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## ***Supreme Administrative Court judgement concerning the tax qualification of “interest” in an international cash pooling structure***

*April 2018*

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### ***In brief***

In the Supreme Administrative Court judgment passed in October (II FSK 2537/15) the Court indicated that the relationship between a permanent establishment and its parent should be treated as a relationship between independent entities.

For the purpose of tax settlements, also those relating to the parent, a permanent establishment should be treated as a separate entity. In consequence, the court decided that “interest” accrued on behalf of the branch and “interest” charged to the branch in respect of the cash transferred under the cash pooling system will constitute the branch’s revenue and costs within the meaning of the CIT Act and should be recognized on a cash basis.

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### ***Essence of the issue***

By issuing the judgement dated 1 October 2017, the Supreme Administrative Court revoked the judgement of the Provincial Administrative Court in Warsaw, which – similarly to tax authorities had previously – decided that transfers of funds between the branch’s accounts, in different currencies, and the parent’s accounts under the cash pooling system do not cause revenue or tax-deductible costs to arise within the meaning of the CIT Act.

The case concerned a taxpayer that is a branch of an international financial

institution with its registered office in Switzerland, which to increase the effectiveness of funds management and the financial liquidity of the Group acceded to a global cash pooling system.

Due to the requirements regarding transfer pricing between the company and the branch, for the purpose of allocating revenues and costs a mechanism of accruing “interest” receivable by the branch for positive balances and by the parent for negative branch balances was set up. The taxpayer indicated that the “interest” accrued on behalf of the branch and “interest” charged to the branch in

respect of the cash transferred under the cash pooling system will constitute the branch’s revenue and costs within the meaning of the CIT Act that should be recognized on a cash basis due to the need to determine the revenues and costs in an amount in which the branch could receive it should it perform its operations (or similar operations) as a separate company.

Both the tax authorities and the Provincial Administrative Court in Warsaw challenged this position stating that this interest does not lead to revenue arising within the meaning of the CIT Act.

Similarly, the transfers do not lead to deductible costs arising. This position was justified by the fact that the branch of a foreign company is not an entity independent of the company, as it only constitutes a part of the company isolated in terms of organizational structure and assets, and mutual settlements between the company and its branch are made within one entity.

### ***Resolution of the dispute***

The Supreme Administrative Court did not agree with this reasoning presented by the tax authorities and the Provincial Administrative Court, and agreed with the taxpayers arguments. Referring to the legal fiction that the establishment is independent, the court decided that for the purpose of tax settlements, also those relating to the parent, the permanent

establishment should be treated as a separate entity.

In the opinion of the Supreme Administrative Court the establishment should be attributed such profits as it could earn if it performed the same or similar operations in the same or similar conditions as an independent enterprise, and if it were totally independent of the parent in its relationships with it.

In consequence, the court decided that “interest” accrued on behalf of the branch and “interest” charged to the branch in respect of the cash transferred under the cash pooling system will constitute the branch’s revenue and costs respectively within the meaning of the CIT Act and should be recognized on a cash basis.

### ***What impact does it have on me?***

The Supreme Administrative Court’s judgement may have a material significance for the approach used in practice to recognize internal transfers between the head office and its branch for tax purposes. Taking into consideration the arguments presented in the grounds for the judgement, the method of qualifying taxable interest income/costs by the branch should be analysed because the judgment may have an impact on the previous approach of the tax authorities to similar cases. In consequence, this could have a real impact on current settlements and the tax profit/loss.

## ***Let’s talk***

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