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Tax authorities change their mind on when there is no tax on exchange of shares

I. A new general interpretation has been issued on share exchanges

On 7 May the minister of finance issued a general interpretation on the application of income tax provisions regulating share exchange transactions. The interpretation (number DD7.8203.1.2021) has been published in the Official Journal of the Ministry of Finance, Funds and Regional Policy of 13 May 2021 (item 76) and pertains to the application of the provisions of Article 24 par. 8a-8c of the Personal Income Tax Act of 26 July 1991 (the PIT Act) and Article 12 par. 4d and 11 and 12 of the Corporate Income Tax Act of 15 February 1992 (the CIT Act), with regard to the fulfilment of a condition relating to the acquisition of a majority holding of shares through the performance of more than one transaction over a period of no more than 6 months.

II. Transfer of shares may be exempt from taxation

The regulations discussed in the interpretation indicate that a taxable person's income does not include the value of shares transferred to a shareholder of that other company and the value of shares acquired by the company on the condition that the entities participating in the transaction are subject to taxation on all of their income in a member state of the European Union or another state of the European Economic Area, irrespective of where it is earned (exchange of shares). This exclusion also applies when more than one share acquisition transaction is performed over a period of no more than 6 months starting from the month in which the first acquisition took place, if as a result of such transactions the conditions specified in the exclusion provisions are met.

Where a share exchange transaction is excluded from a taxable person's income, the conditions for such exclusion are met in a situation where the majority of voting rights in the acquired company is obtained by the acquiring company as a result of the acquisition of the acquired company's shares from a greater number of its shareholders through separate transactions concluded over a period of 6 months.

III. Three conditions must be met to avoid taxation

The income exclusion is applied on certain conditions. This is the case if a company acquires shares of another company from a shareholder of that other company and in exchange for the shares of that other company transfers its own shares to the shareholder of that company, or in exchange for the shares of that other company transfers its own shares to the shareholder of that company along with a payment in cash amounting to no more than 10% of the nominal value of its own shares, and in the absence of a nominal value – of the market value of these shares, and if as a result of the acquisition: the acquiring company acquires an absolute majority of voting rights in the acquired company, or the acquiring company, holding an absolute majority of voting rights in the acquired company, increases its number of voting rights in the acquired company. What is more, the exclusion applies if the acquiring company and the acquired company are entities listed in the appendix to the act, or are entities subject to taxation with income tax on all of their income, irrespective of where it is earned, in an EEA state other than an EU member state, and the shareholder is a person taxable with income tax and the shares contributed by the shareholder constitute a contribution in kind designated in full or in part for raising the share capital of the acquiring company.

IV. EU wants to prevent taxation on contributions of assets or exchanges of shares

The provisions under interpretation are the result of implementation into the Polish legal system of the provisions of Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States. The scope of the changes arising out of the Directive pertained to lifting the tax consequences that accompany share exchanges. Under the Directive, the common tax system should avoid the imposition of tax in connection with mergers, divisions, partial divisions, transfers of assets or exchanges of shares, while at the same time safeguarding the financial interests of the member state of the transferring or acquired company. Polish regulations were changed in January 2015.

V. EU regulations define exchange of shares

The minister of finance reminded that in accordance with the EU Directive, “exchange of shares” means an operation whereby a company acquires a holding in the capital of another company such that it obtains a majority of the voting rights in that company, or, holding such a majority, acquires a further holding, in exchange for the issue to the shareholders of the latter company, in exchange for their securities, of securities representing the capital of the former company, and, if applicable, a cash payment not exceeding 10 % of the nominal value, in the absence of a nominal value, of the accounting par value of the securities issued in exchange. At the same time the Directive provides that on an exchange of shares, the allotment of securities representing the capital of the receiving or acquiring company to a shareholder of the transferring or acquired company in exchange for securities representing the capital of the latter company shall not, of itself, give rise to any taxation of the income, profits or capital gains of that shareholder.

VI. Exchange of shares to acquire majority of voting rights should not be taxed

As indicated in the interpretation, the EU regulations provide that an exchange of shares performed in order for the acquiring company to obtain a majority of voting rights in the acquired company or to increase the number of voting rights if the acquiring company holds a majority, should be tax-neutral for the shareholder of the acquired company. This in turn means the need for the introduction of an exception to the general rules, under which a contribution of shares to another company gives rise to the determination of revenue from and costs of such a transaction, associated with the subject of the contribution. Until the end of 2014 the discussed regulations applied to transactions that directly resulted in the acquisition by the acquiring company of a majority holding of shares, as well as transactions concluded when the acquiring company already had such a holding. Changes were made as of 1 January 2015.

VII. Regulations do not explain if they pertain to acquisition from one or several acquirers

As of 2015 Polish regulations provide that the exclusion from income referred to in Article 24 par. 8a of the PIT Act and Article 12 par. 4d of the CIT Act applies in cases when more than one share acquisition transaction is performed in a period that does not exceed 6 months counting from the month of the first acquisition, if as a result of those transactions the conditions specified in the provision are met. The letter of the provision does not, however, clearly indicate if these regulations apply to the acquiring company’s transactions with one shareholder, or any number of natural or legal persons with whom separate contribution in kind transactions have been concluded, which over a period of no more than 6 months will result in the acquiring company obtaining a majority holding.

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VIII. Administrative courts in favor of exempting all transactions from 6 months

The minister of finance explained that administrative courts have adopted a dominant line of rulings with regard to this matter, whereby the condition of acquiring an absolute majority of voting rights in the acquired company is considered met also when it is achieved through the acquisition of its shares from more than one shareholder in a period of no more than 6 months. Based on the reasons for the amendments that introduced the described changes in regulations, the courts interpreted the legislator's objective as intended to cover with the exemption all transactions that in a period of 6 months led to the acquiring company obtaining a majority holding, which would mean granting such a right to all of the shareholders (group of shareholders) who concluded such transactions.

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IX. It is the period of six months, not the number of acquirers that matters

Based on court rulings, in the summary to the interpretation the minister of finance found that the application of Article 24 par. 8a-8c of the PIT Act and Article 12 par. 4d, 11 and 12 of the CIT Act is permissible in a model where a majority of voting rights in the acquired company is obtained by the acquiring company as a result of acquiring the acquired company's shares from a larger number of its shareholders in separate transactions concluded over 6 months. It needs to be added that until now (before the issue of the general interpretation), the tax authorities were of the opinion that such activities may only involve one (and the same) shareholder. Such interpretation of the regulations would have meant that a tax-neutral exchange of shares would only take place when the shares of a company are acquired from an individual shareholder of that company, if as a result of such a transaction or several such transactions concluded with that shareholder over 6 months the acquiring company obtained an absolute majority of voting rights in the acquired company.

The information presented herein does not constitute comprehensive information or opinion. Consult your adviser before making any decisions.

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