

Polish administrative court rules on “look-through” approach related to withholding tax on interest paid through a bank account of a Korean real estate trust

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Executive summary

On 4 February 2020, the Voivodeship Administrative Court in Gliwice (VACG) issued its decision in a case that relates to a Korean investment institution (Investor) which receives interest payments from a Polish entity. Under the arrangement, interest payments are made through a trust bank account in Poland owned by a Korean real estate fund (Fund) and transferred to the Investor. The VACG confirmed that the role of the Fund in the structure is to transfer profits through interest due on loans receivables paid by the Polish entity to the Fund's beneficiary (Investor). Accordingly, the preferential tax rate applicable to interest based on the tax treaty between Poland and South Korea (PL-SK DTT) should apply, if other conditions are met.

Detailed discussion

The Polish tax authorities took a strict position in relation to the interpretation of Article 11 (2) of the PL-SK DTT with respect to this case. Tax authorities claimed that application of the preferential withholding tax (WHT) rate depends on fulfilling a condition contained in a phrase “if the recipient is the beneficial owner of the interest.” In the case at hand, the direct recipient of the interest is a custodian bank acting in the name of the Fund and then interest is distributed

to the Investor who invested in the Trust. Therefore, in the view of the tax authorities, expressed in a tax ruling, the Investor could not apply the preferential tax rate resulting from DTT PL-SK provisions, as it is not a recipient (in a narrow literal meaning) of interest, despite the fact that it then receives that interest from the Fund.

The VACG reviewed the case and decided to repeal the tax ruling. It emphasized that the role of the Fund (and its bank account) is only to transfer profits from the Polish entity to the Investor on a regular basis. Thus, in order to satisfy the above-mentioned condition, the beneficial owner clause, despite the wording of this treaty, shall not be referred to as a direct recipient (in this case being the intermediary), but to an actual recipient of the interest payments. Such interpretation allows for the application of Article 11 (2) of the PL-SK DTT, meaning that the Investor can benefit from the lower WHT tax rate.

Implications

The discussed VACG verdict is especially relevant for investment structures where there is a look-through entity pooling funds of the investors and passing on profits. At its core, it touches upon the application of a purpose-oriented

interpretation of the provisions of a tax treaty, which should be in line with the purpose of such treaties and their role in international taxation. The decision may have an impact on the interpretation of treaties concluded by Poland with Hungary, Ireland, Israel and Slovenia, among others, which have similar wording of the beneficial owner clause as in the South Korea treaty.

At present, there are no clear rules regarding application of a "look-through" where the literal wording of a tax treaty requires that the very recipient of a payment is its beneficial owner. Therefore, each investment structure should be analyzed separately to assess and manage the risk related to the application of a "look-through" approach.

The verdict is not final yet as the tax authorities can still file for an appeal of last resort before the Supreme Administrative Court. If the VACG's position is upheld, although it does not formally become applicable to other cases, it would be supporting argument for other investors in similar situations.

The discussed judgment was obtained by EY Poland for its client.

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