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CFC Legislation and Tax Planning from the Polish Perspective

Abstract. *In accordance with the European directive against tax avoidance (ATAD), all Member States of the European Union (EU) have to adopt the legislation tackling controlled foreign companies (CFC) as tax planning vehicles. This EU directive is an outcome of the recommendations worked out in 2015 by the Organisation for Economic Cooperation and Development (OECD) as part of the project addressing tax base erosion and profit shifting (BEPS). Against the background of the "hastily" introduced CFC legislation in Poland, this article investigates the advantageousness of tax planning through a CFC, especially for Polish corporations as shareholders, by comparing the tax burden before and after tax optimisation. Although the corporate income tax (CIT) rate in Poland is relatively low compared to other OECD countries, there is a fiscal risk associated with tax planning in Poland because of a very low tax level in some non-OECD jurisdictions, significantly reduced rates on certain types of income and opportunities for tax deferral. When compared to the OECD recommendations and the ATAD requirements, the Polish CFC legislation has some drawbacks. The thresholds for the exemption of the CFC income (of 50% and 10%) as well as the non-inclusion of shares held by associated enterprises do not fulfil the requirements of the ATAD. Moreover, the benchmark for the low tax should refer to the effective tax burden rather than the statutory tax rate. Nevertheless, the recent tax law amendments in Poland eliminate the aforementioned non-conformities with the ATAD and thus must be viewed positively. Regarding the profit repatriation, the approach for elimination of double taxation remains unclear.*

Keywords: *ATAD, BEPS, CFC, corporate income tax, Poland, tax planning, tax rate*

Introduction

Half a century since the anti-avoidance rules on controlled foreign companies (CFC) were first adopted in the U.S., the CFC legislation has attracted attention, becoming one of the issues of the initiative against base erosion and profit shifting (BEPS) of the Organisation for Economic Cooperation and Development (OECD). Following the BEPS project, in 2016 the European Union (EU) adopted the directive against tax avoidance (ATAD), which enforces – among others – the implementation of CFC rules. Against this background and prior to the final OECD recommendations on BEPS as well as the enactment of the ATAD, the CFC legislation was introduced in Poland.

Due to the "hasty" action of the Polish legislator, the question arises whether Poland faces a considerable risk regarding tax planning through a CFC and whether the adopted rules are compliant with the OECD recommendations and the requirements of the ATAD. Since the BEPS project focuses on corporations and the ATAD applies to taxpayers that are subject to corporate income tax (CIT), this article deals with the CFC legislation of the Polish CIT Act. However, it is noteworthy that similar rules also apply to individuals under the Polish personal income tax.

The remainder of this article is structured as follows. Section 2 discusses the CFC as a tax-planning vehicle by comparing the tax burden under and without profit shifting to such foreign entities, with particular regard to the Polish perspective. In this context, tax deferral and dividend taxation are analysed. Section 3 examines the Polish CFC legislation in the context of the building blocks proposed within the framework of the BEPS project (the definition of a CFC, exemptions and threshold requirements, the definition, computation and attribution of income, prevention and elimination of double taxation), in reference to the OECD recommendations and the ATAD, which serves as the benchmark. Finally, Section 4 concludes the article.

1. Tax Planning throught a CFC

Tax planning through a CFC can be demonstrated by means of the following example. Let us assume corporation *P* in country *A* that levies a CIT at the rate τ_A. Since the corporation has unlimited tax liability in country *A*, its overall profit of 1 leads to a tax burden of τ_A.[1] For the purpose of lowering its tax burden,

[1] This applies under the assumption that foreign profits are subject to an (effective) tax rate of τ_A or less in the source country and that country A provides a tax credit as a method to avoid double taxation.

corporation *P* establishes subsidiary *S* in country *B* with a lower tax rate of τ_B ($< \tau_A$) and channels the whole earnings to foreign corporation *S*. At this stage of the tax-planning scenario, exit taxation has to be taken into account if the profit shifting requires a transfer of assets from *P* to *S*. The tax burden depends – among others – on the amount of attributable hidden reserves. However, leaving the exit tax as well as further transaction costs out of consideration, the benefit of tax optimisation is the outcome of the difference of the tax rates in countries *A* and *B*.

A comparison of the combined CIT rates in the OECD countries reveals a relatively low tax burden for Polish corporations and thereby a rather weak incentive for tax planning trough a CFC (Chart 1).

Nevertheless, effective – rather than staturory – tax rates must be taken into consideration. For instance, the relatively high tax rate of approximately 34% in Belgium does not account for the Belgian notional allowance for corporate equity, which may significantly lower the effective tax rate of the corporate profit. Another example is Hungary, where turnover-based local business tax, innovation

Chart 1. Combined CIT rate 2017 in OECD countries

Combined CIT rate is the basic combined central and sub-central (statutory) CIT rate given by the central government rate (less deductions for sub-national taxes) plus the sub-central rate.

Source: own compilation based on OECD 2017c.

tax, bank levy and surtax on the energy sector are not included in the very low rate of 9%. Moreover, Chart 1 does not account for reduced tax rates applied – among others – under the intellectual property (IP) Box regimes.[2] Furthermore, non-OECD countries like Bahamas, Bermuda or Cayman Islands without a corporate tax burden are not included [KPMG 2017]. According to the Polish Ministry of Development, high levels of foreign direct investment in Cyprus and Switzerland are triggered by tax planning of Polish investors [MR 2017: 9; cf. Kuźniacki 2017].

However, the tax treatment of the profit distribution to parent corporation *P* has not been tackled to date. This is relevant since tax planning should not (negatively) affect the initial opportunity of *P* to pay a dividend to its shareholders or reinvest its capital. By considering the repatriation, the entire tax burden after tax optimisation can be calculated. Assuming a dividend from the subsidiary to *P* of $1 - \tau_B$, which is the shifted profit after taxation in country *B*, the overall tax burden is

$$\tau_B + (1 - \tau_B) \times \tau_A \tag{1}$$

whereby the dividend is subject to tax in the home country of the parent corporation and a tax credit for the lower dividend tax in country *B*, if any, applies. In the case that country *A* exempts intragroup dividends from taxation, the tax burden decreases to

$$\tau_B + (1 - \tau_B) \times \tau_B^D \tag{2}$$

where τ_B^D denotes the withholding tax in the source country, which is usually limited in accordance with provisions of double tax agreements. If country *B* follows country *A* and also exempts the dividend, the overall tax burden is equal to τ_B, which leads again to the tax rate difference between country *A* and *B* as a relevant yardstick for tax planning.

Essentially, the dividend income is subject to the Polish CIT, which induces double taxation of corporate profit. In order to tackle this shortcoming, some countries exempt dividend income from the CIT. Through the implementation of the Parent-Subsidiary Directive [EU 2011] in Poland, such an exemption was introduced – among others – for dividends from foreign corporations with unlimited CIT liability in one of the member countries of the European Economic Area (EEA) or Switzerland if the Polish parent corporation holds at least 10% (25% for Switzerland) in the capital of the distributing company (Art. 20 of the Polish CIT Act[3]). The last-mentioned condition is assumed to be fulfilled in the case of

[2] For an overview of IP Box regimes in Europe, see Evers, Miller & Spengel 2015: 506.

[3] Corporate Income Tax Act, Journal of Laws, no. 21, item 86 as amended (ustawa z dnia 15 lutego 1992 r. o podatku dochodowym od osób prawnych, Dz.U. nr 21, poz. 86 z późn. zm.).

a C(ontrolled)FC. This tax exemption enhances the attractiveness of tax planning within the EEA.

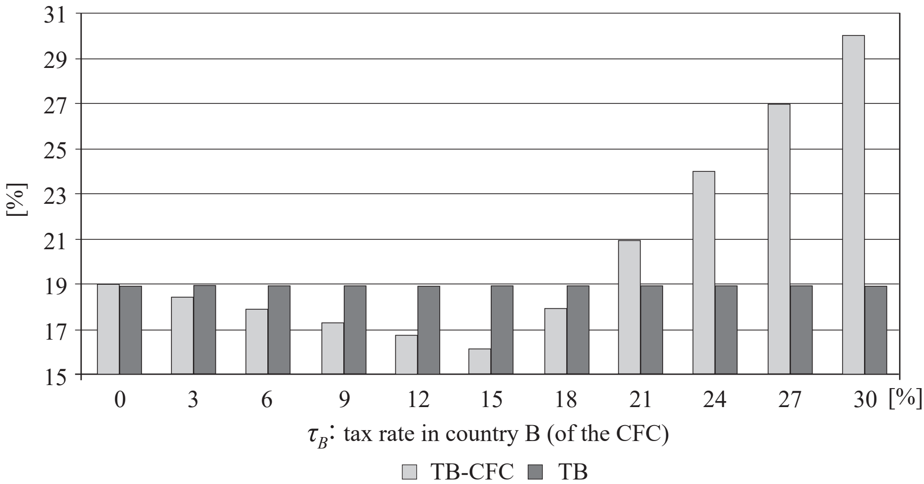
Apart from the exemption, a foreign tax credit is granted, which can be implemented in two ways. The general tax credit for the foreign (withholding) tax on the dividend is appropriate to combat international double taxation of dividend income, although it does not prevent double taxation of distributed and already-taxed profit. Thus, the extended (indirect) tax credit refers to the CIT paid by the distributing company on its profit. Disregarding the withholding tax in the source country, due to the tax credit, the tax burden is reduced as follows:

$$\tau_B + MAX[(1-\tau_B) \times \tau_A - \tau_B; 0] = \begin{cases} (1-\tau_B) \times \tau_A \; if \; \tau_A \geq \dfrac{\tau_B}{1-\tau_B} \\ \tau_B \qquad if \; \tau_A < \dfrac{\tau_B}{1-\tau_B} \end{cases} \tag{3}$$

Interestingly, as far as $\tau_A \geq \frac{\tau_B}{1-\tau_B}$ is fulfilled, the overall tax burden decreases with the increasing tax rate in the country of the CFC $\frac{\partial(1-\tau_B) \times \tau_A}{\partial \tau_B} < 0$.

Chart 2 shows this paradox, which is caused by the deduction of the foreign tax on the CFC's profit, whereby the reduced profit in the form of the dividend is subject to the Polish CIT. On the contrary, the application of the indirect foreign

Chart 2. Tax burden without and under tax planning through a CFC



TB-CFC: Tax burden under tax planning
TB: Tax burden in the initial case (= τ_A)

Source: calculations based on formula (3).

tax credit implies an adjustment of the taxable dividend by the amount of the foreign tax (grossed up dividend, IBFD 2014: 1268).

Nevertheless, the application of the extended tax credit requires an unlimited CIT liability of the distributing company in a country where a double tax agreement with Poland is in place. Including the EEA countries and Switzerland, this applies to over 90 countries [MF 2017]. Furthermore, the Polish company must own at least 75% of the capital of the foreign corporation, which constitutes a significantly higher threshold in comparison with the 10% requirement for the dividend exclusion. The indirect foreign tax credit reduces the tax burden up to approximately 16% (Chart 2), which is not substantially below the baseline Polish tax rate of 19%.

Thus far, given the relatively low Polish tax rate compared to other OECD countries, there seems to be no strong incentive for Polish corporations to use a CFC as a tax-planning vehicle. However, assuming an immediate dividend payment to the parent company, the opportunity to postpone the profit distribution has been neglected. A reinvestment at the level of the CFC may restrict the scope for dividend distribution from the parent company to its shareholders.[4] The latter one would – if necessary – have to sell its shares to achieve access to profits. Regarding the investment activity of the parent company, the transfer of the capital from the CFC to its parent can be conducted in the form of debt. Taking into consideration thin capitalisation rules, the tax advantage can be increased provided interests are deductible at a higher rate from the profit of the parent corporation and are taxable at a lower tax rate in the country of the CFC. In the case where the source country levies CIT only on distributed profits, like Estonia [PWC 2016: 653], the profit retention defers not only the dividend taxation, but also the taxation of CFC income.

Assuming that the reinvests its profit at the rate r over n periods, the after-tax dividend distributed to the parent company in the last period is:

$$(1 - \tau_B) \times [1 + r \times (1 - \tau_B)]^n \times (1 - \tau_A) \tag{4}$$

However, if the tax planning is not in place and the same pre-tax rate of return of r is achievable by the parent, the after-tax profit in the n-th period is:

$$(1 - \tau_A) \times [1 + r \times (1 - \tau_A)]^n \tag{5}$$

Tax planning is advantageous if the after-tax dividend from the CFC exceeds the after-tax profit yielded directly by the parent (4) > (5).

Table 1 displays the benefits of tax planning for a Polish parent as a ratio of the aforementioned profit difference to the net profit without tax planning:

[4] The threshold for distributable profits is regulated in Art. 348 of the Polish Code of Commercial Companies, Journal of Laws no. 94, item 1037 as amended (ustawa z dnia 15 września 2000 r. Kodeks spółek handlowych, Dz.U. nr 94, poz. 1037 z późn. zm.).

$$\frac{(1-\tau_B) \times [1 + r \times (1-\tau_B)]^n \times (1-\tau_A)}{(1-\tau_A) \times [1 + r \times (1-\tau_A)]^n} - 1 \tag{6}$$

Table 1. Benefits of tax planning through CFC (in %)

τ_A = 19%		*n*				
r	τ_B (%)	0	5	10	15	20
5%	0	0.00	4.65	9.51	14.61	19.93
	2	–2.00	2.07	6.31	10.72	15.32
	4	–4.00	–0.49	3.15	6.92	10.83
	6	–6.00	–3.03	0.04	3.20	6.47
	8	–8.00	–5.54	–3.02	–0.43	2.23
	10	–10.00	–8.04	–6.03	–3.98	–1.89
10%	0	0.00	9.10	19.03	29.87	41.69
	2	–2.00	5.95	14.55	23.84	33.89
	4	–4.00	2.85	10.18	18.04	26.46
	6	–6.00	–0.21	5.94	12.46	19.39
	8	–8.00	–3.22	1.80	7.09	12.65
	10	–10.00	–6.19	–2.22	1.92	6.23
	12	–12.00	–9.11	–6.13	–3.05	0.13
	14	–14.00	–11.99	–9.94	–7.84	–5.68

Explanations: τ_A and τ_B denotes the tax rate in the country of the parent and the tax rate in the country of the CFC, respectively. *n* is the number of periods and *r* the rate of return before tax.

Source: calculations based on Formula (6).

The opportunity for tax planning depends on the tax rate in the foreign country, the rate of return as well as the duration of the reinvestment [Arnold 1986]. Even if the repatriated profit in the form of a dividend from the CFC to its parent company is subject to tax in the parent country, a combination of a sufficient long reinvestment time, a high rate of return and low foreign tax burden makes a CFC a useful tax planning vehicle (Table 1).

2. CFC Legislation

Taking into account the advantage of tax deferral achieved through a CFC, the U.S. was the first country to introduce the CFC legislation in 1962, which aims to include CFC earnings in the taxable income of the parent and thereby eliminate the benefits associated with tax planning. Until now, many countries have followed the U.S. by implementing the CFC rules [OECD 2015: 9-10].

Recently, within the scope of the BEPS project, the OECD and G20 countries have dealt with this issue by setting the "Designing Effective Controlled Foreign

Company Rules" as one of the fifteen actions that address tax avoidance by means of artificial profit shifting to low or no-tax locations [OECD 2017a, 2017b]. Following the OECD BEPS conclusions and recommendations, the Council of the EU adopted the so-called Anti-Tax Avoidance Directive [EU 2016], which lays down minimum standards for anti-abuse legislation. Suddenly, during the work on the BEPS project and before enacting the ATAD, the CFC legislation was introduced in Poland. This "hasty" implementation entailed recent tax law amendments in Poland, which aim to achieve compliance with the ATAD (Fig. 1).

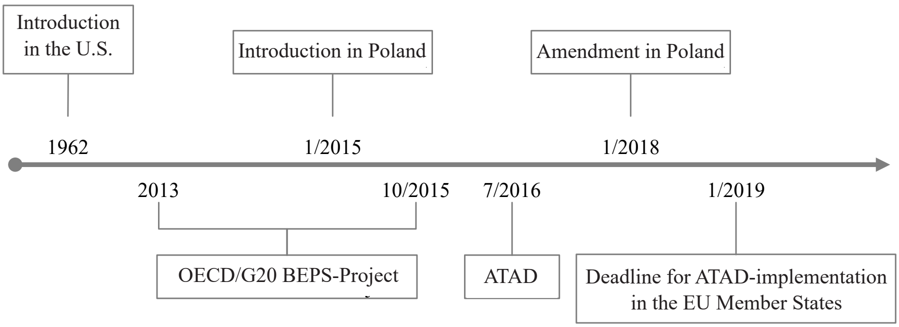


Figure 1. Development of the CFC legislation

Source: based on Rousslang 2000; OECD 2015; EU 2016.

In the light of the above, the design of Polish CFC rules should be analysed regarding the BEPS recommendation as well as the ATAD requirements. Following the BEPS final report on CFC legislation, the comparison is based upon six building blocks: 1. definition of a CFC, 2. CFC exemptions and threshold requirements, 3. definition of income, 4. computation of income, 5. attribution of income and 6. prevention and elimination of double taxation [OECD 2015: 9-10; for a similar analysis on the Nordic countries see Schmidt 2016].

3. Definition of a CFC

The OECD recommends a broad definition of a CFC that is not limited to corporations [OECD 2015: 21]. This is reasonable since not only a foreign corporation but also a foreign permanent establishment as well as a transparent entity may be used as a tax-planning vehicle, as far as the income that is attributable to the foreign entity is not subject to tax in the parent company jurisdiction. In particular, this applies to earnings generated by means of a foreign permanent establishment, which are exempt from taxation according to the respective double tax treaty. The ATAD definition set out in Art. 7 follows this concept. In accordance with Art. 24a of the Polish CIT Act, a corporation or another company that is treated in its country as a corporation for tax purposes falls within the scope of the CFC legislation in Poland. The Polish CFC rules apply to a foreign permanent establishment if its earnings are excluded from the tax base in Poland.

Apart from the legal form, the relation between the domestic shareholder and the foreign entity is crucial for the CFC definition. Essentially, the OECD proposes 50% as a control threshold, and distinguishes between two types – the legal control and the economic control [OECD 2015: 21-24]. Consequently, the ATAD stipulates a 50% threshold, which refers alternatively to the voting rights, capital and profits. For this purpose, direct and indirect participation of the taxpayer as well as its associated enterprises have to be taken into account, as recommended by the OECD. The Polish legislator decided to define the CFC more broadly, which violates neither the OECD recommendations nor the ATAD, since the OECD explicitly allows a lower level of the control threshold [OECD 2015: 21] and Art. 3 of the ATAD emphasises that a higher level of protection for the domestic corporate tax base shall not be precluded by this directive. In accordance with Art. 24a of the Polish CIT Act, a CFC is defined as:

A foreign company domiciled in one of the territories practising a harmful tax competition. These jurisdictions are listed in the Regulation issued by the Minister of Development and Finance that includes countries like Mauritius, Monaco and Panama [MRiF 2017].

A foreign company domiciled in another country without an international agreement with Poland or the EU that would enable Polish tax authorities to receive tax information from the tax administration of this country.

A foreign company, provided that the tax payer owns directly or indirectly over a period of at least 30 days at least 25% of its capital, voting rights or profit share. Additionally, conditions regarding the type of income and the foreign tax burden have to be fulfilled. However, these will be discussed later.

In summary, the Polish control threshold of 25% is set at a significantly lower level than the 50% share required by OECD and EU, though both capture the cumulated shareholding (taxpayer together with its associated enterprises). The approach to the calculation of the indirect control interest increases the strictness of the Polish CFC legislation. Assuming that a Polish company A owns 10% of the shares of company B, which owns 25% of company C, an indirect shareholding of 2.5% (10% × 25%) between company A and company C can be calculated. This is significantly below the Polish control threshold and does not fulfil the OECD recommendation that the control threshold should be met at each level in the chain of ownership [OECD 2015: 29]. Nevertheless, company C can be recognised as a CFC of company A, since according to Art. 11 § 5b of the Polish CIT Act the highest size of the shareholding in the chain – and thus 25% – is relevant. Moreover, there is no threshold for the aforementioned black list countries and jurisdictions that do not participate in the tax information exchange.

According to the latest tax law amendments, the control threshold of 25% will be increased to 50%. Although the definition of the CFC is narrowed down, it is accompanied by a countermeasure in the form of the inclusion of shares owned by associated enterprises. Both adjustments are consistent with the ATAD.

4. CFC exemptions and threshold requirements

In order to design a targeted CFC legislation, entities that are unlikely to be used as a tax planning vehicle should not be affected by the CFC rules [OECD 2015: 33]. Obviously, there is no incentive to implement tax planning if the effective tax burden is not significantly lower than the tax burden in the shareholder's jurisdiction. Art. 7 of the ATAD implements this concept in a very clumsy way. The CFC rules should apply if "the actual corporate tax paid on [CFC] profits by the [foreign] entity or permanent establishment are lower than the difference between the corporate tax that would have been charged on the entity or permanent establishment under the applicable corporate tax system in the taxpayer's country and the actual corporate tax paid on its profits by the entity or permanent establishment."

Assuming a taxable profit of 1, this condition can be expressed as follows:

$$\tau_B < \tau_A - \tau_B \rightarrow \tau_B < 50\% \times \tau_A \tag{7}$$

where (conforming to the previous formulas):

τ_A – tax rate in the country of the shareholder,

τ_B – tax rate in the country of the CFC.

As shown in formula (7), the condition could be phrased more clearly: namely, the CFC rules apply if the effective tax burden of the CFC earnings is lower than 50% of the effective tax burden in the taxpayer's jurisdiction.

The Polish CFC rules regulate a higher threshold of 75% to define low taxation. Since this condition refers to the CIT rate of Art. 19 of the Polish CIT Act (19%), statutory and not effective tax rates seem to be crucial. In line with this opinion, the Administrative Court in Wrocław ruled that a Hungarian company could be recognised as a CFC for the purposes of the Polish CIT even if only part of the income is subject to a tax rate of 14.25% (75% × 19%) or lower [WSA 2016]. This ruling addresses the previously-applicable progressive CIT schedule in Hungary with tax rates of 10% and 19% [*Financial Times* 2016]. Against this backdrop, the recent amendment, according to which the amount of tax actually paid is relevant, must be judged positively. However, the Polish legislator adopted the clumsy wording of the ATAD (cited above) and thus reduced the threshold for low taxation from 75% to 50%.

Apart from the benchmark for low taxation, the scope of the CFC rules may also be limited by a de minimis threshold under which the CFC income is not subject to tax in the parent´s jurisdiction. The BEPS final report does not contain a general recommendation on this issue, although it emphasises the opportunity to circumvent the CFC legislation by splitting the income among multiple foreign entities as well as the increasing complexity due to provisions that aim to prevent such circumvention (anti-fragmentation rule) [OECD 2015: 34].

Since the ATAD provides a minimum standard, it is not surprising that it offers options for non-application of the CFC rules. In accordance with Art. 7 § 3 of the ATAD, a Member State does not have to apply the CFC legislation on foreign entities if the passive income makes up no more than one-third of their entire earnings. Moreover, an exemption may be provided for financial undertakings if up to one-third of passive income comes from transactions with the taxpayer or its associated enterprises. § 4 of the aforementioned provision extends the option for non-distributed income from non-genuine arrangements if the accounting profits and the non-trading earnings do not exceed 750,000 EUR and 75,000 EUR, respectively, or the accounting profits do not exceed 10% of the operating costs.

Compared to the one-third threshold of the ATAD, the Polish legislator set a more generous threshold of 50% for the maximum share of passive income. Nevertheless, according to the recent amendements, this threshold has been adjusted to comply with the ATAD. Furthermore, the CFC rules do not apply if the CFC income does not exceed 250,000 EUR or if the CFC profit does not exceed 10% of earnings from a real economic activity. The circumstances that have to be taken into consideration regarding the assessment of the real economic activity are defined by the CIT law and they illustrate the complexity triggered by the CFC exemptions. Moreover, even if the 10% threshold seems to be in line with the ATAD specification, a closer look reveals that the ATAD refers to the costs (profit $\leq$ 10% $\times$ costs), whereas the Polish CFC rules address the earnings (profit $\leq$ 10% $\times$ earnings). Turning the Polish condition into: profit $\leq$ 10% $\times$ (profit + costs), leads to: profit $\leq$ 11.11% $\times$ costs and thereby a more generous exemption in comparison to its counterpart provided by the ATAD. However, effective from 1 January 2018, these non-application thresholds have been repealed in Poland.

5. Definition, computation and attribution of income

Obviously, a targeted definition of CFC income that results from profit shifting rather than a real economic activity is not easy to determine. The OECD recommends including such a definition into the CFC legislation, although it allows national legislatures latitude concerning its design [OECD 2015: 43]. The ATAD specifies CFC income that should be included in the tax base of the parent company´s country in the form of a list of non-distributed passive income, such as interest, royalties, dividends as well as sales and services income from transactions with associated enterprises without adding a significant economic value. Alternatively, a less concrete definition may apply, according to which non-distributed CFC income arising from non-genuine arrangements with the essential purpose of obtaining a tax advantage should be taxed.

Like the EU directive, the Polish CIT Act defines CFC income by listing types of passive income, such as dividends, capital gains from disposal of shares, interests and royalties. Remarkably, while both the ATAD and the Polish CFC legislation include dividends, the OECD suggests including this type of income with caution, since dividends are exempt from taxation by many countries [OECD 2015: 44]. Nevertheless, the Polish dividend exemption is based upon the Parent-Subsidiary Directive [EU 2011] and thereby essentially applies for dividend distributions within the EU. In other words, if some dividends are subject to the CIT, then it is reasonable to include this type of income within the scope of the CFC legislation to avoid the shifting of dividend income towards a foreign entity. It is noteworthy that a dividend exemption abroad should not be considered as low taxation if it is due to the aforementioned EU directive. Contrary to the ATAD, the Polish CIT Act does not limit CFC income to non-distributed income. However, the Polish tax base has to be reduced by deducting the dividend received from the CFC and capital gain from the sale of CFC shares.

Regarding the computation of CFC income, the OECD recommends applying the rules of the parent's jurisdiction and limiting the offset of CFC losses [OECD 2015: 57]. In compliance with the first recommendation, both the ATAD and the Polish CIT Act require that income has to be calculated in accordance with the tax law of the taxpayer's jurisdiction. This approach is in line with the goal of the CFC legislation and complies with the taxation of foreign income in general (in a non-CFC case). Regarding the loss offset, the EU directive follows the OECD recommendation forbidding the inclusion of CFC losses. However, it is allowed to carry such losses forward. The Polish CFC legislation is more restrictive, since it excludes the application of loss carryforward.

Regarding the extent to which CFC income should be attributable to the shareholder, the OECD proposes referring to both the proportion of ownership and its actual period. In accordance with Art. 8 § 3 of the ATAD, included income should be calculated in proportion to the taxpayer´s participation. Similarly, the Polish CFC rules refer to profit shares and the duration of the qualifying holding for the purposes of income attribution. However, it should be recognised that disregarding the real level of shareholding – especially for the black list countries – the profit share of 100% over the whole year will be assumed.

6. Prevention and elimination of double taxation

The elimination of the incentive to apply tax planning by means of the inclusion of CFC income can lead to double taxation, since this income is taxed abroad at the level of the CFC and after that upon distribution.

This issue can be illustrated by means of a two-period model. In the first and second period, a profit of 1 and 0, respectively, is yielded. If the profit is shifted to a CFC, in the second period the CFC distributes a dividend to the parent company. Regardless of time effects, the tax burden without the CFC is τ_A (tax rate in the parent's jurisdiction). If the CFC exists and the CFC rules in the first period apply, the tax burden is:

$$\tau_B + \tau_A + (1 - \tau_B) \times \tau^D \tag{8}$$

where (conforming to the previous formulas):

τ_A – tax rate in the country of the shareholder,

τ_B – tax rate in the country of the CFC,

τ^D – tax rate on the dividend.

In order to achieve the level of taxation in the parent company's jurisdiction, the additional tax burden of $\tau_B + (1 - \tau_B) \times \tau^D$ should be eliminated. It can be realised by applying the tax credit method (in the first period) and the exemption of distributed profit (in the second period). Since the CFC legislation not only refers to direct but also indirect ownership, double taxation may also arise if the same CFC income is captured by more than one country. In this case, the tax credit would be the appropriate method to mitigate this drawback.

Consequently, the OECD proposes a credit for foreign taxes borne by the CFC and the exemption for dividends and gains from the sale of CFC shares if the income has previously been subject to CFC taxation [OECD 2015: 65]. According to Art. 8 § 7 of the ATAD, the tax liability of the parent should be reduced by the tax paid by the CFC (tax credit method), which complies with the BEPS proposal. However, the ATAD does not grant an exemption for dividends from the CFC and gains from disposition of the CFC shares. Double taxation in this case should be eliminated by deducting the previously-included CFC income from the tax base in the parent's jurisdiction. In my opinion, this approach should not be interpreted as an inconsistence between the ATAD and the OECD's proposal. Rather, the EU directive emphasises that the deduction applies if distributed profits are subject to tax in the parent's jurisdiction. By an *argumentum e contrario*, dividend income may be exempt according to the tax law of the shareholder's country, although this is not aimed to be enforced by the ATAD. It is noteworthy that a general CIT exemption for (foreign) dividends may boost the incentive to shift passive income abroad [Ruf & Weichenrieder 2012].

The Polish rules on the prevention of double taxation are not very clear. Included CFC income should be lowered by deducting dividends and capital gains from CFC shares. This contradicts the timing of profit distribution after its realisation. If the aim of this provision is to include only non-distributed CFC income, then it should be formulated more clearly and in a similar way like under the ATAD. However, the Polish rule extends this deduction for five consecutive years, which underpins this reversed and thereby distorted order of profit generation and distribution. Assuming that the CFC reinvests its income and after many years, the shareholder disposes of CFC shares, unreduced retained CFC income is taxable on the annual basis in Poland, except for the last year of disposition, when capital gain may be deducted. However, due to profit retention, capital gain exceeds CFC income in the year of the share deal and thus double taxation cannot be entirely eliminated. Moreover, the deduction of capital gain in the last period reduces the Polish CIT and therefore limits the scope for the foreign tax credit. This sets the incentive to optimise the distribution policy along the following formula:

$$(1 - D) \times \tau_A - \tau_B = 0 \tag{9}$$

where (conforming to the previous formulas):
τ_A – tax rate in the country of the shareholder,
τ_B – tax rate in the country of the CFC,
D – dividend from the CFC to the shareholder.

The calculated dividend of $\frac{\tau_A - \tau_B}{\tau_A}$ is equal to an annual distribution of approximately 47.4% of CFC income for the domestic and foreign tax rate of 19% and 10%, respectively. Interestingly, this dividend could be paid back to the CFC in the form of equity increase for investment activity of the CFC.

Apart from the above-described deduction and the tax credit, the Polish CFC legislation also deals with double taxation due to the multiple inclusion of the same CFC income in the case of indirect ownership. This shortcoming is mitigated by reducing taxable CFC income to the extent to which this income is included at the level of another controlled company according to the CFC legislation.

Conclusion

The incentive to use a CFC as a vehicle for tax planning results from a lower level of taxation in the jurisdiction where the CFC is based, and the opportunity for tax deferral, which arises if foreign income is retained at the level of the CFC.

Even if the Polish CIT is relatively low in comparison with other OECD countries, the risk of tax avoidance by Polish taxpayers by means of CFCs remains as long as some countries are engaged in (harmful) tax competition by providing low tax rates that apply in general or to selected income sources.

Furthermore, the EU directive (ATAD) obligates EU Member States to implement – among others – the CFC legislation, which complies with the outcomes of the BEPS project.

Nevertheless, the analysis of the "hastily" introduced CFC rules in Poland reveals some significant shortcomings. Essentially, the Polish provisions are stricter than the minimum standard set by the ATAD, although some features of the Polish CFC legislation, like the non-inclusion of shares owned by associated enterprises or the thresholds of 50% and 10% for the exemption of CFC income do not meet the requirements of the ATAD. Moreover, the benchmark for low tax should refer to the effective tax burden rather than the statutory tax rate [OECD 2015: 37]. The recent tax law amendments eliminate the aforementioned non-conformities with the ATAD and thus must be viewed positively.

Concerning profit repatriation, the approach to the elimination of double taxation is still unclear. Arguing that the CFC legislation should lead to a tax burden that would be levied without the CFC, the distribution of the previously-included CFC income should be exempt from taxation in the parent's jurisdiction, as proposed by the OECD. Instead, if distributed CFC profit should be subject to tax, this dividend should be reduced by deducting CFC income that has already been taxed at the level of the shareholder, as proposed by the ATAD. However, the reversed order of the Polish CFC legislation – according to which the dividend should be deducted from included CFC income – is distorted.

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Optymalizacja podatkowa oraz regulacje w zakresie CFC z perspektywy Polski

Streszczenie. *Zgodnie z dyrektywą unijną w sprawie unikania opodatkowania (ATAD, 2016/1164) państwa członkowskie Unii Europejskiej (UE) muszą wdrożyć m.in. przepisy dotyczące kontrolowanych spółek zagranicznych (CFC), które stanowią narzędzie optymalizacji podatkowej. Dyrektywa ta jest wynikiem zaleceń opublikowanych w 2015 r. przez Organizację Współpracy Gospodarczej i Rozwoju (OECD) w ramach projektu dotyczącego erozji podstawy opodatkowania i przerzucania zysków (BEPS). Na tle pośpiesznie wprowadzonych w Polsce regulacji CFC niniejszy artykuł analizuje korzyści wynikające z optymalizacji podatkowej, porównując obciążenia podatkowe przed i po wykorzystaniu CFC jako instrumentu planowania podatkowego. Pomimo stosunkowo niskiej polskiej stawki podatku dochodowego od osób prawnych (CIT) w odniesieniu do krajów OECD ryzyko fiskalne związane z planowaniem podatkowym wynika z bardzo niskiego poziomu opodatkowania w niektórych jurysdykcjach (nienależących do OECD) oraz z możliwości odroczenia opodatkowania. Polskie przepisy CFC są częściowo niezgodne z rekomendacjami OECD oraz wymogami ATAD. Progi określające zakres stosowania regulacji CFC oraz brak uwzględnienia udziałów posiadanych przez przedsiębiorstwa powiązane nie spełniają unijnych wymogów. Ponad-*

to definicja niskiege opodatkowania odnosi się do nominalnych stawek podatkowych, nie zaś do faktycznej kwoty zapłaconego podatku. Mankamenty te zostały wyeliminowane w ramach ostatnich zmian. Sposób zapobiegania podwójnemu opodatkowaniu w przypadku repatriacji zysków pozostał natomiast niejasny.

Słowa kluczowe: *ATAD, BEPS, CFC, podatek dochodowy od osób prawnych, Polska, optymalizacja podatkowa, planowanie podatkowe, stawka podatkowa*