the tax regulations. Therefore, while interpreting the term "related parties" in Article 5 sec. 2 of the Bank Tax Act, we should not refer to IFRS.

5. Possible correct interpretation

Having in mind the standpoint presented by the Minister of Finance and administrative courts, it is clear that the provision in question stipulates that the tax allowance should be calculated only for taxpayers who are dependent or co-dependent on:

- one entity, or
- group of related entities.

In consequence, the main issue is to determine how to determine dependency and co-dependency between entities.

As neither 'dependent' nor 'co-dependent party' were defined in the Bank Tax Act, we must interpret both terms according to appropriate regulations. Since Article 5 sec. 2 directly refers to the Accounting Act and IFRS, we should verify whether the above regulations include appropriate provisions.

Accounting Act and IFRS

It seems the Accounting Act includes all required definitions:

- Pursuant to Article 3 sec. 1 point 39 of the Accounting Act, a dependent entity is a company established and run either based on Polish or foreign corporate law and controlled by a parent undertaking;
- Pursuant to Article 3 sec. 1 point 37 of the Accounting Act, a parent undertaking is a Polish company or Polish state enterprise exercising control over a dependent entity;
- Pursuant to Article 3 sec. 1 point 34 of the Accounting Act, exercising control over another entity is the ability to run financial and operation policy of other entity to gain economic benefits from the activity of the latter;
- Pursuant to Article 3 sec. 1 point 35 of the Accounting Act, exercising joint control over another jointly controlled entity means the ability of one shareholder to run the financial and operating policy of the jointly controlled entity to gain economic benefits from the activity of the latter together and on the same terms as other shareholders — according to agreements between all shareholders.

The above definitions set the following requirements for parent undertaking that should be met jointly:

- Being a company or state enterprise established and run according to Polish company law,
- Having most voting rights either deriving from held shares or agreements with other entities holding voting rights

The above definitions set the following requirements for exercising co-control that should be met jointly:

- Holding shares in other company together with other entities,
- Being able to run the financial and operating policy of the controlled entity, and

- Having an agreement with other shareholders regulating exercising the control over a co-controlled entity.

International Financial Reporting Standards

The same definitions are included in various IFRS's introduced to Polish legislation by the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.

IFRS 10, Appendix A, includes the following definitions:

- 'parent' is an entity that controls one or more entities;
- 'control of an investee' — an investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee;
- 'power' – Existing rights that give the current ability to direct the relevant activities;
- 'Subsidiary' is an entity controlled by another entity.

IFRS 28 defines 'joint control', which is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

Comparison of the Accounting Act and IFRS

Comparison of the above definitions shows that:

- The term 'subsidiary' is defined similarly;
- The term 'parent' is defined broader in IFRS as it is not limited only to companies established according to Commercial Companies Code;
- The term 'control of an investee' is defined similarly to 'exercising control over another entity' as both terms refer to gain benefits from the subsidiary;
- Term' joint control' is defined similarly to 'exercising joint control' as it requires having an agreement with other shareholders.

It derives from the above comparison that the only significant difference is found in the definition of parent undertaking. Therefore, to avoid the situation where the taxpayer's status depends on whether an entity applies the Accounting Act or IFRS, the IFRS should take precedence over the Accounting Act. It should be underlined that the IFRS were introduced to the Polish legal system by the EU Regulation, which is superior to the Accounting Act.

Insurance and Reinsurance Activity Act

Although the Insurance and Reinsurance Activity Act define terms such as 'related party', 'parent undertaking', 'subsidiary undertaking', it is the Accounting Act and IFRS which should be referred to when decoding the meaning of the provision regulating attribution of the tax allowance. The first sentence of the second section of the provision regulating calculation of the taxable base explicitly refers to accounting regulations. Another argument against referring to the Insurance and Reinsurance Activity Act is that this regulation does not define the term 'co-dependent undertaking'.

6. Conclusion

To correctly identify dependent and co-dependent entities and, in consequence, properly allocate the bank tax allowance for insurance companies to each taxpayer, we should refer to proper IFRS.

The standpoint presented by the Regional Administrative Court in Warsaw in the decision delivered on 25 September 2019 (no. III SA/Wa 736/19) denying referring to rules of law outside the tax regulations when interpreting rules concerning key elements of tax (here: taxable base calculation rules) seems to be overstated. The Bank Tax Act does refer to the rules of law outside the tax regulations in other provisions, in particular when defining taxpayers or assets. Moreover, IFRS were introduced to Polish legislation as a part of EU law and, therefore, are superior to national regulations, in particular the Accounting Act. Another argument to apply in this case the IFRS instead of the Accounting Act – even when a taxpayer applies local

accounting standards – is that it does not cause any concerns regarding equality and possible violation of the Constitution.

Alternatively, the government may amend the Bank Tax Act and introduce less ambiguous provisions governing tax allowance calculation.

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