

## Withholding tax – Ministry of Finance consults the draft of official guidelines

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On 28 September 2023, the **draft of the official clarifications on withholding tax [Draft]** was **published**. The Draft refers to the beneficial owner criteria, which includes, inter alia, the condition of a genuine economic activity to be conducted by the recipient of the payment. Public consultations are expected to last until 24 October 2023.

The Draft indicates a broad approach to the definition of beneficial owner and lists a number of prerequisites to be met by the recipient of payment. These include:

- ✓ owning a property,
- ✓ proper management, including decision-making in its country of tax residency,
- ✓ a real office of an operational size,
- ✓ staff with qualifications and competences appropriate to the business,
- ✓ bearing the costs of its own activities, including staff costs.

However, there is a lack of precision or at least guidance as to how the above criteria should be understood. In addition, the Ministry of Finance states that even if the above prerequisites are met, the tax authorities may still apply the criterion of artificial transaction, which will be the basis for refusing to apply either exemption from withholding tax or its lower treaty rate.

The Draft also identifies circumstances that in practice lead to withholding tax discrimination of certain categories of entities or even entire industries. According to the Draft, a tax remitter will not be able to apply a reduced withholding tax rate or exemption if, among others:

- ✓ the recipient of payment earns a small margin,
- ✓ the recipient of payment receives income mainly of a passive nature, including financial payments from related parties,
- ✓ there is a short time lapse between the receipt of funds and their subsequent payment,
- ✓ received payments are transferred to a subsequent recipient which would not be able to benefit from a preference or exemption from withholding tax,
- ✓ the recipient of payment does not reinvest the funds received,
- ✓ there is no effective taxation of the receivable in the country of recipient's tax residency,
- ✓ the recipient of payment shows significant related party transactions in its financial statements,
- ✓ the recipient of payment is based in a country with an extensive network of double taxation treaties.

The Draft also rejects in principle the *look-through* approach, i.e. the possibility of applying withholding tax preferences of the beneficial owner of the payment to the intermediary entity receiving the payment from Poland.

A positive feature of the Draft is the withdraw from imposing the criterion of effective taxation of dividends paid abroad, although even that is not entirely clear. The Ministry of Finance acknowledges that the exemption of distributed profits from income tax in the country of tax residency of the dividend recipient, is not a reason to deny the right to exemption from withholding tax. However, the recipient of dividend must not be entirely exempt from CIT.

In its current version, the Draft lacks specifics. Moreover, despite previous meetings with business representatives and advisors, the Ministry of Finance does not take into account the nature of business in specific industries or within international groups. Considering the above, MDDP is participating in the public consultations of the Draft.

**We encourage to provide MDDP with your comments and experiences with regard to the application of exemptions or withholding tax settlement if you would like us to include them in anonymized form in the consultation document we are preparing.**

We also remain at your disposal if you are wondering:

- how to comply with tax remitter due diligence obligations and identify the beneficial owner,
- what strategy to adopt and what to do in order to, on one hand, achieve the desired security and, on the other hand, remain rational in terms of cost and time,
- whether to apply for the formal ruling/opinion on the application of withholding tax preferences,
- whether to follow the pay & refund mechanism in the context of liquidity risks and sanctions of management board members.

**If you wish to provide us with comments for consultation, as well you are interested in the above information and its impact on your business, please contact:**

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or your advisor from MDDP.

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