

NSA on the calculation of debt financing limit

I. There is a ruling on debt financing and incorrect directive implementation

The Supreme Administrative Court (NSA) has published the reasons for its ruling issued on 26 October 2021 (case file II FSK 976/21) on the determination of limits on the deductibility of debt financing costs. The ruling favors taxable persons and relates not only to the manner in which the debt financing costs limit is determined, but also to the interpretation of the rules that have been implemented in Poland based on EU directives. In consequence, the ruling goes beyond a mere interpretation of debt financing regulations.

II. Regulations limit tax-deductibility of debt financing costs

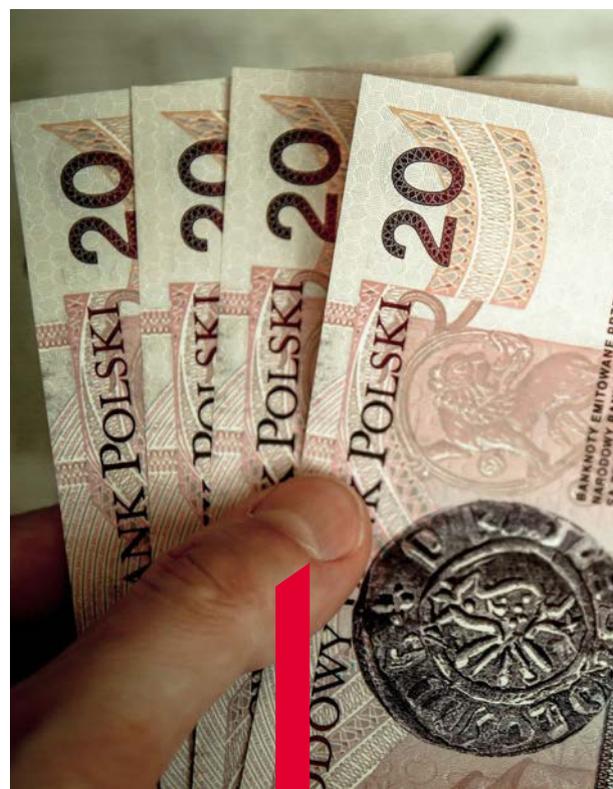
The NSA ruling relates to the provisions of Article 15c of the CIT Act in effect until the end of 2021. Under those provisions taxable persons were required to exclude from tax-deductible costs that portion of debt financing costs which exceeded 30% of the amount corresponding to the excess of total revenues from all revenue sources less interest revenues over total tax-deductible costs less tax-deductible depreciation and amortization charges taken in the tax year, as well as debt financing costs not included in the initial value of the tangible or intangible asset (so-called tax EBITDA). This limit was not applied to that portion of excess debt financing costs which did not exceed PLN 3 million in a tax year. In addition, the limit did not apply to financial enterprises.

III. Prior to change in regulations PLN 3 million limit was not covered by 30% rule

The Court has found that where the excess of debt financing costs is below PLN 3 million, the taxable person is eligible to deduct it in its entirety, and that the statutory proportion of 30% should only be applied once that amount is exceeded. This is because the provisions clearly state that the limit does not apply to the said portion of the excess of debt financing costs, i.e. to the portion that does not exceed PLN 3 million in a tax year. Thus the Court has ruled incorrect the tax authorities' interpretation that the excess of debt financing costs considered in the calculation of the 30% should not be reduced by the PLN 3 million limit. The PLN 3 million may at the most increase the limit arising out of the application of the restriction, i.e. constituting its cap when the amount calculated based on the 30% is lower than PLN 3 million.

Where the excess of debt financing costs is below the PLN 3 million threshold, the taxable person is eligible to deduct the excess in its entirety, and the statutory proportion of 30% should only be applied once that amount is exceeded.

The right to directly apply an EU directive while bypassing national regulations cannot be used by the state authorities to limit the rights arising out of national regulations – the Supreme Administrative Court has ruled.



IV. Linguistic interpretation most important in interpretation of laws

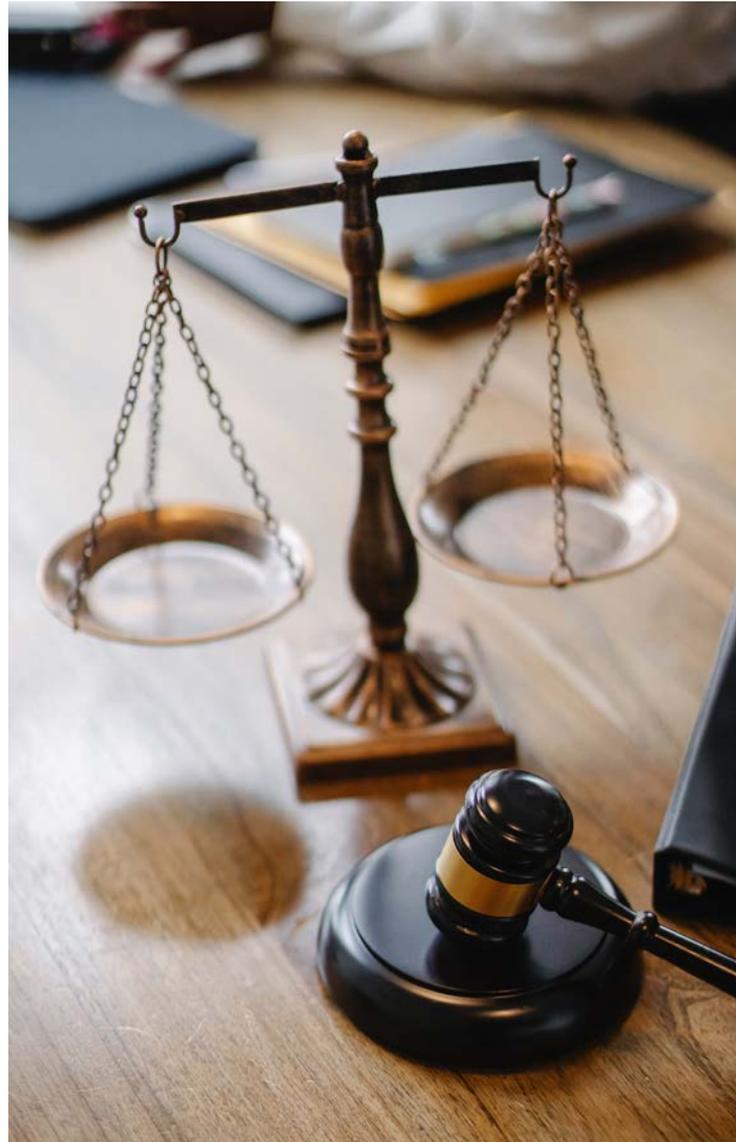
The Court pointed out the critical significance of linguistic interpretation in the understanding of laws. Grammatical interpretation is meant to determine the meaning of expressions and phrases used in regulations (semantic analysis). In accordance with the long-standing principle of priority of linguistic interpretation, a directive should first be subjected to a linguistic interpretation, with systemic or functional interpretation to be used only when doubts continue to persist, or to strengthen the outcome of the linguistic interpretation. And in this case, linguistic interpretation did not permit for an interpretation other than that indicated in the ruling.

V. Reasons for amendments that contradict the wording of the regulations cannot be invoked

In response to the interpretation presented by the representatives of the tax authorities, the Court stressed that it would be difficult to adopt a method for interpreting tax regulations where a legal norm would be decoded based on the reasons for amendments to those regulations, which contradict their literal meaning. The act has been written in the Polish language and every taxable person can get to know its provisions based on the rules of the language – stated the NSA. Although it is true that when interpreting a law the interpreting body should not completely disregard its systemic or functional interpretation by limiting itself to only performing a linguistic interpretation of a given regulation, when it comes to the regulations discussed in this case, on the grounds of their linguistic interpretation it cannot be assumed, as the interpretive body (the tax authorities) has done, that it is necessary to reconstruct the meaning of the regulations in contradiction to their linguistic meaning, based on assumptions arising out of the reasons for the draft amendments and the provisions of the ATAD Directive.

VI. Taxable persons cannot bear consequences of imprecise directive implementation

The NSA further found that the right to apply a directive directly, by bypassing national regulations, cannot be used by the state authorities to limit the rights arising out of national regulations. This is because it is those authorities that are responsible for the proper and full implementation of EU norms. Taxable persons cannot bear the negative consequences of applying clear provisions of a national act, which as a result of an incorrect implementation of a directive are inconsistent with that directive. The Court also held that when performing its duty to interpret an internal law in the light of the wording and objectives of a directive, a national court cannot go beyond the express wording of that internal law, as this would allow national courts to by virtue of interpretation impose on citizens the requirements of a directive in conflict with national norms, without the proper transposition of that directive into national law.



VII. Court must apply more favorable regulations at taxable person's request

When a comparison of the wording of a directive and a national law indicates that to confer on the national law the meaning arising out of an unconditional and precise EU norm would contradict the grammatical meaning of the national law, the court should – if a taxable person demands that the norm be applied as specified in the directive – refuse to apply the national norm and enable the taxable person to apply the EU norm. If, however, the taxable person finds it more advantageous to apply the national norm that has been poorly formulated in the process of its transposition into national law, there are no bases to perform a pro-EU interpretation of the norm, resulting in a contra legem interpretation and to the imposition on the citizen of the obligations that arise solely out of the directive.

VIII. Polish regulations achieve the objectives of EU directive

In the reasons for its decision the NSA found that in accordance with the wording of the EU law, only 30% of excess external borrowing costs (referred to as “excess debt financing costs” in the Polish act) should be deductible. As an exception to this rule, member states can allow taxable persons to deduct excess external financing costs up to a maximum of 3 million euro. Poland decided to exercise this option and has permitted the application of this exception. Thus the establishment in the Polish act of a rule whereby subject to exclusion from the calculation of 30% of excess external financing costs will first be the amount of PLN 3 million, and only after that 30% of the excess of debt financing costs means that it meets the objective of the ATAD Directive.

IX. Polish Deal has changed debt financing regulations to the detriment of taxable persons

As a reminder, the provisions of the Polish Deal that have been in effect as of 1 January 2022 have introduced a rule whereby excess debt financing will be deductible at no more than 30% of tax EBITDA or no more than PLN 3 million. Thus the Ministry of Finance has implemented its own interpretation of the application of this limit, which had been disputed by administrative courts and which was rejected by the Supreme Administrative Court in the described ruling. As of 1 January 2022, taxable persons are required to exclude from tax-deductible costs that portion of their excess debt financing costs which exceeds: PLN 3 million or the amount calculated using the formula presented in the regulations. Additional restrictions apply to transactions with related parties.



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