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Thin capitalisation – application and limitations under Polish tax law and EU Council Directive 2016/1164 (ATA Directive)

Niedostateczna kapitalizacja – zastosowanie i ograniczenia w świetle polskiego prawa podatkowego i dyrektywy Rady UE 2016/1164 (ATAD)

Streszczenie

Cel: W artykule przedstawiono zjawisko niedostatecznej kapitalizacji, a także przeprowadzono analizę jego istoty i zastosowania. Rozważania zostały dokonane na gruncie historycznego i aktualnego ustawodawstwa polskiego, z uwzględnieniem wpływu prawa unijnego, dzięki czemu możliwe było porównanie różnych systemowych rozwiązań w zakresie regulacji niedostatecznej kapitalizacji.

Metoda badawcza: Podstawą rozważań dokonanych w artykule są zarówno uchylone, jak i aktualne przepisy ustawy z dnia 15 lutego 1992 r. o podatku dochodowym od osób prawnych z zakresu niedostatecznej kapitalizacji. Z racji konieczności implementacji do polskiego systemu prawnego dyrektywy Rady UE 2016/1164 z dnia 12 lipca 2016 r. (dyrektywa ATAD), również jej treść została poddana analizie.

Wyniki: Zmiany w zakresie niedostatecznej kapitalizacji, wprowadzone na mocy implementowanej dyrektywy ATAD, należy uznać za korzystne dla systemu prawnego. Aktualne przepisy w znacznie bardziej klarowny i mniej podatny na manipulację sposób regulują problematykę niedostatecznej kapitalizacji niż uprzednio stosowane rozwiązania. Dodatkowo w sposób odpowiedni wyważają interesy zarówno państwa, jak i podatników.

Konsekwencje/Następstwa: Wprowadzone w całej Unii Europejskiej zmiany wynikające z postanowień dyrektywy ATAD, a uprzednio także działań OECD w ramach planu BEPS, powinny przynieść zamierzony skutek w postaci eliminacji przynajmniej części działań mających na celu agresywną optymalizację podatkową, nie naruszając przy tym w istotny sposób interesu podatników.

Wkład/Wartość dodana: W artykule przedstawiono analizę porównawczą uprzednich i aktualnych rozwiązań w zakresie niedostatecznej kapitalizacji, co pozwoliło na dokonanie oceny przepisów wprowadzonych przez polskiego ustawodawcę, jak i rozwiązań unijnych.

Słowa kluczowe: niedostateczna kapitalizacja, cienka kapitalizacja, unikanie opodatkowania, BEPS, dyrektywa ATAD

Abstract

Objective: This article aims to present the phenomenon of thin capitalisation as well as to analyse its essence and application. The considerations are based on the historical and current Polish legislation, taking into account the impact of EU law, which makes it possible to compare various regulatory solutions in terms of thin capitalisation.

Research Design & Methods: The considerations made in this article are based on both repealed and current provisions of the Act of 15 February 1992 on corporate income tax in the scope of thin capitalisation. Due to the need to implement EU Council Directive 2016/1164 of 12 July 2016 (ATA Directive) into the Polish legal system, its content has also been analysed.

Findings: Changes in the scope of thin capitalisation introduced by the implemented ATA Directive should be considered favourable for the legal system. The current regulations govern thin capitalisation in a much clearer and less manipulable way than the previous solutions. In addition, they appropriately balance the interests of both the state and taxpayers.

Implications / Recommendations: The EU-wide changes resulting from the provisions of the ATA Directive and previously also from the OECD actions under the BEPS Action Plan should have the intended effect of eliminating at least some of the aggressive tax optimisation activities without significantly affecting the interests of taxpayers.

Contribution / Value Added: The article presents a comparative analysis of previous and current thin capitalisation solutions, which allowed the evaluation of regulations introduced by the Polish legislator as well as EU solutions.

Key words: thin capitalisation, tax avoidance, BEPS, ATA Directive

JEL classification: K34

1. Introduction

According to the principle provided in the model system of tax law, the profits of a shareholder (stockholder) of a capital company – resulting from dividends attributable to its share in the share capital – are subject to double taxation. This means that a capital company which reported a profit from its activities must first pay corporate income tax. The profit taxed in this way may – depending on the decision – be paid out to shareholders (stockholders) as a dividend or left in the company's assets. However, choosing the first of the indicated solutions implies the necessity to pay another income tax which is personal income tax this time. In view of the adoption of such a solution, shareholders (stockholders) of capital companies are looking for various ways to reduce the tax burden. One of the ways this is made possible is through the phenomenon of thin capitalisation, which has been developed in practice. In its model formulation, it consists in interest-bearing loans granted to the company by its shareholder (stockholder), the profit from which, unlike dividends, is only subject to personal income tax. As a result of this activity, the shareholder (stockholder) shifts the source of his income from the dividend paid by the company to the repayment of the interest-bearing loan, thereby enjoying a significant tax benefit.

The subject of this article is to present the phenomenon of thin capitalisation, whereas its aim is to analyse the essence and application of thin capitalisation. These considerations will be presented on the basis of Polish legislation, taking into account the impact of EU law. This issue seems to be important mainly due to the increasing popularity of the thin capitalisation mechanism in capital companies, as well as due to the recent changes in tax law in this respect. Of particular importance in this case is the need to implement Council Directive (EU) 2016/1164 of 12 July 2016, also commonly referred to as the Anti-Tax Avoidance Directive (ATA Directive). It should be noted that the problem of broadly understood tax avoidance has increasingly become the subject of interest of international organisations in recent years, which, through the development of joint projects for many countries, aim to introduce a coherent tax policy, allowing the entire system to be sealed both in internal and international terms. For this reason, legislation on thin capitalisation, as one of the most common methods of tax avoidance, has also undergone major changes in Poland recently. A preliminary analysis of the introduced solutions makes it possible to pose a thesis that the legislator has grasped the phenomenon of thin capitalisation much more completely than before, regulating it in a manner adequate to market needs.

To assess the current legislation on thin capitalisation, the definition and advantages of using this institution will be presented first. Furthermore, due to the description of the already repealed provisions of the Corporate Income Tax Act (hereinafter the CIT Act), as well as the ATA Directive and the manner of its implementation, it will be possible to compare the previous and current solutions, and to assess the impact of EU measures on the Polish tax law system.

2. Nature and implementation of thin capitalisation

a. Definition and advantages of thin capitalisation

The thin capitalisation mechanism involves financing the activities of a capital company through loans granted by its shareholder (stockholder). As a result of this practice, the company incurs such significant costs that it does not report a profit from its operation.[1] By doing so, the shareholder can "transfer" the source of his earnings from the company's activities, which become interest on his loans instead of a standard dividend. Such steps are taken to ensure tax optimisation, which may occur when a country's tax system subjects interest

[1] See R. Krasnodębski, 2.2.1.2. *Niedostateczna kapitalizacja* [Thin capitalisation] in: *Opodatkowanie spółek* [Taxation of companies], ed. H. Litwińczuk, Warsaw 2016.

income to a more favourable tax treatment than the alternative dividend. In the absence of specific provisions to counteract thin capitalisation, such as those arising from Art. 4 of the ATA Directive, such a relationship will arise in most jurisdictions. The norms of Polish tax law, according to which the profits of capital companies are taxed twice from the perspective of their shareholder (stockholder), first as corporate income tax and then as flat-rate income tax on collected dividends, may be an example of this. For interest, contrary to the above, only the shareholder (stakeholder) is charged with the flat-rate income tax, as for the company itself, the repayment of the loan and interest will constitute a tax-deductible expense.[2]

Granting a loan by shareholders may also be more beneficial to them for other reasons than recapitalising the company by increasing their input. This includes not having to change the Articles of Association or maintaining the ownership structure, as contributions of various entities remain the same. In addition, such an activity may in some way "protect" against claims of company's external creditors because, in this situation, not only does the company's equity itself decrease – as potential profits become a loan with interest that must be repaid – but the shareholders (stockeholders) themselves also become the company's creditors. It is also worth noting that on the basis of Art. 9 sec. 10 letter i of the Act on Tax on Civil Law Transactions, loans granted by a shareholder (stockholder) to a capital company are exempt from tax on civil law transactions.

b. Applying thin capitalisation in cross-border relations

Further advantages for company's shareholders (stockholders) arise from the use of thin capitalisation in cross-border relations. An attempt may then be made to determine the most favourable state from a tax perspective for the residence of both the lender and the borrower. The first could be a resident of a low-tax country or the so-called "tax exile" in order not to be obliged to pay tax on interest income at all or to have the tax reduced as much as possible.[3] The borrowing company could in turn choose the state as its domicile, regardless of the amount of income tax it would not have to pay. The cross-border application of thin capitalisation is mainly dealt with in bilateral double taxation treaties between states, based on the model of the OECD Convention.[4]

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[2] See Article 15 sec. 1 of the Act on Corporate Income Tax (CIT).

[3] See H. Litwińczuk, 2.2.1.3. *Przerzucanie zysków w drodze nadmiernych płatności z tytułu odsetek* [Profit shifting through excessive interest payments] in: *Międzynarodowe prawo podatkowe* [International tax law], Warsaw 2020.

[4] See https://www.oecd.org/ctp/treaties/articles-model-tax-convention-2017.pdf.

c. Thin capitalisation as a form of tax avoidance

For the reasons mentioned above, thin capitalisation can be considered a form of tax avoidance. This concept should be understood as a measure that reduces tax burden as much as possible while pursuing the intended economic purpose of the entity.[5] The erosion of the tax base that occurs with the use of thin capitalisation as a method of recapitalising companies due to the benefits it brings to the companies' shareholders (stockholders) is also a very undesirable phenomenon for the Treasury, whose potential tax revenues are significantly reduced. For this reason, before the implementation of the ATA Directive was required, there were restrictions in the Polish legal system on the possibility of applying thin capitalisation.

3. Polish legislation on thin capitalisation prior to the ATA Directive

a. Amendments to regulations pursuant to the signature of accession treaty

The issue of applying thin capitalisation was systematised in Polish tax law even before the ATA Directive came into force. These provisions were intended to set a safe limit from the perspective of the legislator, which was to determine the maximum level of indebtedness of the company to its shareholders (stockholders).[6] Exceeding this limit would result in the company's inability to classify the loan-related costs as a deductible expense.[7] The first provisions in this area (Art. 16 sec. 1 points 60 and 61 of the CIT Act) came into force as early as 1 January 1999, but at first, they mainly concerned the situation of non-residents – persons without unlimited tax liability in Poland – as lenders.[8] Such a significant distinction between residents' and non-residents' positions was unacceptable under European law and, therefore, following the signing of the accession treaty and Poland's accession to the European Union, it was necessary to amend the regulations, which took place on 18 November 2004. It extended the application of Art. 16 sec. 1 points 60 and 61 of the CIT Act to domestic situations as well, although it

[5] See Z. Kukulski, D. Strzelec, *Prawnopodatkowe ograniczenia swobody finansowania podmiotów zależnych* [Legal and tax obstacles to the freedom of financing subsidiaries], Krytyka Prawa [Criticism of the legal] 2013, vol. 5, p. 318–319 and the literature cited therein.

[6] See R. Krasnodębski, *2.2.1.2. Niedostateczna kapitalizacja* [Thin capitalisation] in: *Opodatkowanie spółek* [Taxation of companies], ed. H. Litwińczuk, Warsaw 2016.

[7] See Article 15 sec. 1 of the Act on Corporate Income Tax (CIT).

[8] Residents were subject to these regulations only if they benefited from tax reductions and exemptions under Art. 17 sec. 1 point 34 of the CIT Act.

should be noted that under one of the transitional provisions, interest on loans (credits) granted by resident taxpayers before 1 January 2005 went beyond Art. 16 sec. 1 points 60 and 61 of the CIT Act Discrimination against non-residents and thus continued for some time after the amendment was adopted.[9]

b. Restrictions under Art. 16 sec. 1 points 60 and 61 of the CIT Act as amended on 1 January 2015

Article 16 sec. 1 points 60 and 61 of the CIT Act were the basis for the (so-called "basic method") thin capitalisation provisions until the entry into force of the provisions implementing the ATA Directive, which occurred on 1 January 2018. Until then – in the wording of the provisions that came into force on 1 January 2015[10] – in order for the aforementioned limit to be exceeded, which prevents the company from recognising interest on a loan granted by a shareholder (stockholder) as a deductible cost, two conditions had to be met. One was related to the shareholding of the lending entity or the shareholder (stockholder) of the companies that are parties to the loan agreement, and the other, to the value of the loan. According to the first, the lender would have to be an entity holding, directly or indirectly, no less than 25% of the shares of the borrower company, or entities holding jointly, directly or indirectly, no less than 25% of the shares of that company. Alternatively, to avoid the possibility of applying thin capitalisation through transactions between two subsidiaries of the same entity, if the entity directly or indirectly holds not less than 25% each of the shares (stocks) in both companies, the condition is also met. It should be noted that the percentage indicated in the provision concerning the shares held by the entity should be determined taking into account the potential preference in terms of the number of votes per share.[11]

The second condition concerns the value of indebtedness of the company, which in respect of entities holding, directly or indirectly, not less than 25% of shares (stocks) of this company (or in respect of the company granting the loan and in respect of entities holding, directly or indirectly, not less than 25% of shares

[9] See H. Filipczyk, A. Zalasiński, *1.3.2. Nowelizacja z dnia 18 listopada 2004 r.* [Amendment of 18 November 2004] in: *Polskie prawo podatkowe a prawo unijne. Katalog rozbieżności* [Polish tax law vs. EU law. Catalogue of discrepancies], eds. B. Brzeziński, D. Dominik-Ogińska, K. Lasiński-Sulecki, A. Zalasiński, Warsaw 2016.

[10] The content of Art. 16 sec. 1 points 60 and 61 of the CIT Act before the amendment of the Act which came into force on 1 January 2015 has been the subject of much controversy in the context of its practical application; see H. Litwińczuk, *20.3. Regulacje polskie* [Polish Regulations] in: *Międzynarodowe prawo podatkowe* [International Tax Law], Warsaw 2020.

[11] See R. Krasnodębski, *2.2.1.2. Niedostateczna kapitalizacja* [Thin capitalisation] in: *Opodatkowanie spółek* [Taxation of companies], ed. H. Litwińczuk, Warsaw 2016.

(stocks) of the company receiving the loan, pursuant to Art. 16 sec. 1 point 61 of the CIT Act, must exceed, including loan indebtedness, the total equity of the company receiving the loan. This meant that the company's indebtedness to the previously mentioned three groups of entities listed in Article 16 sec. 1 points 60 and 61 of the CIT Act could be at a maximum level of the company's equity capital. When this limit was exceeded, the value of the interest in the proportion in which the value of the debt in excess of the company's equity remains compared to the total amount of this debt, as determined on the last day of the month preceding the month in which the interest on the loans was paid, was not considered deductible.

c. Article 15c of the CIT Act as amended on 1 January 2015.

Apart from the amended provisions of Art. 16 sec. 1 points 60 and 61 of the CIT Act, prior to the implementation of the ATA Directive, thin capitalisation has been analysed by Article 15c of the CIT Act, which has been in force since 1 January 2015 – under the Act of 29 August 2014 amending the Corporate Income Tax Act, the Personal Income Tax Act and other acts. This provision introduced the so-called "alternative method of interest deduction", allowing taxpayers to choose a method of determining the interest limit other than that relating to the company,s debt level.[12] It was only possible to apply this method if the taxpayer decided to do so because the basic method was automatically applied in other situations. Pursuant to Art. 15c sec. 2 of the CIT Act: *Interest on loans, including interest on loans granted by non-affiliated entities, may be considered as tax-deductible costs in a fiscal year up to the amount corresponding to the product of the reference rate of the National Bank of Poland in force on the last day of the year preceding the fiscal year, increased by 1.25 percentage point and the tax value of the assets within the meaning of the accounting regulations, including the nominal value of the amounts of loans granted, except for intangible fixed assets. The value of such assets shall be determined as at the last day of the relevant fiscal year.* To discuss this provision, it is necessary to highlight its two aspects. The first is that the norm includes loans from entities not affiliated to the company. The second one is to make the amount of deductible interest dependent on the product of the reference rate set by the NBP [National Bank of Poland] – the Monetary Policy Council – Increased by 1.25% and the tax value of the assets within the meaning of Article 37 sec. 2 of the Accounting Act of 29 September 1994. Both of these terms need to be defined. The reference rate is the yield on money bills issued by the NBP in

[12] See R. Krasnodębski, *2.2.1.2.3. Alternatywna metoda rozliczania odsetek* [Alternative method of accounting for interest] in: *Opodatkowanie spółek* [Taxation of companies], ed. H. Litwińczuk, Warsaw 2016.

the course of basic open market operations, i.e. purchase or sale of short-term money bills on the interbank market.[13] Setting the reference rate is one of the basic actions that the MPC [the Monetary Policy Council] takes to regulate the amount of money in circulation. It should be noted that at the time the provision in question entered into force, the reference rate was 2%, but it has subsequently been reduced several times to as low as 0.10%[14], which would significantly limit the applicability of Article 15c of the CIT Act as worded on 1 January 2015. The tax base of assets, on the other hand, is defined as the amount that reduces the tax base in the event of an economic benefit being derived from it, either directly or indirectly.[15]

The alternative method thus differed from the basic method both in the choice of the criterion determining how to calculate the maximum value deductible using thin capitalisation (the product of the reference rate plus 1.25% and the tax value of the assets, and the value of the company's equity) and in the basis itself, which could not exceed the specified limit (the value of interest from both affiliated and non-affiliated entities, and the value of debt from subsidiaries). The alternative method, although considered in the doctrine as simpler and easier to apply[16] compared to the basic method, could only be applied for three years, as on 1 January 2018, Art. 15c of the CIT Act was amended following the implementation of the ATA Directive.

4. Restrictions under Art. 4 of the ATA Directive and their implementation in Polish tax law

a. ATA Directive - general characteristics

The purpose of Council Directive (EU) 2016/1164 of 12 July 2016 was to lay down rules to counter tax avoidance practices that have a direct impact on the functioning of the internal market. The content of the Directive and the actions set out therein were significantly influenced by the Organisation for Economic Co-operation and Development (OECD) report published on 19 July 2013, commonly known as the BEPS Action Plan. The document compiles 15 postulates outlining actions that should be taken by states to prevent tax avoidance. One of them was the need to limit

[13] See https://pozyczkiunijne.bgk.pl/moj-biznes/stopa-referencyjna-czym-jest-i-od-czego-zalezy-2526/.

[14] This was the lowest ever value of the reference rate in Poland.

[15] See Article 37 sec. 2 of the Accounting Act of 29 September 1994 (consolidated text: Journal of Laws of 2013, item 330, as amended); E. Walińska, *Ustawa o rachunkowości. Komentarz* [Accounting Act. Comments], Warsaw 2013, p. 454.

[16] See P. Małecki, M. Mazurkiewicz, *CIT. Podatki i rachunkowość. Komentarz* [CIT. Taxes and Accounting. Comments], 6th ed., Warsaw 2015, Art. 15(c).

the erosion of the tax base through the deduction of interest and other charges for financial services.[17] This demand is therefore precisely a matter of thin capitalisation.[18] As the BEPS Action Plan has been adopted by the G20, to which the European Union is a member, the content of the ATA Directive also covers this issue in Art. 4.

b. Article 4 of ATA Directive.

This provision normalised the limits related to thin capitalisation differently than the one applied so far in Poland, i.e. according to Article 4 sec. 1 of the ATA Directive, *the excess of borrowing costs is deductible in the accounting period in which they were incurred only up to 30% of the taxpayer's earnings before interest, tax, depreciation and amortisation (EBITDA).* In respect of the basic method used in Poland at that time (Art. 16 sec. 1 points 60 and 61 of the CIT Act), two aspects should be noted. The first of them is the Directive's use of the concept of *borrowing costs*, which in the context of a loan, means only the value of the interest that the company has to pay over a given period of time, i.e. the value of the loan itself and whether it comes from affiliated or non-affiliated entities is irrelevant. Pursuant to Art. 16 sec. 1 points 60 and 61 of the CIT Act, the total amount owed to the entities listed in those provisions is relevant. Both the value of the interest and the value of the loan itself are therefore included, and their sum may not exceed the value of the company's equity. When analysing both solutions, the superiority of Article 4 sec. 1 of the ATA Directive should be clearly stated. It is due to the fact that regulations applied in Poland at the beginning of 2015 could be "circumvented" to a significant extent by a shareholder (stockholder) of the company, who, by granting a loan with a low nominal value, but with a relatively high interest rate, still had the possibility to avoid taxation to a significant extent. However, this is not allowed by the EU solution as only borrowing costs are taken into account, which are deductible up to 30% of EBITDA for the settlement period.

The second aspect which differs the EU solution from the Polish one is that the maximum value of deductible costs depends not on the company's equity but on 30% of EBITDA. This concept (*earnings before interest, taxes, depreciation and amortisation*) has been negatively defined in the provision itself, as *the financial*

[17] See M. Czerwiński, A. Wieśniak-Wiśniewska, *Świat podatków po projekcie BEPS i jego wpływ na polskich podatników* [The post-BEPS tax world and its impact on Polish taxpayers], PP 2016, No. 6, p. 22.

[18] It is worth noting that certain thin capitalisation solutions suggested in the report were introduced into Polish tax law prior to the implementation of the ATA Directive, with the Act of 29 August 2014 amending the Corporate Income Tax Act, the Personal Income Tax Act and other acts, which entered into force on 1 January 2015. An example is the maximum ratio of 1:1 between the value of a company's debt and its equity, already discussed in the paper.

result of the taxpayer before interest, taxation, depreciation and amortisation. EBITDA could be defined positively as operating profit plus depreciation of fixed assets. Using this indicator seems to be a more appropriate solution in relation to Polish legislation. This is because a company's equity is a value that can be largely shaped by its shareholders (stockholders) in such a way as to ensure maximum tax optimisation when using the thin capitalisation instrument. EBITDA appears to be a more lender-independent measure, meaning it provides higher security for EU states. It should be noted that Member States could adopt an alternative measure, referring to the taxpayer's earnings before interest and taxes (EBIT) as well as determined in an equivalent manner to an indicator based on EBITDA.[19]

The assumptions of the ATA Directive in relation to the alternative method of interest deduction applied in Poland should also be regarded as more favourable. The advantages of EU solutions include their low complexity, linked only to the need to monitor EBITDA, and the lack of dependence on government actions (as with the alternative method to the reference rate set by the MPC). Solutions under Art. 4 of the ATA Directive are also characterised by uniformity and clarity which certainly contribute to the certainty and transparency of the tax system.

Article 4 goes on to set out how EBITDA is calculated (section 2), the derogations and exemptions from section 1 that may apply (sections 3 and 4), the rights of a taxpayer when it is part of a consolidated group for accounting purposes (section 5), and other solutions that may be envisaged by Member States (sections 6 and 7). The process of applying the method from Article 4 of the ATA Directive, as well as other solutions that have been adopted on the grounds of the Polish tax law, will be described later in this paper, within the discussion of the implementation of the Directive.

c. Implementation of Article 4 of the ATA Directive - Article 15c of the CIT Act.

The provisions implementing Article 4 of the ATA Directive into the Polish legal system entered into force on 1 January 2018, by virtue of the amendment to the Corporate Income Tax Act. To analyse the amended Article 15c of the CIT Act, it is first necessary to define three new concepts that have been introduced to the legal system along with the described changes. The first of these is *debt financing costs*, which are understood to be all costs associated with obtaining funds from other parties, including non-affiliated entities and with the use of those funds, in particular interests, including interests capitalised or included in the initial value

[19] See Recital 6 of the preamble to the ATA Directive.

of a tangible or intangible asset, fees, commissions, bonuses, interest part of the lease instalment, penalties and charges for late payment of liabilities and costs of hedging liabilities, including the costs of derivative financial instruments, regardless of to whom they were incurred.[20] Therefore, this concept includes the value of interest and other similar charges (excluding the value of the loan itself) associated with debt, whether from affiliated or non-affiliated entities. The second concept is *interest income*, which is income from interest, including capitalised interest, and other income economically equivalent to interest corresponding to the cost of debt financing.[21] It is somewhat the opposite of the first described concept, as it includes income related to loans granted by the company. The last element to be defined is *debt financing cost surplus*, i.e. the amount by which the debt financing costs incurred by a taxpayer and deductible in a fiscal year exceed the taxable interest income earned by him in that fiscal year.[22] Such a surplus is thus the difference between debt financing costs and the entity's interest income.

These three concepts have been used to describe the mechanism for limiting the possibility of using thin capitalisation, which is included in Article 15c sec. 1 of the CIT Act. According to this provision, entities which are corporate taxpayers are obliged to exclude from tax-deductible costs the costs of debt financing in the part in which the excess of the costs of debt financing exceeds 30% of the amount corresponding to the excess of the sum of revenues from all sources of revenues less revenues of an interest nature over the sum of tax-deductible costs less the value of depreciation and amortisation deducted as tax-deductible costs in a fiscal year, as referred to in Art. 16a-16m of the CIT Act and debt financing costs not included in the initial value of the tangible or intangible asset. The amount mentioned in the above provision is equivalent to EBITDA indicated in the Directive. To apply Article 15c sec. 1, it is necessary to calculate the value of the debt financing surplus and check whether it exceeds 30% of EBITDA. Any value above this limit must be excluded from deductible expenses. However, the Act provides two exceptions to the rule described above, which are indicated in Article 15c sec. 14 of the CIT Act. According to the first, Article 15c sec. 1 does not apply if the excess of the costs of debt financing does not exceed PLN 3 million in a given fiscal year. However, the second exemption to this provision applies to the so-called financial undertakings, the catalogue of which is listed in Article 15c sec. 16.[23]

[20] See Art. 15c sec. 12 of the CIT Act.

[21] See Art. 15c sec. 13 of the CIT Act.

[22] See Art. 15c sec. 3 of the CIT Act.

[23] The catalogue includes entities such as domestic banks, SKOKs [Credit and Savings Unions] or numerous funds within the meaning of the Act of 28 August 1997 on the Organisation and Operation of Pension Funds.

Particular attention should be paid to the first of the exceptions. Thanks to its application, even if the excess of the entity's debt financing costs exceeds 30% of EBITDA, it can still be considered a tax-deductible cost if its value does not exceed PLN 3 million. Applying such a limit to small, sometimes also medium-sized and growing companies will many times allow their shareholders (stockholders) to completely shift the source of their income from dividends to interest on their loans. In relation to such entities, thin capitalisation regulations should be considered of secondary importance, as exceeding the barrier of PLN 3 million in excess of the costs of debt financing, in practice means that the company has to pay at least PLN 3 million in interest alone, without even taking into account the value of the loan. Setting the limit at this level demonstrates the legislator's objective, which is undoubtedly to limit thin capitalisation in relation to large, leading companies, often with a long-established position on the market. This approach should be considered as relevant as it allows significant tax optimisation for many family businesses, as well as for growing companies, allowing them to grow even faster. However, it should be noted that this regulation has led to two opposing views in the doctrine concerning the practical application of Article 15c sec. 14 point 1[24] According to the first one, upon exceeding the limit of PLN 3 million of debt financing surplus, a taxpayer may decide whether it is more beneficial for him to include PLN 3 million or the value of 30% EBITDA as tax-deductible costs. The opposite approach implies that the value of PLN 3 million is a kind of tax exempt amount, so that if the limit is exceeded, the taxpayer could deduct 30% of EBITDA, additionally increased by PLN 3 million. The first view, although less favourable to the taxpayer, is the more legitimate one. Its legitimacy derives both from an interpretation of the preamble to the ATA Directive and from a linguistic interpretation of Art.[25] 15c of the CIT Act.[26]

Article 15c also contains certain specific provisions, concerning the types of debt financing costs that are not taken into account when calculating surplus value[27],

[24] For more information, see M. Jarosławska-Gurgacz, *Ograniczenie kosztów finansowania dłużnego – analiza praktyki rynkowej oraz orzecznictwa po roku stosowania znowelizowanych przepisów o niedostatecznej kapitalizacji* [Limiting debt financing costs – an analysis of market practice and jurisprudence after one year of the application of the amended thin capitalisation provisions], PP 2019, No. 4, p. 38–44.

[25] See Recital 8 of the preamble to the ATA Directive.

[26] Otherwise – see K. Winiarski, *Formy przeciwdziałania unikaniu opodatkowania w polskim systemie prawnym w zakresie podatków dochodowych* [Forms of counteracting tax avoidance in the Polish income tax legal system]. *Wybrane problemy orzecznicze* [Selected jurisprudential problems] in: *Uszczelnienie systemu podatkowego w Polsce* [Tightening of the tax system in Poland], ed. D.J. Gajewski, Warsaw 2020.

[27] See Article 15c sec. 8 of the CIT Act.

long-term public infrastructure projects[28], capital groups[29], foreign establishments located in Poland[30], and the possibility of crediting debt financing costs excluded in a given fiscal year in the following 5 years.[31]

5. Conclusions

To draw conclusions with regard to the impact of EU solutions that have been introduced into the Polish legal system in the area of thin capitalisation through the necessity to implement the ATA Directive, it is necessary to summarise the hitherto considerations. According to the arguments presented in the paper, the impact of EU legislation should be considered favourable. Art. 15c of the CIT Act in the current wording appears to be a clear and unified provision, introducing the method that is much easier to apply and less susceptible to manipulation by the taxpayer or state authorities than those which were in force in Polish law before 2018. EBITDA appears to be a much more reliable measure for the safety of the tax system than shareholders' equity or the reference rate set by the MPC. The advantages over the previous solutions include the fact that there is a single method, instead of a division into basic and alternative options, as well as the introduction of a limit allowing the deduction of the excess of debt financing costs up to PLN 3 million regardless of EBITDA result, which makes it possible to obtain significant tax optimisation of small and medium-sized companies in the development stage. The aforementioned controversy with regard to the practical application of this limit should be regarded as a relatively insignificant problem, especially as it was resolved with the entry into force of the Act of 23 July 2021 on amending the Power Market Act and other acts, which clarified the content of Article 15c of the CIT Act unequivocally, favouring the solution adopted in this paper. However, the doctrine also critically assesses some other solutions of the Polish legislator. This includes provisions for independent entities that benefit from financing from non-affiliated entities, as well as groups of affiliated entities whose activities are not aimed at eroding the tax base. Solutions in this area are said to be too inflexible.[32] In spite of this, changes introduced in the area of thin capitalisation not only in Poland, but also in the entire European Union, under the provisions of the ATA Directive,

[28] See Article 15c sec. 9 and 10 of the CIT Act.

[29] See Article 15c sec. 2 and 11 of the CIT Act.

[30] See Article 15c sec. 20 of the CIT Act.

[31] See Article 15c sec. 18 and 19 of the CIT Act.

[32] See M. Jamroży, A. Łożykowski, *Ograniczenia kosztów finansowania dłużnego od 1.01.2018 r.* [Limitations of debt financing costs from 1 January 2018] PP 2018, No. 6, p. 36–41.

and previously the actions of the OECD under the BEPS action plan, should be regarded as appropriate. Over the next few years, their implementation should have the planned effect of eliminating at least some activities aimed at aggressive tax optimisation, without significantly affecting the interests of taxpayers.

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