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Beneficial Ownership in Cash Pooling Arrangements

Abstract

Cash pooling is a method of managing financial resources, which works well primarily in enterprises with an extensive corporate structure and operating within capital groups. The choice of a given form of cash pooling will depend on the entrepreneur's individual preferences. Although using this method has many advantages, it still raises legal doubts. There is a lack of provisions in Poland that would precisely regulate this type of agreement. In many cases, the design of the cash pooling agreement is similar to a loan agreement. However, it is worth paying attention to the basic differences, such as the fact that the essence of cash pooling is not an obligation to transfer a specific monetary value to an entity specified in the contract. These and other specific features of cash pooling agreements mean that it is not always obvious to which entity and on what terms an entity can be granted the status of beneficial owner. An additional, verification obligations imposed on the Polish payer and the need to act with due diligence are practical impediments.

Keywords: beneficial owner, liquidity management, loan agreement, interest, market value, capital group, pool leader, global agent, OECD, transfer prices, cash pooling

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Introduction

One of the most pressing problems in the context of the beneficial owner clause in Poland is the possibility of granting this status to a pool leader who manages the liquidity of the capital group under the cash pooling structure. It is worth examining what will change in the current state of knowledge developed by Polish case law in connection with the change in applicable regulations. Which court judgments and to what extent will lose relevance? In what direction will the practice of courts and tax authorities develop? What should entrepreneurs especially keep in mind while operating in the cash pooling structure after the amendment to the CIT Act?² In order to answer the above question, it is necessary to analyze the case-law and list the arguments contained in the judgments with the latest legal status. In addition, it is also worth paying attention to the international landscape and think about how other countries have dealt with the problem of obtaining the status of beneficial owner by a pool leader.

Currently, the beneficial owner has become a concept of domestic law. Thus, with regard to withholding tax (“WHT”) usually collected on passive income, there are currently two basic sources of preferences: participatory exemptions, providing for zero WHT tax rate if i.e. the specific condition of capital ties are met – these exemptions are an implementation of EU directives and are provided for in the CIT Act (for license fees and interest – Article 21 paragraph 3, for dividends – Article 22 paragraph 4); (ii) preferential rates based on the relevant double tax treaty (“DTT”).

Cash pooling – characteristics

Cash pooling is a method of managing financial resources, which works well primarily in enterprises with an extensive corporate structure and operating within capital groups.³ This is a form of centralized liquidity management, which responds

² Act of February 15, 1992 on corporate income tax (consolidated text: Journal of Laws of 2019, item 865, as amended) (“CIT Act”).

³ J. Tymczak, *Cash pooling jako metoda optymalizacji przepływów finansowych w korporacjach finansowych*, [w:] K. Wach, A. Marjański (red.), *Uwarunkowania internacjonalizacji przedsiębiorstw w gospodarce przedsiębiorczej*, Łódź–Warszawa 2018, p. 3.

to the problem that there are obvious differences between companies within a capital group in terms of the need for external capital.⁴ Acquiring a loan, however, is a relatively expensive solution and involves paying interest.⁵

There are many advantages to using cash pooling. It can increase financial liquidity, optimize interest and reduce external debt.⁶ The main purpose of any cash pooling is to optimize and use the surplus funds of all companies in the group to reduce external debt and increase available liquidity. Particularly attractive for cash pooling participants could be the interest benefits.⁷ Financing costs at the group level will be reduced, and proper management will ensure an efficient allocation of funds. Economies of scale can thus increase return on investment and significantly simplify liquidity management from the perspective of a participating company. Banking costs will be reduced thanks to centralization. Central coordination of the funding cycle will also help optimize cash flow forecasts.

It is also important to properly define the rights and obligations in the cash pooling agreement and to develop an adequate treasury policy. Functional processes must be well-defined for a number of reasons: security, performance, consistency. Treasury processes in particular have a fairly high level of complexity. The treasurer's activities affect clients, relations with financial institutions, accounting processes and even personnel management. Liquidity management is an important financial process that requires continuous balancing of cash surpluses and deficits across multiple entities, regulatory environments and currencies. In the case of medium and long-term cash mismatches, it may also be a good idea to use an intra-group loan.

The choice of a given form of cash pooling will depend on the individual preferences of the entrepreneur. Legal and tax issues as well as accounting organization will play a key role in this respect. Cash pooling, despite being a popular method of liquidity management, still raises legal doubts. Nevertheless, it is a very beneficial technique for companies operating within a capital group. It allows you to effectively avoid raising the costs associated with the possibility of cash shortages.

⁴ M. Remlein, *Cash pooling jako instrument zarządzania środkami pieniężnymi w grupie kapitałowej*, „Zeszyty Naukowe Uniwersytetu Szczecińskiego. Finanse, Rynki Finansowe, Ubezpieczenia” 2014, 70, pp. 135–145.

⁵ M. Piazzessi, M. Schneider, *Payments, Credit and Asset Prices*, „BIS Working Papers” 2018, 734, pp. 6–7.

⁶ See more: B. Czuba-Kulisińska, *Sterowanie płynnością finansową z wykorzystaniem cash pooling na przykładzie grupy kapitałowej*, „Zeszyty Naukowe Politechniki Częstochowskiej. Zarządzanie” 2017, 25(1), pp. 194–204.

⁷ See more: P. Bąk, A. Sierpińska-Sawicz, *The effects of cash pooling application in funds management in a capital group in hard coal mining industry*, „Archives of Mining Sciences” 2016, 61(1), pp. 95–107.

Lack of normative definition of cash pooling agreement in Polish law

Cash pooling is a valuable tool for managing cash flow. Cash pool allows the multinational group to centralize internal funding rules, allowing greater control, efficiency and increased synergies between group members. In recent years, however, it has become clear that the cash pooling arrangements of the group can also contribute to significant legal risks, e.g. related to the possibility of assigning beneficial owner status to the relevant entity. Legal risks are also associated with transfer pricing issues, interest costs that cannot be deducted, double taxation or ultimately also penalties that may outweigh the benefits.

There is a lack of legal regulations in Poland that would precisely define the basic features and consequences of a cash pooling agreement. There is no such regulation in civil or banking law. In Polish law, the cash pooling agreement is considered in the categories of an unnamed agreement, pursuant to art. 351¹ of the Civil Code.⁸ However, some residual regulation can be found in the Banking Law.⁹ In accordance with art. 93 a paragraph 1 of this act, in a contract concluded with companies forming a tax capital group within the meaning of the provisions on corporate income tax, represented by the parent company in this group, the bank may specify the amount of consolidated interest rate for funds accumulated on the bank accounts of these companies and loans and credits granted to them cash. In the second paragraph of this article, the legislator introduces the basic rules for calculating the amount of consolidated interest on the accounts kept for companies forming a capital group. Pursuant to this paragraph, the consolidated interest rate is calculated on the amount which is the difference between the sum of the balances on the bank accounts of the companies forming the tax capital group and the sum of receivables from loans and cash loans granted to these companies. It is worth noting that the cited regulation applies only to agreements such as notional cash pooling. For this reason, above all, there is no regulation particularly regarding real cash pooling. Therefore, in practice, banks use the institution of subrogation as the basis for cash pooling.¹⁰

In many cases, the design of the cash pooling agreement is similar to a loan agreement. It is therefore worth paying attention to the basic differences. First of all, unlike the loan agreement, the essence of cash pooling is not the obligation to

⁸ Act of 23 April 1964 Civil Code, Journal of Laws 2019 No. 1145 ("Civil Code").

⁹ Act of 29 August 1997 Banking Laws, Journal of Laws 2019 No. 2357 ("Banking Law").

¹⁰ J. Szlezak-Matusewicz, *Tax risk in cash pooling agreements in polish enterprises*, "Management Theory and Studies for Rural Business and Infrastructure Development" 2014, 36(4), p. 981.

transfer a specific monetary value to the entity specified in the agreement. The obligation to return the same amount of money is also not directly applicable. In addition, the other party to the transaction (actually many transactions) is not specified, because which entity will actually be the other party to the transaction depends on the current capital needs of structure participants.¹¹ The results of the analysis of the cash pooling agreement in the context of its similarity to the loan agreement also raise doubts in the context of the tax on civil law transactions, since this tax is imposed i.e. on loan agreements.

In the cash pooling agreement, the interest paid to companies with a negative balance should not exceed the market values specified for the case in which these companies would not participate in such a structure. In turn, interest paid to companies with a positive balance should not be lower than the market value of interest earned by companies that do not participate in the cash pooling structure.¹² In the opinion of some tax advisers, if the companies from the capital group do not conclude agreements with each other, but only with a financial institution, then there is no actual transfer of funds between the accounts of these companies operating in the cash pooling system.¹³ Interest is paid and collected by the pool leader, and each participant in the structure settles directly with him.¹⁴ Consequently, it is not possible for companies to have knowledge of which of them is currently financing the shortages of other participants' funds. Companies with available funds also do not know whether these funds will be used at all, in what amount and for which participant. Therefore, neither the other party to the transaction nor its subject is determined here. The companies also have no influence on settlements.¹⁵ In this case, the provisions on transfer pricing, which result in the need to regulate the mutual relations of related entities (e.g. participation in capital and management) in accordance with market principles will not apply.¹⁶ Unless the group account holder introduces appropriate restrictions, each participant in the cash pooling structure should be able to use the total balance of the group account.¹⁷

¹¹ W. Niemczyk, *Cash pooling. Aspekty teoretyczne w praktyce biznesowej przedsiębiorstw*, „Palestra” 2013, 58(1–2), pp. 47–56.

¹² Ibidem, pp. 57–58.

¹³ E. Matyszewska, *Cash pooling to dobry sposób na optymalizację podatkową*, „Dziennik Gazeta Prawna”, <http://www.ozog.pl/pdfs/1276594079-dziennik-gazeta-prawna-14062010-cash-pooling-to-dobry-sposob-na-optymalizacje-podatkowa.pdf> (access: 22.06.2018).

¹⁴ W. Niemczyk, op. cit., pp. 57–58.

¹⁵ E. Matyszewska, op. cit.

¹⁶ Ibidem.

¹⁷ Judgment WSA in Warsaw of 24 March 2010, III SA/Wa 2056/09; Judgment NSA of 7 December 2010, II FSK 1277/09.

Based on the OECD¹⁸ discussions on international liquidity management systems, it can be concluded that one practical difficulty is determining how long the balance should be treated as part of a cash pool under a cash pooling agreement before it can potentially be treated as something else, for example a loan.¹⁹ This is due to the assumption that operations made as part of cash pooling are to be short-term and primarily liquidity-driven. In the case of cash pooling, it may be appropriate to consider whether the operations are carried out according to the same pattern each year. It is also worth finding out what financial management policies a given company has in place, in particular considering that profitability of balances is a key issue in financial management.²⁰

Designation of a beneficial owner in a cash pooling structure

It is characteristic for Poland that most individual interpretations and rulings relating to the beneficial owner clause were issued in connection with cash pooling agreements. However, from January 1, 2019, it is no longer possible to confirm the correctness of the determination of the fulfillment of the condition of the actual owner (including the conduct of actual business) under individual interpretation. The individual interpretations issued so far have expired by virtue of law pursuant to art. 30 paragraph 1 of the Amendment.²¹ According to the currently applicable art. 14b § 2a point 2 of the Tax Ordinance,²² the subject of the application for individual interpretation may not be the provisions of tax law aimed at preventing tax avoidance, which refer to the abuse of tax law, conducting actual business activity or undertaking actions in an artificial way or without economic justification. Although the assessment of changes in issuing individual interpretations is not the subject of this research, it should be noted that the situation of entrepreneurs has become complicated. Until now, the possibility of using individual interpretations

¹⁸ Organisation for Economic Co-operation and Development (“OECD”).

¹⁹ OECD, *Base Erosion and Shift Profiting (BEPS), Public Discussion Draft*, BEPS Actions 8–10, Financial Transactions, 3 July–7 September 2018, p. 9.

²⁰ *Ibidem*, pp. 12–13.

²¹ Act of 23 October 2018 amending the act on personal income tax, act on corporate income tax, the act – Tax Ordinance and some other acts (Journal of Laws item 2193) (“Amendment”). See M. Kwaśniewski, P. Wojszko-Maciulewicz, *Rzeczywisty właściciel i rzeczywista działalność gospodarcza – co to znaczy?*, *Crido Taxand tax blog*, 20 November 2018.

²² Act of 29 August 1997 Tax Ordinance, Journal of Laws 2019, item 900 (further: “Tax Ordinance”, “o.p.”).

was eagerly used by entrepreneurs to understand the tax situation in which they find themselves or in which they may find themselves in the future.²³ Currently, entrepreneurs will have to independently decode legal norms based on the amended provisions of the CIT Act by the Amendment exposing themselves to greater risk.

Until now, in Poland, the analysis of the concept of beneficial owner in jurisprudence has mainly focused on the participation of taxpayers in the international system of financing cash pooling.²⁴ In the legal state in which this problem arose, the CIT Act did not yet specify the definition of the beneficial owner, nor did it specify the criteria to be used by payers and tax administration in determining the applicability of the beneficial owner clause in a given case. DTTs do not indicate such definition or guidelines. According to the Commentary,²⁵ the entity entitled to interest on the basis of a given DTT should be considered to be the entity which has ultimate power over interest and this is not the privilege, which is applicable only at one of several stages of the transaction. Accordingly, in order to apply an exemption or reduced WHT rate, it is not sufficient to simply reveal the place of residence of the recipient of interest, but it must also be confirmed that in connection with the financial operations carried out, the recipient of the interest experienced a real financial increase. Beneficial ownership in this context is understood rather as ownership in the economic sense. It is not simply about the title to interest earned.

The Supreme Administrative Court decided that the beneficial owner status should be assigned to the economic owner of the capital provided, and not to the formal recipient of interest alone.²⁶ Therefore, when the receivables are paid to a recipient who is not their ultimate owner at the same time, and his competence is primarily focused on managing funds, such an entity cannot be considered as the beneficial owner. Consequently, if, according to the cash pooling agreement, the pool leader has the competence only to administer the funds in the system, i.e. acts as an intermediary, distributing interest to their final recipients, then he does not actually gain any capital in economic terms, he cannot therefore benefit from the beneficial owner status. Under the above conditions, the beneficial owner status can be assigned to the structure participants who have made their funds available to cover the debit balance. Consequently, a pool leader can also take advantage of this privilege, but only to the extent that his own funds have been used. It should

²³ Związek Przedsiębiorców i Pracodawców, *Interpretacje podatkowe w Polsce*, Warszawa, September 2018.

²⁴ See: D. Gajewski, *Cash pooling – aspekty podatkowe*, "Palestra" 2013, 1–2, pp. 15–16.

²⁵ OECD, *Commentary to the OECD Model Tax Convention on Income and Capital*, 2017 ("Commentary").

²⁶ See: Judgment NSA of 18 March 2016, II FSK 82/14.

therefore be emphasized that for a pool leader to benefit from an exemption or reduced WHT rate, it will not be sufficient to show that he is the owner of the consolidated account or that he has managerial functions in the system.²⁷ In practice, Polish tax authorities can be expected to question the possibility of assigning the status of beneficial owner to a pool leader and would be rather expected to grant tax benefits to structure participants who transfer surplus funds on the basis of a cash pooling agreement.²⁸

Hypothetically, the interest paying company could apply the provisions of the DTT concluded with the participant's country of residence and such participant could be considered as the actual beneficiary. However, the use of such a solution could encounter practical difficulties. The company paying interest would find itself in a situation where it would be necessary to identify all participants in the structure whose funds were used to cover the negative balance, as well as to know the amount of interest attributable to each participant. As a standard, the participant of the cash pooling arrangement does not possess this type of information. Therefore, due to the inability to get the valid information, assigning the beneficial owner status to the structure participants is difficult or virtually impossible.²⁹ If the final recipient of the interest is not the pool leader, then the company paying out the interest would in practice have to apply a 20% WHT rate. In view of this type of practical difficulties in the literature, it was postulated to develop the concept of beneficial ownership in order to adapt to the requirements of the rapidly growing and innovative financial industry.³⁰ As the Amendment entered into force relatively recently, there is not enough research material to determine the effects of the changes. However, it can be assumed that the inability to use individual interpretation in the new conditions is a significant obstacle for entrepreneurs.

After the legislator has introduced a domestic definition of the beneficial owner, the content of the individual interpretation of May 18, 2018, issued by the Director of the National Revenue Information (pol. Krajowa Informacja Skarbowa – "KIS" – No. 0111-KDIB1-3.4010.63.2018.3.JKT deserves special attention. In the application, the company asked, among others the question of whether it will be obliged, as a payer, to collect a flat-rate tax on interest paid to the agent due to a negative balance on the transaction account pursuant to art. 26 of the CIT Act. The Director of the

²⁷ J. Dąbrowska, *Opodatkowanie dochodu nierezydentów*, [in:] M. Jamróży (red.), *Opodatkowanie dochodów transgranicznych*, Warszawa 2016, p. 28.

²⁸ See e.g.: Interpretacja Dyrektora Izby Skarbowej w Katowicach z dnia 22 kwietnia 2015 r., IBPBI/2/4510-123/15/MO.

²⁹ J. Dąbrowska, op. cit., p. 32.

³⁰ See e.g.: *ibidem*, p. 35–36.

KIS, regarding the possibility of classifying the pool leader as the beneficial owner, decided that in the cash pooling model used by the applicant, the pool leader will not have the status of beneficial owner in relation to the total interest paid by the applicant for receiving funds under the cash structure pooling because of his functions in this particular system.³¹ According to the Director of the KIS, this is not the same as exclusive power over the funds collected under the system. Only the economic owner (and not the administrator of the interest) can be entitled to the capital provided. The individual interpretation indicated that the status of beneficial owner can be attributed to the entity with the right to capital, in connection with which interest will be due together with the right to manage it as the owner. It has been emphasized that interest is closely related to the right to which it relates (with which it arises, e.g. a loan agreement). Consequently, if the owners of capital on which interest is calculated are individual participants of cash pooling arrangements, then they can benefit from beneficial owner clause.

At the same time, the application clearly indicates that interest paid to the agent (pool leader) means interest paid to the pool leader as a participant in the system, as well as interest paid through this agent to other participants achieving financial surpluses. Therefore, it was rightly recognized in the individual interpretation in question that in such conditions the pool leader is entitled to the interest paid by the applicant only in relation to the part of interest due to him directly. Pool leader to some extent also functions as a participant in the system and to the same extent can be granted the status of beneficial owner. The function of pool leader is not tantamount to having power over all the funds accumulated in the system. As part of its function, the pool leader works primarily for other system participants. He receives interest only for the purpose of further transfer to authorized structure participants. Therefore, answering the applicant's question, the Director of KIS finally concluded that the pool leader cannot be assigned the beneficial owner status in relation to the entire interest.

The above shows that this is difficult to refer to the possibility of assigning the status of beneficial owner to a pool leader only in abstract terms, while the test of the actual beneficiary must always be carried out under specific operating conditions of a given system. Compliance with the verification requirements set out in the CIT Act may prove burdensome, especially for entities operating in the cash pooling

³¹ Regarding the comparison of this concept with the principles introduced by the Amendment, see letter from Maciej Witucki, President of the Lewiatan Confederation, Uwagi Konfederacji Lewiatan do projektu objaśnień podatkowych z dnia 19 czerwca 2019 r. "Zasady poboru podatku u źródła" z dnia 28 czerwca 2019 r. nr KL/237/119/PP/2019 (Remarks of the Lewiatan Confederation on the draft tax explanation of 19 June 2019 'Rules for the collection of withholding tax' of 28 June 2019 No. KL/237/119/PP/2019) addressed to the Minister of Finance.

structure. Although, in accordance with the Tax Explanation Draft of 19 June 2019, published on the website of the Ministry of Finance, “Source tax collection rules” (pol. “Zasady poboru podatku u źródła”) should not be interpreted as introducing restrictions,³² the WHT reimbursement mechanism may prove to be practically unavailable in the case of paying interest to entities that keep documentation in a way that the Polish payer has no influence on. It may turn out that the payer will not have adequate information to identify the recipient of interest. According to the Lewiatan Confederation, this may increase the costs of Polish entities by approx. 25%.³³

Possibility of granting the status of beneficial owner in the absence of the beneficial owner clause in DTT

Even before the definition of the beneficial owner along with additional identification requirements was introduced into the Polish legal order, the most pressing problem was the possibility of using the beneficial owner clause in the cash pooling structure based on DTT, which does not directly contain such a clause. The case law has established the view expressed in the justification of the judgment of the Provincial Administrative Court in Warsaw of 27 February 2014, reference number III SA/Wa 2375/13. This ruling was made on the basis of art. 11 Polish-French DTT,³⁴ which does not provide for withholding tax on interest paid to a French company. As the Polish-French DTT does not refer in any way to the status of the beneficial owner, interest paid under a cash pooling agreement to an entity based in France can only be taxed in that country.

The introduction of the beneficial owner clause in the Polish legal order raises first and foremost justified doubts with respect to DTTs which imprecisely regulate the beneficial owner clause or in which such clause is simply missing. As an example, the already mentioned Polish-French DTT, which uses only the concept of “interest owner”, and not “beneficial owner”, has the history of being a subject of litigations. In the current legal situation, it can be concluded that even if a given DTT does not include the beneficial owner clause, the exemption provided for explicitly in the CIT Act can be used, along with the actual beneficiary test, allowing for a WHT exemption. It will always be possible to grant the entity the status of beneficial

³² Tax Explanation Draft of 19 June 2019, p. 5.

³³ See letter of Mr Witucki, op. cit.

³⁴ Agreement between the Government of the Polish People’s Republic and the Government of the French Republic on the prevention of double taxation in the field of taxes on income and property (Journal of Laws of 1977 No. 1, item 5) (“Polish-French DTT”).

owner once the relevant criteria have been met. Consequently, in the legal status after the Amendment, even despite the lack of the beneficial owner clause in a given DTT, it will be possible to grant a WHT exemption on the basis of internal law, since participatory exemptions and preferences arising from DTT are not competitive with each other. An entity not authorized to one of the above preferences may be entitled to the other. Foreign entities should take into account not only the provisions of DTT, but also Polish law.

In practice, the definition of beneficial owner developed by international jurisprudence based on the OECD Model Convention and the Commentary is more favorable (has a broader scope) than the definition of actual owner introduced in the CIT Act.³⁵ In the domestic definition of the real owner, the main emphasis was placed on the possibility of free disposal of the amount due.

Remuneration of a pool leader

The remuneration obtained by the pool leader is significant from the point of view of transfer prices, but also in terms of the possible granting of the status of the beneficial owner to the pool leader, as the remuneration should be adequate to the competences assigned to the given entity, the function performed, significant facts and circumstances, assets used and risks taken.³⁶ In practice, different intentions can be attributed to a given transaction description. Therefore, each case should be analyzed taking into account its specific facts and circumstances.

To illustrate an example of the division of competences in the structure of cash pooling the case study discussed as part of works on BEPS will be used.³⁷ Let's assume that X is the parent company of the group, which also consists of subsidiaries H, J, K and L, participating in the system of physical cash pooling together with another subsidiary M, acting as a pool leader. All participants use the same currency and this is the only currency in the system. M concludes an intra-group agreement on cash pooling with an unrelated bank. Arrangements under this system are binding on all participants who have agreed to transfer funds from or to the main account (based on the agreement company M is in charge of the main account) in

³⁵ M. Szatkowska, A. Makiela, *Zmiana brzmienia klauzuli rzeczywistego właściciela to nie tylko dodatkowe obowiązki dla podatników, ale również szereg problemów praktycznych przy stosowaniu przepisów o podatku u źródła*, KPMG Frontiers in Tax. Polish edition, June 2019.

³⁶ OECD, *Base Erosion...*

³⁷ *Ibidem*.

order to achieve a specific target balance for each participant in the structure. Pursuant to the agreement, the bank makes all necessary transfers required to reach the target balance for each participant in the structure. M took advantage of the guarantee granted by X. The third party bank pays M interest or obtains interest on M based on the pooled position.

Thus, for example, company M receives a surplus of funds from companies H and J and provides funds to companies K and L that show a need for funds. As a result of the arrangements in force, M pays less interest to the bank or receives more interest from it than it would have received in the absence of arrangements for cash pooling. Functional analysis shows that company M is not subject to credit risk, which other members of the cash pooling structure are subject to, but only performs an administrative function. Additionally, in this case M does not bear the risk and does not perform such an important function in the system as the bank does. For this reason, M should not expect such a high remuneration as the bank will receive. In addition, the bank also benefits from spreads. M provides only an administrative service. Although the above example is mainly used to illustrate transfer pricing issues, it also has cognitive value in the context of beneficial owner status.

In practice, it is often assumed that the pool leader's remuneration for the liquidity management services provided is included in the interest he is entitled to using the liquid funds made available by the company (i.e. from debit balances). Then the question about the WHT value reduction would relate to the interest exceeding the pool leader's remuneration. The pool leader remuneration itself, included in interest received on debit balances, can be attempted to qualify as corporate profits subject to tax in the country of residence. How the pool leader's remuneration is related to the determination of the beneficial owner status can be traced on the basis of two interrelated individual interpretations No. S-ILPB4/423-310/13/17-S/ŁM of November 5, 2013 and No. S-ILPB4/423-310/13/17-S/ŁM from July 17, 2017.

The remuneration in the form of interest obtained by the participants of the cash pooling agreement is actually obtained from temporary financing of the debit of other agreement participants. The full amount of interest paid is a remuneration for providing capital. Therefore, the provisions of the cash pooling agreement regarding remuneration for the liquidity management services performed by the pool leader, which is included in interest paid by the company (the applicant), do not change the nature of the payments made by it to the pool leader. The discussed individual interpretation also stated that the remuneration received by the pool leader (in the amount of the difference between the amount of interest received by the pool leader and the amount of interest paid by the pool leader) is associated with the use of liquid cash and therefore should be treated as interest. In addition, perhaps the actual documentation to prove beneficial owner status should be

collected together with the transfer pricing documentation, as these two issues may have a significant impact on each other.

Cash pooling in new conditions – increased payer obligations

It can be concluded that a significant part of the problems related to taxation of cash pooling structures and the possibility of applying the beneficial owner clause to the pool leader results from the need to take into account the Polish regulation of cash pooling, given DTT as well as the provisions of the Interest Directive³⁸ and other elements of European Union law that may affect the case at hand. The domestic law and particular provisions of the given DTT may not clearly complement each other. Moreover the provisions in use may require further interpretation with regard to the particular case.

Such a canvas arose even a problem with the use of the Polish-French DTT, which does not directly use the beneficial owner clause (in its exact wording). In general, the need to operate on different legal systems is the cause of numerous disputes. The problem of the interface between different legal systems clearly existed even before the introduction of the domestic definition of the beneficial owner along with additional requirements imposed by the domestic law. At that time, it seemed that more precise domestic regulation could dispel existing doubts. Some authors, however, warned against the hectic introduction of national regulations regarding beneficial owner status, arguing that this is a legal construct only of an international law.³⁹

In the latest European case-law, the importance of domestic regulations and the role of national authorities is increasingly appearing. In 2019, the Court of Justice of the European Union in Joined Cases C-116/16 and C-117/16 recognized that it is the duty of national authorities to refuse to grant the privileges provided for in the Interest Directive if they are invoked for fraudulent or abusive purposes.⁴⁰ In a situation where based on the Interest Directive the system of exemption from WHT of the interest paid by a company established in a Member State to a company establi-

³⁸ Council Directive 2014/48/EU of 24 March 2014 amending Directive 2003/48/EC on taxation of savings income in the form of interest payments, OJ L 111, 15.4.2014, pp. 50–78 (“Interest Directive”).

³⁹ See e.g.: M Wilk, *Klauzula rzeczywistego beneficjenta (beneficial ownership) w międzynarodowym prawie podatkowym*, Warszawa 2015.

⁴⁰ Judgement of the Court (Grand Chamber) In joined Cases C-116/16 and C-117/16, T Denmark, Y Denmark Aps, 26 February 2019, ECLI:EU:C:2019:135.

shed in a second Member State does not apply because of fraud or abuse has been found within the meaning of Article 5 of the directive, it is not possible to rely on the freedoms enshrined in the Treaty on the Functioning of the European Union⁴¹ to undermine the legislation of the state of the interest-paying company on which WHT depends.⁴² This underlines the importance of national regulation.

There is no doubt that as a result of changes in Polish law which came into force on 1 January 2019, the payer's obligations will increase. According to Article 26 section 1 of the CIT Act, when verifying the conditions for applying a tax rate other than specified in Article 21 paragraph 1 or Article 22 paragraph 1 of the CIT Act, exemption or conditions for not collecting tax resulting from special provisions or DTT, the payer is obliged to exercise due diligence. When assessing due diligence, the nature and scale of the payer's activities shall be taken into account. Pursuant to the Article 58a § 1 item 5 and art. 58b § 3 of the Tax Ordinance⁴³ (which also came into force on January 1, 2019), if the payer did not carry out the required verification or it was not adequate to the nature and scale of the payer's activity, an additional tax liability is established in the amount of 10% of the tax base of the receivable, for which the payer applied a lower tax rate or did not collect tax. In addition, in accordance with art. 58c o.p. in certain cases, the rate of additional tax liability may even increase. Ultimately, therefore, the payer is responsible for verifying the status of beneficial owner and it is the payer who must examine the relevant provisions of the CIT Act and the relevant DTT.

Pursuant to the Act on anti-money laundering and anti-terrorist financing,⁴⁴ obligated institutions paying out funds are obliged to take appropriate actions to verify the (real) beneficiary (defined for the purposes of this act) and determine its capital structure. Similarly to this act, it may be useful for the payer to introduce internal regulations on the basis of which it will be possible to verify the payments made and appropriate documentation, as well as assign appropriate tasks to the respective employees. Practically, the verification requirements will not be limited to WHT, i.e. the subject of taxation, the status of the payee, tax rates, but they should also take into account the factual circumstances. In addition, it should be noted

⁴¹ The Treaty on the Functioning of the European Union of 25 March 1957, OJ C 326, 26/10/2012 P. 0001–0390 (referred further as "TFEU").

⁴² See: Judgment of the Court (Grand Chamber) of 26 February 2019 (requests for a preliminary ruling from the Østre Landsret, Vestre Landsret – Denmark) – N Luxembourg 1 (C-115/16), X Denmark A/S (C-118/16), C Danmark I (C-119/16), Z Denmark ApS (C-299/16) v Skatteministeriet.

⁴³ Act of 29 August 1997 – Tax Ordinance (consolidated text: Journal of Laws of 2019, item 900, as amended).

⁴⁴ The Act of 1 March 2018 on counteracting money laundering and terrorist financing (consolidated text: Journal of Laws of 2019, item 1115, as amended).

that for payments subject to WHT, anti-tax avoidance clauses may be used, e.g. GAAR (general anti-avoidance clause) and SAAR (specific anti avoidance clause).⁴⁵ Before making a payment subject to WHT taxation, the payer should understand the economic purpose of the transaction (excluding strictly tax benefits) and be able to justify it. Payer should also be able to exclude the possibility of applying the above clauses. It will also be useful to know the capital structure of the payee.

Prior to the Amendment, the payer had to verify whether the recipient of receivables (e.g. dividends, royalties or interest) could be assigned the beneficial owner status based on the relevant DTT, but this obligation was more limited than it is under the CIT Act. The payer also had to complete basic verification obligations if he wanted to take advantage of the exemption. If the verification of the status of the recipient of the receivables was not successful, it was necessary to determine which entity will actually be the beneficial owner of the receivables on the basis of an adequate DTT or collect tax in accordance with Polish regulations. Although the Polish definition of the actual beneficiary appeared already in 2017, the CIT Act at that time did not refer to the process of verifying this status. Therefore, if an entity planned to benefit from the reduced WHT rate, is introduced specific provisions to the agreement, such as cash pooling agreement, which explicitly stated which entity is believed by the structure participant to be the beneficial owner and on which basis this was determined.

From 2019, the process of verification of contractors has become more demanding due to the new WHT collection rules. The novelty is that the payers have been given the opportunity to issue a statement about qualifying for a WHT exemption or applying a reduced WHT rate to them or to apply for an opinion on the application of the exemption, even if the payment limit of PLN 2 million is exceeded.

Cash pooling in Czech jurisdiction – comparison

Poland is not the only country where there is a risk of being unable to obtain the beneficial owner status by a pool leader. A similar problem also occurs even in the Czech Republic. In general, interest on a loan paid to entities established outside the Czech Republic is taxed by WHT at 15%.⁴⁶ However, an exemption can be obtained provided that the status of beneficial owner of the company associated with the Czech company paying interest to another EU Member State, Switzerland, Norway, Iceland or Liechtenstein is demonstrated. The competent Czech authorities

⁴⁵ M. Szatkowska, A. Makiela, *op. cit.*

⁴⁶ Accace, 2018 Tax Guidline, Czech Republic, 2018.

issue a certificate of exemption. The Czech tax authorities issue such certification based on the documents submitted in the application process. The basic documents include a certificate of residence issued by the tax authorities of a given Member State, confirmation of the appropriate legal form of a foreign entity, a document confirming the relationship of a Czech company with a foreign company, a description of the methodology adopted for determining the amount of interest under the cash pooling structure and confirmation that the entity receiving interest is the beneficial owner.⁴⁷ Taxpayers from the European Union and the European Economic Area may submit an application for reimbursement of expenses related to the payment of interest.

Czech law, like Polish law, does not introduce specific regulations regarding cash pooling. Despite this, the arrangements for cash pooling may be of interest to the Czech central bank.⁴⁸ The CNB's supervisory tasks were significantly modified in August 2013, when decree No. 235/2013 concerning submission of declarations to the CNB entered into force. The previous decree No. 34/2003 relating to compliance requirements and notification obligations directly mentioned cash pooling as a type of financial operation not requiring notification to the CNB. However, the 2013 decree no longer provides for such an exemption for cash pooling. Instead, it introduces an annual limit of funds that can be paid abroad and received from abroad. If this limit is reached, the responsible entity must provide CNB with a statement on the matter. It should be emphasized, however, that the decree of 2013 does not include the term "cash pooling", but CNB declared that it would treat such operations within the limits specified in the decree on an equal footing with loans. In other words, if the total volume of funds that the Czech entity has received or made available to the entity in another country is CZK 100 million or more, then the entity must draw up monthly debt financing statements and transfer them to ČNB. Failure to do so is a criminal offense in the Czech Republic punishable by an administrative penalty of up to CZK 1 million, which CNB has the power to impose.

Czech legislation does not recognize the concept of a capital group, just as it does not use the concept of cash pooling. Nevertheless, cash pooling operates in the Czech Republic and there are no regulations directly dealing with the specificity of this type of financial operations. There are, however, rules that should be followed to avoid tax problems and excessive reporting obligations. It is practically impossible to conclude a cash pooling agreement in the Czech Republic if one entity is not the majority shareholder of the other entity. It is common practice that decisions to enter the cash pooling structure are taken by the Czech equivalent of

⁴⁷ CMS, *Cash pooling*, July 2013 (corporate report).

⁴⁸ Further referred to as "CNB".

the general meeting or shareholders' meeting, as strict control over the funds management agreements signed on behalf of the company is required.⁴⁹ The decision to participate in the cash pooling structure may even require a change in the company agreement.

The company is a Czech resident if it is registered in the Czech Republic or if management and control are exercised from the Czech Republic. Resident companies are subject to global income tax. Non-resident companies are taxable only on income from the Czech source of income. The WHT amount in the Czech Republic is 15%. Although the Czech legislation, like in the Polish legislation, lacks regulations directly referring to the concept of cash pooling, it is difficult to find in the literature descriptions of similar problems and matters that appeared in Poland in the context of the use of the beneficial owner clause. Based on the above considerations, it can be assumed that this is due to the fact that the cash pooling agreement under Czech law is nevertheless more similar to the loan agreement than the same agreement in Poland, for example due to the CNB announcement regarding treating the cash pooling agreement analogously to loan agreements. In addition, literature on the topic of cash pooling in the Czech Republic directly uses the concept of "loans" to describe operations between accounts of structure participants.⁵⁰ It may also result from the fact that the authors of the publications cited in this part are not lawyers. Nevertheless, they show the optics of practitioners in this matter. In Poland, on the other hand, there are opposite views, trying to highlight the differences between the cash pooling agreement and the loan agreement.⁵¹ Basically, a cash pooling agreement can be structured differently and will generally be classified as an unnamed agreement. Therefore, the role of the financial institution granting the loan will be different from that of the financial institution operating in the cash pooling system. The freedom of contracts introduces a wider range of options for determining pool leader status. In such conditions, it does not always have to be an entity exclusively administering capital flows between structure participants. Perhaps that is why the issue of assigning the beneficial owner status to the pool leader becomes so pressing particularly in Poland.

⁴⁹ K. Kocurek, P. Polak, *Cash Pooling in The Czech Republic*, "International Journal of Accounting and Financial Management" 2013, 12(7).

⁵⁰ Ibidem.

⁵¹ See: W. Niemczyk, *op. cit.*

Summary

At the moment, it is difficult to predict all the consequences of the Amendment, because the practice of treasury bodies has not yet developed, in particular with respect to interest paid under the cash pooling agreement. The tax consequences of this type of agreement have historically aroused numerous tax controversies and it can be assumed that the Amendment will not bring an end to these controversies, especially taking into account the new obligations of the payer provided for in the CIT Act and the simultaneous functioning of participatory exemption and exemption on the grounds of DTT. The classification of the cash pooling agreement as an unnamed agreement or a series of agreements, including unnamed agreements also does not facilitate the prospect analysis.

There were significant doubts regarding the introduction of the due diligence requirement, effective from January 1, 2019, for all entities paying out receivables covered by WHT. This obligation applies to all payments, regardless of their value. At the same time, the legislator did not indicate in the tax regulations relating to WHT how to interpret "due diligence" and what real actions should be taken in order for this requirement to be considered fulfilled. The tax acts only specify that the assessment of due diligence takes into account the nature and scale of the payer's operations. However, it should be borne in mind that this concept can be interpreted broadly, in particular in the absence of specific conditions, in which there will be difficulties in verifying foreign interest, obtaining a reduction or exemption from WHT may prove practically impossible. New regulations may prove burdensome for entrepreneurs and hamper the functioning of cash pooling structures.