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TAXATION RULES FOR ALTERNATIVE INVESTMENT COMPANIES

Abstract

This article deals with tax rules for alternative investment companies. The main aim of the contribution is approximation of the specifics of income taxation and also the answer to the question whether companies of this type can be used more widely outside Poland for the purposes of international tax planning.

Key words: alternative investment company, exemption from taxation, hybrid structures.

JEL Classification: G34

1. Introduction

The aims of this article is approximation of the specifics of income taxation of alternative investment companies and terms of exemption from income tax of their gains. Also, the aim is the search whether such specific rules of taxation could result in any international effects, such as incompatibility with OECD regulations. One of the hypothesis is that alternative investment companies could be deemed as hybrid structures for the purpose of avoidance of taxation. There were scientific methods used in writing of this article, such as interpretative method also legal dogmatics. For the purposes of this article, several agreements on the avoidance of double taxation were also compared.

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The main books used for this article were Borowicz 2009, Zolt 1998 and OECD Report on Harmful Tax Competition, An Emerging Global Issue and Base erosion and profit shifting.

ASI is an alternative investment fund that can be run by one of the following companies: limited liability company, joint stock company, partnership limited by shares or limited partnership, ASI is therefore an collective investment institution through which it is possible to collect assets from many investors in order to invest in their best interest. It should also be mentioned that the provisions of Community law require the collective investment institution to have a management entity [Kidyba 2018: 1-157]. The European Union has worked on establishing a basic legal framework for investment funds with the aim of liberalizing capital flows among the member countries. It has sought to define the basic qualification requirements for an investment vehicle known as “undertakings for collective investment in transferable securities” (UCITS) and has tried to foster reciprocal agreements among member countries for the operations of these funds. Investment funds – and also ASI may offer privatized businesses management expertise and expanded access to capital or other business relationships [Hagopian 1975: 81-84].

In pursuit of the objectives of EU law, the provisions of the Amending Act did not create new legal forms of conducting the activities of the managers of a collective investment institution, but they covered, in terms of entities, the forms of conducting activities covered by the regulations of the AIFM and UCITS Directive, identified on the domestic market. In the amended Act on Funds, a solution was adopted in relation to ASI, consisting in not separating the investment portfolio from the remaining assets of the company, therefore all assets of the alternative investment company constitute its investment portfolio at the same time.

The introduction to Polish law of regulations on the conduct of business by ASI and the ASI manager is a result of the implementation of the AIFM Directive. The purpose of the AIFM Directive is to establish an internal market for alternative investment fund managers, i.e. managers of all types of funds that are not covered by Directive 2009/65/EC on the coordination of statutory provisions, regulations and administrative provisions relating to undertakings for collective investment in transferable securities and a harmonized and strict regulatory framework and supervisory bodies of the Union for their activities.

The sole object of ASI's activity, subject to the exceptions provided for in the Act on Funds, is collecting assets from many investors in order to invest them in the interests of these investors in accordance with a specific investment policy. ASI, as one of the alternative investment funds, supplemented the existing range of collective investment

entities [Śikova 2021: 49-50]. This means that ASI cannot simultaneously carry out the activities described above and conduct other economic activities.

ASIs can operate as internally manager (through limited liability company or joint stock company) or externally managed (through limited partnership or partnership limited by shares). Externally manager ASI can have only one general partner, which can only be a limited liability company or joint stock company with a status „externally managing company" approved by Commision of Financial Supervision. There are specific rules for taxation of investment funds, because of possible goals of tax regimes to be achieved. The main goals are as following: encourage development of investment funds, market neutrality and administration and compliance considerations [Zolt 1998, 5-8].

2. Taxation of ASIs for income taxes

Generally, there are several prototypes of taxation of investment funds: tax-advantaged prototypes, pass-through prototypes, surrogate prototypes and distribution-deduction prototypes [Zolt 1998: 5-8]. The taxation rules for ASI seems to be the combination of the pass-through prototype (treats the investment fund partially as transparent and allocate some items of income and loss indirectly to investors) and tax-advantaged prototype – to provide tax benefits to ASI that are not generally available to direct investments.

Until the end of 2016, the income of investment funds in Poland was exempt from corporate income tax. From January 1st, 2017, the previously applicable subjective exemption was replaced with the objective exemption, and an income tax exemption was introduced for certain revenues or income of investment funds. Due to the fact that as a result of the amendment to the Act on Investment Funds, a new type of collective investment institution was introduced from June 4, 2016 – an alternative investment company, and bearing in mind that the alternative investment company has become an alternative investment fund by operation of law, some of the exemptions in income tax introduced from January 1st, 2017, it automatically applied to ASI.

It is worth noting, however, that in the period from January 2017 to the end of 2020, ASI could operate both as partnerships (limited partnership and limited joint-stock partnership) and as capital companies (limited liability company or joint stock company). During that period, only the limited partnership was treated as a tax transparent entity, while the income of the other three companies was subject to corporate income tax. The above meant that the rules of ASI taxation differed until the end of 2020, depending on the legal form in which the ASI activity was conducted. From January 1st, 2021, all limited

partnerships are treated for tax purposes as legal persons, which means that ASI taxation from January 1, 2021 should be uniform.

Polish act of 26th July, 1992 on Corporate income tax (hereinafter: CIT Act) contains two material subject exemptions that differentiate the situation of these entities in relation to other persons. Both objective exemptions are included in Article 17 (1) (58a) of the CIT Act, with one relating to income or income from the sale of shares, and the other to income or income from the sale of shares. The material exemption for the sale of shares will most often in practice apply to the sale of shares or stocks. In such a situation, we will be dealing with "income exemption" from tax. It is worth noting, however, that the words "income / income" used in the aforementioned provision as well as the wording "from sale" indicate a much wider scope of the exemption than just sales income. Currently, revenues from the sale of shares or stocks are classified as income from capital gains, which results directly from Article 7b of the CIT Act. The regulations contain some terminological confusion. Well, in the context of the sale of shares, it is said about: revenue (in Polish „przychód") from sale, income from capital gains and income (in Polish „dochód") from sale.

It is worth noting that another conceptual confusion in the context of the disposal of shares or stocks results from the fact that the legislator in Article 17 (1) (58a) and Article 7b of the CIT Act refers to the "disposal of shares", while in other parts of this Act it is referred to as income from the "disposal" of shares or stocks. The term "sale of shares or stocks for consideration" is used in the case of the so-called short sale [Borowicz 2009: 24-28][1]. According to the rule of a rational legislator, a hypothesis arises that the revenues from "sale for consideration" will not coincide with the concept of "sales revenues" [Podleś 2020].

In the context of the aforementioned objective exemption, it can be assumed that the tax exemption will apply to all income and revenues from the sale of shares or stocks, with two reservations. First of all, such an exemption will not apply to shares or stocks in the so-called real estate companies. Secondly, such an exemption will not apply to the so-called short sale.

[1] It is also noted that the reference in the process of interpretation the right to will of the real legislator should be treated as one of many interpretative arguments and not as the sole basis for constructing a general normative theory of legal interpretation.

3. Short sale of shares or stocks by ASI

The CIT Act provides in Art. 12 sec. 4c and art. 15 sec. 1n special rules for the taxation of short sales transactions. Both Art. 12 sec. 4c of the act (relating to revenues) and Art. 15 sec. 1n of the act (relating to costs) define a special tax moment for transactions made on the regulated market as part of short sales. In this context, in order to apply the above regulations, it should be determined whether the following conditions are met:

1. the transactions are made as a short sale;
2. sale in the short sale takes place on the regulated market.

Short sale The CIT Act defines short selling in art. 4a point 25 as a short sale within the meaning of art. 2 clause 1 lit. b of the Regulation of the European Parliament and of the Council (EU) No 236/2012 of March 14th, 2012 on short selling and selected aspects of credit default swaps. Pursuant to the Regulation, "short sale" of shares or debt instruments means any sale of shares or debt instruments that, at the time of the conclusion of the sale agreement, are not owned by the seller, including such sale in a situation where, at the time of concluding the sale agreement, the seller borrowed shares or debt instruments. for the purposes of their delivery on settlement or has agreed to borrow them, not including: i. a sale by either party under a repurchase agreement, where one party has agreed to sell the security to the other party at a specified price and the other party has agreed to resell that security at a later date at another specified price; ii. transfer of securities under a securities loan agreement; or iii. enter into a future or other derivative contract where it has been agreed to sell the securities at a specified price at a later date [Podleś 2020: 458-459].

The construction of "short selling" assumes that real economic profit is obtained not from an increase in the value of shares but from a decrease in it. Recognizing that the objective exemption referred to in Article 17 (1) (58a) of the CIT also applies to income from short sales would be contrary to the entire structure of the exemption, in which it is assumed to reward investing in developing companies, as this provision speaks of "income from the sale of shares or stocks. It is often assumed that short selling is an instrument of speculative trading in securities [Regulation 236/2012][2]. Hence, apart from the linguistic

[2] In the preamble to Regulation 236/2012 it has been pointed out that, in order to ensure the proper functioning of the internal market and improve the conditions for its functioning, in particular as regards financial markets, and to ensure a high level of consumer and investor protection, it is therefore appropriate to establish a common regulatory framework for short selling and swap requirements and powers. risk, and ensuring greater coordination and coherence between Member States when measures need to be taken in exceptional circumstances. It is necessary to harmonize the rules relating to short selling.

meaning of Article 17 (1) 58a and Article 7b of the CIT, it seems reasonable to examine whether the functional interpretation also leads to the exclusion of short selling profits from the hypothesis of that provision. The justification of the draft act amending certain acts in order to introduce simplifications for entrepreneurs in tax and economic law shows that the structure of the exemption is to limit the application of the corporate income tax exemption to a situation where an alternative investment company that sells shares (shares), before the date of sale, it directly held not less than 10% of shares (stocks) in the capital of the company whose shares (stocks) are being sold, continuously for a period of two years, it is intended to exempt the so-called portfolio investments, e.g. in shares listed on the WSE [Substantiation 2018: 19]. It can therefore be assumed that the legislator's goal was to make investments more attractive, for example in in the so-called start-up companies, and not in speculative investments. Thus, it should be assumed that the ASI tax exemption does not apply to profits from short sales.

4. Swapping and exchange of shares or stocks and ASI tax exemption

Swapping shares or, like selling, is one form of disposal. Pursuant to Art. 603 of the polish Civil Code, by an exchange agreement, each party undertakes to transfer ownership of things to the other party in exchange for a commitment to transfer ownership of another thing. Due to the fact that pursuant to Art. 604 of the Civil Code the provisions on sale shall apply accordingly to the exchange, its subject may be both movable and immovable property, as well as property rights. It is also commonly accepted that the subject of the exchange may be financial instruments, including ex. shares [Ciszewski, Nazaruk 2019: art. 603].

The exchange of shares or stocks made by ASI will also benefit from the tax exemption provided for in Article 17 paragraph 1 point. 58a CIT Act. In certain situations, the material scope of this exemption may coincide with the so-called exemption share exchange.

It should be noted that - pursuant to Art. 12 sec. 4d CIT Act, if the company acquires from a partner of another company shares (stocks) of that other company and in exchange for shares (shares) of that other company transfers its own shares (shares) to its partner or in exchange for shares (shares) of that other company transfers to a partner of this other company of another company own shares (shares) with payment in cash in the amount not exceeding 10% of the nominal value of own shares (shares), and in the absence of a nominal value – the market value of these shares (shares), and if as a result of the acquisition: the acquiring company obtains an absolute majority of voting rights in the

company whose shares are acquired, or the acquiring company, which has an absolute majority of voting rights in the company whose shares (stocks) are being acquired, increases the number of shares (shares) in this company - the revenues do not include the value of shares (shares) transferred to a shareholder of this other company and the value of shares (shares) acquired by the company, provided that the entities participating in this transaction are subject to taxation in a Member State of the European Union or another country belonging to the European Economic Area on their total income, regardless of where they were obtained (share exchange).

The cited provision was added by Art. 2 point 2 let. b of the Act of April 20th, 2004 amending CIT Act on the date of accession of the Republic of Poland to the European Union. Subsequently, it was amended by Art. 1 point 8 let. h of the Act of November 16, 2006 on January 1st, 2007 and by art. 2 point 5 let. b of the Act of November 25th, 2010 amending CIT Act on 1st January 2011. The purpose of introducing a norm exempt from taxation of the income arising from the operation of exchange of shares (shares) was the necessity to adjust the provisions of the Act on corporate income tax and the act on personal income tax to the provisions contained in Council Directive 90/434/EEC.

Subsequent amendments to Art. 12 sec. 4d CIT Act were caused by the necessity to adapt to the changing EU regulations in this respect, including the current Council Directive 2009/133/EC. The current wording of this provision was given by the amendment introduced in Art. 1 point 8 lit. g of the Act of August 29th, 2014 amending the CIT Act as of January 1st, 2015. In practice, the above regulations concerning the “exchange of shares” most often apply to the transfer of shares or stocks in the form of a cash contribution in exchange for shares in the company to which such a contribution is made[3].

A literal interpretation of Article 12 (4d) of the CIT Act indicates, however, that this provision also applies to the conversion of shares or stocks. The so-called a small anti-avoidance clause[4]. From January 1st, 2017, paragraph 4a was added to Article 10 of the CIT Act, introducing the legal presumption that any exchange of shares that will not be carried out for justified economic reasons served to avoid or evade taxation. It seems, however, that this clause does not apply to the situation where the party that transfers the shares or stocks in the form of an in-kind contribution is ASI. This is due to the fact that Article 17 (1) (58a) of the CIT is a special provision in relation to the provisions regulating

[3] The acquisition of own shares or stocks is possible in certain situations - e.g. in the case of acquisition for redemption.
[4] The concept of "small anti-tax avoidance clause" will appear in jurisprudence – ex. Supreme Administrative Court, II FSK 1964/15.

the so-called exchange of shares. The exchange of shares (made pursuant to Article 603 of the Civil Code) may be related to the problem of the value of the income determined in connection with the sale of shares or stocks. In the event that an alternative investment company receives shares or stocks with a value that will be recognized by the tax authorities as higher than the value of the shares or stocks that it transfers itself, then such company may generate income from partially free of charge – in accordance with Art. 12 section 1 point 2 CIT Act.

In such a situation, there may be doubts as to whether this income constitutes a separate source of income – than the income from the sale of shares or stocks. It seems not, as it can be assumed that pursuant to Article 12 (3aa) of the CIT Act, the receipt by an alternative investment company as part of the exchange of shares or stocks with a value higher than the value of the shares or stocks transferred by such company will not be treated as obtaining income from partially free of charge, but correspondingly higher income from the sale of shares or stocks[5].

5. Terms of release of the said sale of shares or stocks by ASI

The objective exemption referred to in Article 17 (1) (58a) of CIT Act applies to the sale of shares or stocks when two conditions are jointly met: the company had directly no less than 10% of shares (stocks) in the company's capital before the sale date whose shares (stocks) are sold continuously for a period of two years. The first condition: ASI owning at least 10% of shares or stocks does not apply to the number of shares or stocks sold but held before the sale. This means that such a company could have, for example, 11% of shares for two years, and in a situation where, for example, it sells a 2% stake in the share capital, it may also benefit from a tax exemption. It should be noted that the condition of "holding shares" does not necessarily have to do with title.

It is worth pointing out at this point that other tax exemptions – related to the payment of dividends, are also subject to "ownership of shares or stocks" for a specified period of time – Article 22 (4) of the CIT Act. However, since Article 22 (4d) specifies that the exemption referred to in paragraph 4 applies if the ownership of shares (shares) results from ownership or title other than ownership, provided that these income (revenues) would be dismissal if the ownership of these shares (stocks) has not been transferred. The lack of

[5] It is true that the indicated Article 12 (3aa) of the CIT concerns the adjustment of transfer prices, i.e. controlled transactions, however, taking into account the *a minori ad maius* rule, it should be assumed that it also applies to transactions other than controlled.

such a reservation in relation to the proceeds from the sale of shares or stocks by ASI may mean that the condition of holding shares or stocks referred to in Article 17 (1) (58a) does not have to apply to ownership only on the basis of the ownership right. Such possession may result, for example, from a pledge or use of shares and the actual exercise of corporate rights[6]. It is worth mentioning that due to the mandatory dematerialization of shares[7] from March 1st, 2021, the problem of showing "share ownership" disappears – if the shares were bearer shares. From the other hand there are more and more ways to control companies without owning shares of stocks such as put-call parity for example [Geronimo 2018: 18]. The exemption under Article 17 (1) (58a) of the CIT meets one significant limitation. This exemption does not apply to income (revenue) obtained from the sale of shares (shares) in a company, if at least 50% of the value of the company's assets, directly or indirectly, are real estate located in the territory of the Republic of Poland or rights to such real estate.

It results directly from Article 17 (10b) of the CIT. This (negative) condition refers (through appropriate application) to Article 3 (4) of the CIT. In turn, the same Article 3 (4) of the CIT specifies how the value of such assets is determined. The value of the company's assets, the shares of which are subject to sale, shall be determined on the last day of the month preceding the month of earning income, referred to in that provision. In the case of companies issuing securities admitted to trading on a regulated market, the value of assets may be determined on the basis of balance sheet assets included in periodic reports published at the end of the last quarter preceding the quarter of the calendar year in which the income was generated.

Narrowing the application of the provision of Article 17 (10b) of the CIT to real estate located only on the territory of Poland may indicate that the structure of the entire exemption from Article 17 (1) (58a) of the CIT is an element of the so-called international tax competition applied by Poland [OECD 1998: 22]. This solution seems attractive to foreign people who would like to use ASI as a vehicle to sell shares or stocks in companies owning real estate located outside Poland. Unfortunately, such a differentiation of the exemption conditions (or actually introducing tax preferences only for companies owning directly or indirectly real estate located outside Poland) may expose Poland to the

[6] It seems that by analogy, Article 336 of the Civil Code can be applied, which, although it refers to the principle of domination (as e.g. a usufructuary or a pledgee) over things, however, in the absence of other interpretative guidelines, the term "possession of rights" may also include such states as a pledge or use.

[7] At the end of February 2021, the documents of all bearer shares will expire because of amendment of Commercial Companies Code.

accusation of running the so-called harmful tax competition, which may lead to recognition of Poland as the so-called tax haven [Orędziak 2007: 76]. It is worth noting that tax competition is no longer just about applying low tax rates [Wyciślok 2013: 55]. Poland has introduced the differentiation of the exemption terms which may lead to recognition of Poland as the so-called tax haven. The intellectual history of tax competition seems to have taken a normal route, going from simple models yielding straight forward results to more complicated and less clear-cut conclusions [Wilson 1999: 298]. Perceiving Poland as a tax haven, of course, may be considered controversial, but the introduction of the possibility of transferring control over real estate located outside Poland through the use of the ASI structure may be one of the attributes of countries applying harmful tax competition. Moreover – in a situation where the real estate is located in another EU country – the differentiation of the tax consequences of the sale of shares or depending on the location of the real estate may be considered as infringing Community law on the free movement of goods, services and capital [Szwajdler 2016: 470-480].

A tax exemption consisting in the possibility of selling shares in the so-called real estate companies without income tax applies to both real estate companies based in Poland and abroad (of course, provided that the real estate itself is located abroad). However, in the event that shares or stocks in companies owning real estate located outside Poland are to be sold, then the limitation in the real tax exemption may additionally result from the so-called real estate clauses contained in individual double taxation agreements. Examples of such clauses are: Article 13 (4) of the Poland-Belgium DTA or Article 13 (2) Poland-Austria DTA. However, there are still bilateral agreements that do not contain the indicated ones or Article 13 (2) Poland-Austria DTA and there are still bilateral agreements in force that do not contain the indicated real estate clauses – ex. Poland-Russia DTA, as well as agreements that have not yet been modified by the MLI Convention and do not contain a real estate clause – ex. agreement between Poland-Greece DTA.

Real estate clauses contained in bilateral agreements (including those modified by the MLI Convention) are similar to the provision contained in Article 17 (10b) of the CIT, except that they usually do not specify how to calculate and at what time the value of real estate and other assets of the company the shares are to be sold. The above will probably enable the use of the so-called new hybrid structures in international tax law. The studies on use of such hybrid structures has been rather focused on financial instruments [Gajewski 2012: 86-88]. The OECD distinguishes 4 main areas of hybrid structures. Hybrid mismatch arrangements generally use one or more of the following underlying elements:

- Hybrid entities: Entities that are treated as transparent for tax purposes in one country and as non-transparent in another country.
- Dual residence entities: Entities that are resident in two different countries for tax purposes.
- Hybrid instruments: Instruments which are treated differently for tax purposes in the countries involved, most prominently as debt in one country and as equity in another country.
- Hybrid transfers: Arrangements that are treated as transfer of ownership of an asset for one country's tax purposes but not for tax purposes of another country, which generally sees a collateralized loan [OECD 2012: 4-11].

However, the introduction of a tax exemption for ASI for some real estate companies will probably distinguish a new hybrid structure, i.e. companies that in one country (e.g. in Poland) are treated as real estate companies and will not be considered under the bilateral agreement on the avoidance of double taxation. for real estate companies (differences may result, for example, from adopting a different moment for which the structure of the company's property is determined). In this context, it is also worth quoting the Interpretation IPPB5/423-770/12-4/PS, where the authority stated that: "To answer the question whether the company's shares reach, directly or indirectly, more than 50% of the value of their property located in the Contracting State, the value of these properties should be compared with the value of all property belonging to the company, not taking into account its debts and other obligations (regardless of whether it is secured by a mortgage on the property concerned). In other words, the term "mainly" in Article 13 (5) of the CIT Act suggests that this share must be dominant, never less than half, and the term "assets" in this context undoubtedly refers to the assets of a given entity on a balance sheet basis. As a result, in the light of the OECD Commentary, the determination of the 50% threshold should be based on balance sheet criteria. The precise analysis of double taxation avoidance agreements may indicate that the value of the property will be determined not on the basis of Polish law, but on the basis of the law of the location of the property. However, the definition of the company's total assets in both contracting states is crucial as varying definitions may result in a different value of the shares derived from real estate. Thus, the minimum threshold may be met in one state, but not in the other. Furthermore, it remains unclear in Polish double taxation treaties how to evaluate the immovable property. Fair market values are commonly regarded to be appropriate, but are rarely available. From a Polish tax perspective, it is rather referred to the (lower) tax book values of the immovable property according to tax accounting principles.

It is worth noting that in some double taxation treaties there are sometimes substantive exceptions in real estate clauses, e.g. for hotels or real estate used in production. This may lead to greater interest in the phenomenon of treaty shopping described in BEPS action 6 with use of ASI structuresnt.

6. Conclusions

Alternative investment companies can be an attractive investment vehicle, enabling the sale of stocks or shares in companies, after meeting the conditions of minimum involvement in the capital of such companies and holding such shares or stocks for a specified period of time. On the other hand, differentiating the tax consequences of the disposal of shares depending on where the real estate is located may expose Poland to the accusation of conducting harmful tax competition and the allegation of violation of the law resulting from the EU treaties. Differentiating the concept of a real estate company for the purposes of the tax exemption provided for ASI income or revenues and for the purposes of double taxation agreements as modified by the MLI Convention may lead to the emergence of new hybrid structures used for international tax planning. The mere adoption of certain tax benefits, i.e. exemption from tax of certain capital gains - under the tax-advantaged prototype does not raise much doubts, as it is often used in the world. However, the question of whether the profits from the sale of shares in companies owning the majority of real estate assets located abroad should be exempt from taxation should be considered. The problem of using ASI as hybrid structures will not disappear even if the adoption of the MLI convention is extended on a larger scale. The possible prevention of the use of ASI as hybrid structures would require the introduction of a uniform definition of a "real estate company" under the Corporate Income Tax Act and the provisions of both bilateral agreements on the avoidance of double taxation and the MLI convention.

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