Excerpt

Controlled Foreign Companies (CFC) and Tax Avoidance: International and Comparative Perspectives with Specific Reference to Polish Tax and Constitutional Law, EU Law and Tax Treaties

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Chapter 1. Introduction

1.1 Problem: Tax avoidance via controlled foreign companies

Although a modern taxpayer has access to a variety of international tax planning methods,[1] one of the most frequently used by taxpayers in high tax jurisdictions is to establish a company or other entity in a jurisdiction with little or no taxation to which they transfer sources of income before taxation.[2] Such companies are actually controlled by taxpayers in high tax jurisdictions (i.e. individuals or entities other than individuals) and are therefore often referred to as *controlled foreign companies* (CFCs), from the perspective of the residence State of the controlling taxpayers. A CFC is regarded as a taxable company in the State of Residence of its participants (CFC's participants).[3] According to the principle of personality – which applies under the domestic tax laws of most states around the world, including the State of Residence of the CFC's participants – an income derived by a CFC (a taxpayer) cannot be taxed at the level of its participants (another taxpayer).[4]

Pursuant, then, to the principle of personality, a separate taxpayer is taxed on his own income, not on income derived by another taxpayer or together with

[1] See more widely Russo (2009); Langston (2011).

[2] See OECD (2013), p. 40 and OECD (2015), p. 9.

[3] The reason the phrase "CFC's participants" is used is that, as will be further explained (see 1.6.1), persons that can control a CFC and are entitled to receive profits from the CFC are not only the shareholders, but also beneficiaries of trusts/foundations, partners of partnerships, and others. This is because a CFC can take the form of an entity other than a company, such as a trust, foundation, association, and even a partnership, branch of a company. All persons mentioned in this thesis are named "CFC's participants," since all of them, regardless of category, participate in the CFC's profits and control of the CFC.

[4] See Sandler (1998), p. 3. Cf. Monsenego (2011), pp. 71–72; Vanistendael (2003), p. 192. Indeed, the principle of personality in conjunction with the arm's length principle constitute an internationally recognized standard of taxation of multinational enterprises (MNEs). See OECD (2010), paragraphs 5–6. See Article 5(7), Article 7(1) and Article 10(5) OECD MTC and Article 5(8), Article 7(1) and Article 10(5) UN MC 2011. Cf. Herzig, Teschke and Joisten (2010), p. 335. For the history of this principle in international tax law see Picciotto (1992), pp. 27–35.

another taxpayer.[5] As a point of departure, the CFC's income cannot therefore be taxed in its participants' residence State (CFC participants' state) under its domestic tax law at their level until it is either (i) distributed by the CFC to them; or (ii) shares in the CFC are sold by them. Bearing in mind that the CFC is controlled by its participants, they may decide not to distribute the CFC's income to themselves or sell its shares, in which case the taxation of the CFC's income can be deferred for substantial periods of time in countries following worldwide taxation systems. If such deferrals last long enough, the value of the taxes due may eventually sink virtually to nil.[6] This type of tax planning by deferral is of primary concern to countries with a pure worldwide taxation system (e.g. the US).[7] The countries which, in turn, exempt dividends or capital gains derived by their taxpayers from foreign entities[8] face with more far reaching consequences of using CFCs than tax deferral, i.e. the CFC's income will not be taxed at the level of its participants at all. If there is no taxation in the CFC's State or taxation is very low, then taxation of the CFC's income overall can be reduced to zero or kept at a very low level.

In sum, CFCs can be used by their participants to avoid tax by means of indefinite tax deferrals, effective reduction of tax rates, or avoidance of income taxation altogether. The global scale of this phenomenon seems to be enormous,[9] not least as international business is increasingly integrated, combining technology, production, marketing, and a diversity of related tangible and intangible services across states.[10] All this allows MNEs to run their international businesses with relative freedom, limited mainly by their financial capacity and managerial ingenuity. Indeed, in combination, the principle of personality and abilities of MNEs provide for a sideline in tax avoidance via CFCs.[11] "CFC tax

[5] Apart from the domestic laws of various countries' legislation on group taxation regimes, i.e. consolidation rules or tax equalization systems that apply to companies that are legally and/or economically closely related to each other. Such regimes, however, apply usually only to domestic companies, see Wiman (1999), pp. 363 et seq.

[6] As Avi-Yonah explains, tax deferral is equivalent to exemption of the interest on the amount of tax that is deferred. Thus, if tax deferral lasts long enough, the interest eventually dwarfs the principal amount entirely. It is the interest effect of tax deferral. See Avi-Yonah (2007), pp. 124–125.

[7] See *infra* 2.3.1.2.

[8] This exemption usually applies in countries with territorial system (e.g. France, Hong Kong and Singapore), or countries with worldwide taxation systems (e.g. most EU Member States), which exempt foreign dividends and capital gains from taxation while applying the method of avoidance of double taxation or the participation exemption domestically, see *infra* 2.3.1.2.

[9] See *infra* 3.2.1.

[10] See OECD (1996), p. 9; OECD (2013a), p. 25.

[11] This may be an additional reason to the problems connected with transfer pricing that certain prominent scholars advocate switching from separate taxation of separate companies (the principle of personality regarding taxation of companies) to unitary taxation of companies that are functionally

avoidance,"[12] as it is called, increases the competiveness of the involved taxpayers, but has several negative consequences for other concerned parties.

First, avoiding tax via CFCs is a feasible option only for companies capable of generating large profits and wealthy individuals, since establishing and exploiting CFCs are efficient only if the income diverted to CFCs is substantial. It consequently benefits taxpayers with the resources to avoid taxes in this way, while disadvantaging those without such resources. With respect to individuals mainly, this is contrary to the principle of horizontal equity, i.e., the principle of the taxpayer's ability to pay taxes.[13] CFC tax avoidance is also likely widen the gap between the poorest and the richest, and may adversely affect sustainable development.[14]

Second, it erodes the tax base of the CFC participants' resident States, and, in turn, undermines the integrity of the tax system insofar as the media and ordinary taxpayers perceive the low taxation levels enjoyed by MNEs and very wealthy individuals as unfair.[15]

Third, it can harm fair competition inasmuch as domestic enterprises, such as family-owned businesses, new and innovative companies and enterprises operating internationally without the ambition, moral laxity or possibility to avoid taxation via CFCs may find it harder to compete with taxpayers who shift profits across borders to avoid or minimize tax.[16]

Considering the negative consequences of tax avoidance via CFCs, governments have worked hard to create efficient tax systems able to regulate tax issues related to cross-border activity. They have enacted provisions specifically designed to prevent tax avoidance via CFCs. These regulations are internationally known as CFC rules. The US was the first country to introduce CFC rules; they were added to Subpart F of the Internal Revenue Code in 1962, and are known as "Subpart F" rules in the US. CFC rules are currently in force in 34 countries.[17]

Normally, the application of CFC rules leads to taxation of tax residents with respect to income of a foreign company controlled by them proportionally to their share in the company's profits regardless of whether they have received this income or have it at their disposal.

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and economically connected (i.e. MNEs). See Bellingwout (2015), p. 10; Piccioto (2014), p. 15; Avi-Yonah (2015), pp. 90–109; De Graaf, De Haan, and De Wilde (2014), pp. 315–316; Kobetsky (2008), p. 215; Sadiq (2001), pp. 285–286. See, however, Herzig, Teschke and Joisten (2010), pp. 343 and 349.

[12] For the definition of "CFC tax avoidance" see *infra* 1.6.3.

[13] See Birk (2000), p. 104. Cited after: Selera (2010), No. 118234. Cf. *infra* 14.4.2.

[14] See Kuźniacki (2012), pp. 141–142.

[15] Cf. OECD (2013), p. 8.

[16] Cf. OECD (2013), p. 8.

[17] See *infra* 2.3.2.2.

Generally speaking, the application of CFC rules may raise issues concerning their effectiveness in preventing the tax avoidance and possible distortion of genuine cross-border economic activities (i.e. genuine activities undertaken for legitimate economic purposes beyond obtaining tax savings).[18] Other worries concern compatibility of CFC rules with constitutional provisions,[19] EU/EEA law,[20] and tax treaties.[21]

1.2 Purpose of the thesis and research question

Prior to 1 January 2015, Poland had no CFC rules or other provisions with similar content and purpose in place.[22] Little has therefore been written on problems arising from their application. The purpose of this thesis is thus first to analyze Poland's enacted (2015) and amended (2018 and 2019) CFC rules and to establish whether they (i) are effective in preventing tax avoidance by Polish taxpayers via CFCs; (ii) do not distort genuine cross-border economic activity;[23] and (iii) are compatible with superior law, i.e. the Polish Constitution, EU law, and tax treaties. The thesis therefore poses the following research questions. Are the Polish CFC rules effective in preventing tax avoidance by Polish taxpayers via CFCs? Do they distort genuine cross-border economic activity? Are they compatible with superior law?

If the analyses uncover issues relating to these three questions, efforts will be made to devise and propose appropriate counter-measures. This will give rise to additional research questions. In what way should the Polish CFC rules be re-designed/amended to reach a satisfactory level of effectiveness in preventing tax avoidance by Polish taxpayers via CFCs? And what steps should be taken to avoid any distortion in their application of genuine cross-border economic activity? Finally, what can be done to ensure a high degree of compatibility between the CFC rules and superior law?

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[18] See *infra* Part II.

[19] See *infra* Part III.

[20] See *infra* Part IV.

[21] See *infra* Part V.

[22] The CFC rules are in force in Poland from 1 January 2015. See Article 1 of the Act of 21 October 2014, item 1478.

[23] I.e. activities undertaken for legitimate economic purposes beyond obtaining tax savings.

1.3 Relevance of the thesis

No comprehensive study has been carried out on the CFC rules in force in Poland, either in general (apart from this author monography published by this author in 2017)[24] or with respect to the issues covered by this thesis. Other, more general reasons, advocate the relevance of the thesis in a global perspective.

For comparative tax law purposes and given its transition starting in the early 1990s from a centrally planned economy to a market-based economy, Poland can be said to belong to the transition and post-conflict group of nations.[25] Income tax legislation reflecting a free market economy has therefore been developed relatively recently in Poland, although advances have been also made in response to EU standards since the early 2000s following Poland's accession to the EU.

In addition to Poland, prior the implementation of ATAD, CFC rules are in force in just five of the 29 countries in the transition and post-conflict group of nations, i.e., Lithuania, Estonia, Hungary, China,[26] and Russia.[27] Since I have been unable to locate comprehensive studies on CFC rules in these countries, the current study may also shed light on the development of CFC rules there as well.

The comparative approach of the thesis[28] might also prove useful as a source of knowledge in the field of anti-tax avoidance rules not only in terms of Polish practice and theory of tax law regarding CFC rules, which are currently *in statu nascendi*, but also of other countries, insofar Polish CFC rules are largely similar in structure and substance to those of other countries on which they were based. This applies in particular to EU/EEA Member States and countries with large networks of tax treaties, because Poland is an EU Member State and is party to a large network of tax treaties.

The questions to be discussed in this thesis are therefore of global relevance. Their importance and timeliness are further justified by the international initiative of the OECD to address base erosion and profit shifting (BEPS), insofar as OECD BEPS Action 3 aims primarily at strengthening CFC rules.[29] There is also the EU's initiative under the ATAD which includes minimum standard

[24] See Kuźniacki (2017).

[25] See Thuronyi (2003), pp. 33–37 and 43. Indeed, Victor Thuronyi divides the group into three sub-groups: (i) former Soviet Union; (ii) other; and (iii) post-conflict. Poland belongs to sub-group (ii).

[26] For these four countries see Deloitte (2015), pp. 42, 17, 28, and 12.

[27] See Kogut (2015), p. 73.

[28] See *infra* 1.5.3.

[29] See OECD (2015a), paragraph 1.

for CFC rules.[30] And most recently, the OECD released its public consultation document concerning the GloBE proposal (Pillar Two), which assumes an income allocation (income inclusion) mechanism in line with the CFC rules in order to develop a co-ordinated set of rules to address ongoing risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or very low taxation.[31]

1.4 Previous research

The subject of CFC rules attracted scholarly interest for decades; indeed, there is so much material, providing references to it all is impossible. I shall therefore refer to particular works in this thesis whenever relevant. In this section, I only discuss previous research with a significant bearing on the issues analyzed in the thesis and is of a standard and comprehensiveness commensurate to a PhD thesis. The discussion proceeds in chronological order.

It is useful to begin with Brian Arnold's 1986 monograph on *The Taxation of Controlled Foreign Companies: An International Comparison*. As far as I know it has the most comprehensive comparative analysis of CFC rules, applicable in this case in six countries: the US, Germany, Canada, France, Japan, and the UK. The study is relevant for the current thesis in that it provides an excellent in-depth analysis of CFC rules in countries in which such rules were introduced many years before the Polish ones and therefore constitutes a good point of reference for analyzing the origin of CFC rules.

Two other relevant studies were issued by the OECD, namely, *Double Taxation Conventions and the Use of Base Companies* and *Controlled Foreign Company Legislation* published in 1986 and 1996 respectively. The former focuses on the compatibility of CFC rules with OECD-based tax treaties and will be of particular use in Part V on the compatibility of the Polish CFC rules with tax treaties ratified by Poland. The latter offers descriptive information on CFC rules in force in 14 OECD Member States and is thus mainly relevant to the international and comparative analysis of the Polish CFC rules.

Another important and comprehensive study related to CFC rules is Daniel Sandler's 1994 (rev. 1998) monograph on *Tax Treaties and Controlled Foreign Company Legislation: Pushing the Boundaries* in which he grapples in detail

[30] See Articles 7 and 8 of the ATAD. See originally the text of this Directive in the Proposal for Anti-Tax Avoidance Directive of 28 January 2016 (COM(2016) 26 final).

[31] See OECD (2019), paragraph 63 and OECD (2020), paragraph 8.

with the problem of compatibility of the CFC rules of several countries with tax treaties (1994 version) and EU law (1998 version).

Also worth mentioning is a Swedish PhD thesis published in 2000 by Mattias Dahlberg on *Svensk skatteavtalspolitik och utländska basbolag: en studie av svensk skatteavtalspolitik i förhållande till utländska basbolag mot bakgrund av svensk intern internationell skatterätt* (Swedish Tax Policy and Foreign Based Companies: A Study of Swedish Tax Policy in Relation to Foreign Based Companies in Light of Swedish Domestic International Tax Law). This study focuses in part on the Swedish CFC rules and tax treaties with a view to systematizing, analyzing, and evaluating some of the anti-avoidance provisions in the Swedish tax treaty network applicable to foreign based companies, and, to some extent, Swedish domestic anti-avoidance provisions (e.g. the Swedish CFC rules).

There is an interesting collection of comparative material of largely CFC rules in two studies from IFA "Cahiers" 2001 and 2013: (i) *Limits on the Use of Low-Tax Regimes by Multinational Businesses: Current Measures and Emerging Trends* (2001); and more recently *The Taxation of Foreign Passive Income for Groups of Companies* (2013). These studies are a compilation of several national reports preceded by a general report and are useful for comparative purposes.

Another valuable study on CFC rules is the 2004 volume edited by Michael Lang, Hans-Jörgen Aigner, Ulrich Scheuerle and Markus Stefaner: *CFC Legislation, Domestic Provisions, Tax Treaties and EC Law*. Analogous to the studies of IFA, this book is also a compilation of national reports preceded by a general report. It is useful for the analysis of various problems addressed in this thesis as it includes an analysis of CFC rules in several countries and their compatibility with EU law and tax treaties.

There is another PhD thesis worth mentioning, Alexander Rust's 2007 *Die Hinzurechnungsbesteuerung: Notwendigkeit und Umsetzbarkeit einer Reform* (CFC rules: The Necessity and Feasibility of Reform), which deals with Germany's CFC rules. In my thesis, I will make use of articles written by Rust in English, as they largely replicate the position he takes in his thesis.

The PhD thesis of Peter Koerver Schmidt on *Dansk CFC-beskatning – I et internationalt og komparativt perspektiv* (Danish CFC-Taxation – from International and Comparative Perspective) was published recently in Danish (2013).

I have also had access to Fiona Felicitas Gebhardt's 2014 PhD thesis (not published) on *The CFC Rules in the CCCTB Proposal Directive: Analysis and Prospect of a Common CFC Regime in Light of the Fundamental Freedoms Provided by the TFEU, the EEA Agreement and the FMPA*. It was defended in October 2014 and deals with the CFC rules included in the CCCTB Proposal Directive.

The most recently published study of global coverage is the 5 October 2015 *Designing Effective Controlled Foreign Company Rules: Action 3 Final Report* which includes OECD recommendations to improve the effectiveness of CFC rules in dealing with base erosion and profit shifting.

In respect of the Polish CFC rules, at the time of finalizing this study (December 2019), the only monograph (written and published in Polish) is that of this author entitled *Opodatkowanie zagranicznych spółek kontrolowanych (CFC): Konieczność reformy* (Taxation of Controlled Foreign Companies (CFC): The Necessity for the Reform).

All these studies – as well as others published in the form of articles not mentioned here – address questions dealt with in this thesis. None of them, however, have the scope and purpose of the current thesis. That is to say, no comparative analysis, either in the form of an article, PhD thesis or monograph, has been done so far on the Polish CFC rules, their effectiveness in preventing CFC tax avoidance, their distortion (or not) of genuine cross-border economic activity, and their compatibility with the Constitution, EU law, and tax treaties. Neither has the topic of the thesis been the subject of a comprehensive study, i.e., monograph, in English.[32]

1.5 Methodology

1.5.1 Introduction

This section explains features of the methodology of relevance to the current study. Sections 1.5.2–1.5.4 discuss in turn legal analysis in conjunction with *de lege lata* and *de lege ferenda* approaches undertaken under such analysis; the comparative research method; and reasons for comparing the Polish CFC rules with Norwegian and UK CFC rules, and with elements of CFC rules recommended by OECD under BEPS Action 3.

Sections 1.5.5–1.5.7 discuss issues of particular interest to the thesis such as the of hierarchy of sources of law in Poland, the peculiarities of canons of interpretation of Polish tax law, and finally the function and interpretative weight of foreign case law. Other methodological issues are not discussed in this section as they will be evident from the text itself. Whenever further methodological explanations are necessary, they will be provided on a case-to-case basis.

[32] My monograph – Kuźniacki (2017) – deals only with the effectiveness of the Polish CFC rules (2015) in preventing CFC tax avoidance and their distortion (or not) of genuine cross-border economic activity. The questions of their compatibility with the superior law are left aside and addressed in this study exclusively.

1.5.2 A legal analysis: *De lege lata* and *de lege ferenda* approaches

The legal character of the study means that the thesis will mainly rely on a traditional dogmatic approach that undertakes a legal analysis of issues covered by the research questions.[33] The approaches taken in this study can be described as *de lege lata* and *de lege ferenda*.

A *de lege lata* approach is first used to analyze the Polish CFC rules in order to determine their content and then to analyze them as applied in real and hypothetical situations. The latter aims to evaluate the effectiveness and precision of the Polish CFC rules in prevention of tax avoidance via CFCs. In this case, from the perspective of the Polish legal system and Polish tax law, CFC rules are binding legal acts. Foreign tax law is treated as a reference point in connection with real or hypothetical situations. Furthermore, the *de lege lata* approach applies to my analyses of the Polish CFC rules, Constitution, EU law, and tax treaties where I evaluate the compatibility of the CFC rules with superior law, i.e. binding legal acts from the perspective of the legal system in Poland.

Turning to the *de lege ferenda* approach, it first applies to an analysis of the Polish CFC rules in real and hypothetical situations in order to identify ways of amending the Polish CFC rules to increase (if necessary) their effectiveness and precision in prevention of tax avoidance. In this case, Polish tax law, primarily CFC rules but also foreign tax law, is treated as points of references when referring to real or hypothetical situations. Second, this approach applies to an analysis of the Polish CFC rules for the purpose of devising proposals to amend these rules that secure (if necessary) their compatibility with the Constitution, EU law, and tax treaties. As in the case of *de lege lata,* superior law constitutes binding legal acts. Rather than providing a different wording of the Polish CFC rules under the *de lege ferenda* approach, the critical comments and proposals are meant to serve as a resource for the legislature when considering amendments to the law.

The *de lege ferenda* approach also covers policy considerations regarding the need to balance the dual needs to ensure taxpayer equality and to enable the normal workings of business taxation.[34] This requires a nuanced analysis of the pros and cons of more or less robust CFC rules in light of their effectiveness, administrative burden, and compliance costs. The analysis of the Polish CFC

[33] For a recent PhD thesis on CFC rules using this method, see Koerver Schmidt (2013a), p. 36. See also less recently Dahlberg (2000), p. 56.

[34] It regards the equality between taxpayers with the resources to avoid taxes via CFCs and those without such resources as well as restoring the normal application of business taxation which was distorted by taxpayers who avoid taxation via CFCs.

rules in this way under *de lege ferenda* approach should therefore allow us to recommend the best possible balance of measures.

Lastly, it should be said that even though the thesis mainly relies on legal analyses, reference is also made in parts of the thesis, notably sections 3.2–3.4, to economic data, which may be useful in relation to *de lege lata* and *de lege ferenda* approaches to the question of the effectiveness of CFC rules. While the present study will not apply economic theory nor conduct any empirical studies of CFC tax avoidance, reference will be made to data gathered and published by international organizations (OECD and IMF), the Polish Ministry of Economy, tax authorities and legal writings.

1.5.3 Comparative research method

The international and comparative character of the present study implies that the thesis will mainly use the comparative legal method.[35] In this respect, the thesis adopts and uses a methodology associated with existing general comparative law.[36] It is a pertinent approach with regard to the research questions and achieves the purpose of the thesis. Comparative analysis is particularly useful for exploring the legal solutions of other countries. As noted by Zweigert and Kötz (italics added),

> comparative law has been proving extremely useful in the countries of Central and Eastern Europe [as Poland] where legislatures face the need to reconstruct their legal systems after the collapse of the Soviet system [Poland had not been part of the Soviet Union, but was under its influence]. The experience of other European countries helps them choose the solution which best suits their own legal traditions, overshadowed for much of the country though they have been.[37]

This comparative legal methodology will primarily be in conjunctions with the *de lege ferenda* approach where it will help in the identification of similarities and differences in relation to the Polish CFC rules and those of the selected comparisons (Norway and the UK). The same applies to foreign case law and administrative practice. The aim is to develop appropriate solutions for the Polish tax law system under current social and economic circumstances.[38] It can also

[35] See Zweigert and Kötz (1998) for more on this issue. See more on comparative research method in tax law in Thuronyi (2003); Ault and Arnold (2004); Mössner (2008), pp. 19–26; Garbarino (2009); Marian (2010), pp. 415–470.

[36] See Zweigert and Kötz (1998).

[37] Id., p. 17.

[38] Cf. Thuronyi (2003), pp. 152–153; Mössner (2008), pp. 13–15; Rosenblatt (2015), p. 6.

assist, albeit to a smaller extent, in clarifying the Polish CFC rules, where it is therefore used in conjunction with a *de lege lata* approach.[39]

It should be also underlined that the relevant EU law is as binding in Poland as it is in Norway (via the EEA Agreement)[40] and the UK and constitutes superior law to CFC rules in these states.[41] Consequently, a relationship of the Norwegian and UK CFC rules with EU law may have a direct influence on *de lege lata* and *de lege ferenda* approaches regarding the compatibility of the Polish CFC rules with EU law. The same conclusion, albeit to a smaller extent, obtains with respect to relations between the Norwegian and UK CFC rules and tax treaties of these states, on the one hand, and between the Polish CFC rules and Polish tax treaties, on the other.[42]

1.5.4 Reasons for comparing the Polish CFC rules with the Norwegian and the UK CFC rules, elements of CFC rules recommended by OECD under BEPS Action 3 and the EU's CFC rules

Although it is suggested in the literature that "the comparatist has to apply and interpret [foreign] sources in the same way as the lawyers in his chosen system do in order to give them same content and meaning which they are understood to have in that system",[43] I do not aspire to interpret the Norwegian and UK CFC rules[44] as if I were a Norwegian or UK lawyer. Whenever appropriate, however, I consult the work of Norwegian and UK practitioners and academics to establish how certain terms are understood in their respective countries' tax law. The same applies to other foreign law and comparative materials, such as case law and administrative practices.

I provide in this section substantial reasons for choosing Norwegian and the UK CFC rules to compare with the Polish rules and will also explain the reason for analyzing the building blocks of CFC rules as recommended by OECD under BEPS Action and the EU's CFC rules.[45]

[39] Cf. Wiman (2005), p. 510.

[40] See *infra* 1.5.4.

[41] Id.

[42] Id.

[43] See Vogenauer (2006), p. 872.

[44] The comparison was done in relation to the Norwegian and the UK CFC rules valid as of 2016. To my knowledge, they remained largely unchanged up until now (December 2019).

[45] For the purpose of this thesis, "the EU's CFC rules" are understood as a minimum standard for CFC rules set forth in Articles 7 and 8 of the ATAD. The Commission originally proposed as

The argument in favor of the chosen comparative material is that Poland has currently a very little experience in the application of this type of legislation, while Norway and the UK do have more experience in that regard. OECD, in turn, uses experts from all OECD Member States that have had CFC rules in force for many years. Finally, the relevance of the comparative analysis of the EU's CFC rules is self-evident given Poland's membership of the EU.

A comparison of the CFC rules of Norway, the UK, and Poland is also of high relevance since all three are EU (the UK and Poland) or EEA (Norway) Member States, and therefore their domestic tax law must be compatible with the fundamental freedoms. While this is self-evident in the case of Poland and the UK given their EU membership, comparability in the case of Norway stems from the country's EEA membership whereby the majority of EU legislation is enacted and implemented by Norway just as it is in EU Member States.[46] Most importantly, this regards the fundamental freedoms, CJEU case law on CFC rules, and their compatibility with the fundamental freedoms. The main difference in this regard relates to the scope of the free movement of capital, since this freedom is applicable in an unrestricted way to EU Member States, while it applies only between EEA Member States in the case of Norway. Moreover, Norway does not apply EU Directives on direct taxation and administrative assistance.

The selected countries also have extensive tax treaty networks[47] and at least some experience in handling the relationship between their CFC rules and tax treaties. A tax treaty is higher in the hierarchy of sources of law in Poland than Polish statutory law.[48] In Norway, in turn, tax treaty provisions are regarded as *lex specialis* for domestic law purposes, and, in principle, are on the same level as Norwegian statutory law. This means that a tax treaty takes precedence over older statutes, but may be overridden by newer. In other words, treaty overriding is possible.[49] However, treaty override has never taken place so far in Norway; nor is it likely to change in future given the practice of the Norwegian Parliament (*Stortinget*). Furthermore, when interpreting new statutes, it is assumed that efforts will be made to avoid deviation from tax treaties.[50] Much the same can be

a minimum standard for CFC rules that legislators of Member States take note of Article 8 of the ATAD's proposal of 28 January 2016.

[46] See Müller-Graff (1997), p. 19; Bullen (2007), pp. 261–263.

[47] Poland and Norway have signed more than 80 tax treaties, and the UK around 120 treaties. See the full list of tax treaties signed by Norway at https://www.regjeringen.no/en/topics/the-economy/taxes-and-duties/tax-treaties-between-norway-and-other-st/id417330/ and the UK at: http://www.hmrc.gov.uk/taxtreaties/in-force/index.htm.

[48] See *infra* 1.5.5.3.

[49] See Zimmer (2001), p. 63.

[50] See Zimmer (2001), p. 63; Glad (2004), p. 508.

said about the relations between UK domestic law and tax treaties,[51] apart from the fact that the cases of treaty override have been noticed in the UK.[52]

It will therefore be interesting to see whether these countries take similar or different approaches to issues regarding the application of CFC rules within the ambit of EU/EEA law and tax treaties. This is where the question of compatibility of CFC rules with EU/EEA law and tax treaties arises.

At the same time, the three countries have different legal systems based on different social, economic, and historical factors. Norway and Poland are civil law countries, albeit they belong to different subgroups: Norway belongs to the Nordic legal family, Poland to the Germanic legal family. The UK, in turn, is common law country that belongs to the Anglo-American legal family.[53] Moreover, in the literature, Norway, the UK, and Poland have been classified for comparative tax law purposes as belonging to the Nordic, Commonwealth, and Transition and Post-Conflict groups of legal families respectively.[54] In this regard, the question is whether the differences between these legal systems influence in any way the wording, structure, and place of CFC rules in their tax law systems. Besides this, comparing CFC rules of three countries that belong to three different legal systems facilitates an international perspective. This will be evident when we compare the Polish CFC rules with the OECD recommendations, not least inasmuch as these recommendations articulate many of the solutions embodied in the CFC rules of dozens of countries and at least try to accommodate the efficiency-promoting elements of those rules.[55]

1.5.5 The hierarchy of sources of Polish law

1.5.5.1 Constitution

According to Article 8(1) Constitution and its interpretation by CT,[56] being a guardian of the constitutionality of statutes and international agreements,[57] the

[51] See Avery Jones (2001), p. 360; Sandler (1998), pp. 51–52.

[52] See Avi-Yonah (2006), p. 65 et seq.; McIntyre (1989), pp. 611–614.

[53] This division was based on the qualification of legal families made by comparative law scholars. See Zweigert and Kötz (1998), pp. 63 et seq. However, one should not forget that some countries can be classified as members of different legal families for private law purposes, but belong to the same family for tax law purposes due to the similarities of their tax systems. See Zweigert and Kötz (1998), pp. 65.

[54] See Thuronyi (2003), pp. 33–37 and 43.

[55] See OECD (2015a), paragraph 2.

[56] See CT's judgements of: 27 April 2005; 11 May 2005; and of 24 November 2010.

[57] See Article 188(1) Constitution.

Polish Constitution is the "supreme law of Poland" in relation to all other laws,[58] including EU law.[59] CT has also said that the Constitution remains the supreme law of Poland in respect of all binding international agreements ratified by Poland (EU law and tax treaties).[60]

1.5.5.2 EU law

Article 9 Constitution says that Poland shall respect international law binding upon it, although, as indicated by Article 90(1), Poland may, by virtue of international agreements, delegate to an international organization or international institution the competence of organs of state authority in relation to certain matters.[61] Article 91(3), in turn, stipulates that laws issued by an international organization established under an international agreement ratified by Poland shall be applied directly and have precedence in the event of a conflict of laws. Clearly, EU law, both primary and secondary, therefore takes precedence over Polish domestic statutory law.

Although Article 288 TFEU does not establish the CJEU's judgments as legal acts of the EU, an interpretation of EU law expressed in CJEU case law is binding on the courts of the Member States having asked the CJEU to resolve questions referred to it for a preliminary ruling under Article 267 TFEU. This is confirmed by the doctrines of *acte éclairé* and *acte clair* established by the CJEU's case law.[62] More generally, CJEU case law develops general principles of EU law that constitute supplementary sources of binding, unwritten EU law.[63] As a result, Member States must draft laws in line with the CJEU's case law if they want to ensure compatibility of domestic with EU law.

1.5.5.3 Tax treaties

According to Article 91(1) Constitution, tax treaties after their promulgation in the Journal of Laws (*Dziennik Ustaw*) become part of the domestic legal

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[58] See different viewpoints of Polish scholars on the application of statutory law conflicting with the Constitution by administrative authorities and courts: Jaśkowska (2001), pp. 278–79; Wronkowska (2001), pp. 17–23; Mączyński (2000), pp. 10–14; Wasilewski (1998), p. 18.

[59] A similar view has been expressed by the Supreme and Constitutional Courts of Germany, Italy, Ireland, Denmark, Greece, Spain, and France. See Kwiecień (2005), pp. 1486–88 and cited case law therein. A significant collection of the national courts' judgements relating to the EU law can be found in Oppenheimer (2003).

[60] See CT's judgement of 24 November 2010, paragraph 2.5.

[61] This provision was the legal basis by which Poland became a Member State of the EU and adopted EU law.

[62] See 28/62, 29/62 and 30/62; 283/81, paragraphs 13–14 and C-428/06 and C-434/06, paragraph 42. See in literature Baudenbacher (2005), p. 397; Van Thiel (2008), pp. 279–290.

[63] Sources of European Union law (2010).

order and shall be applied directly. This is because they include "self-executing" provisions, i.e. clear and complete rights and obligations on the subjects of law without the need for further implementing actions through domestic legislation,[64] apart from equivalents of Article 9 OECD MTC.[65] Although ratified tax treaties do become part of Polish statutory law, Article 91(2) in conjunction with Article 89(1) point 5 and Article 217 Constitution indicate that they take precedence over statutory law if the statute cannot be reconciled with them. Tax treaty precedence over the statutory tax law takes place therefore only at the level of the application of these sources of law, and only if their application cannot be reconciled with the treaty in question.[66] In practice, such reconciliation should be achieved via a proper interpretation of the relevant treaty and statutory provisions.[67] Tax treaties are consequently considered to be superior sources of law than the Polish CFC rules if the CFC rules cannot be reconciled with the treaties by the way mentioned.

Finally, it should be noted that EU law is superior to tax treaties ratified by Poland due to the principle of the primacy of EU law over the laws of its Member States, including laws implemented in result of a ratification of a tax treaty. This conclusion is also supported by the principle of loyalty in EU law under Article 4(3) TEU[68] and CJEU case law.[69]

1.5.5.4 Polish statutory law: The legal position of the Polish CFC rules towards Constitution, EU law and tax treaties – lex superior derogat legi inferiori

Article 87(1) Constitution reads: "[t]he sources of universally binding law of the Republic of Poland shall be: the Constitution, statutes, ratified international agreements, and regulations." Article 92(1) also states that "[r]egulations shall be issued on the basis of specific authorization contained in, and for the purpose of implementation of, statutes by the organs specified in the Constitution." These provisions, seen in light of discussion in the previous three subsections, stipulate

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[64] See Kwiecień (2000), p. 31.

[65] See Infanti (2006); Reimer (2001), p. 124. It is generally agreed that Article 9 of tax treaties based on the OECD MTC does not provide a legal basis for the adjustment of profits in the case of transactions which were not agreed on an arm's length principle between associated enterprises, but solely creates limitations on the use of transfer pricing provisions of Contracting States, see Bullen (2011), pp. 75–76; Lehner (1997), p. 517; Litwińczuk and Karwat (2006), p. 428.

[66] See Haczkowska (2014), paragraph 4.

[67] See SAC's judgement of 11 June 2015 and VAC's (Gorzów Wielkopolski) judgement of 2 June 2015. For canons of interpretation in that regard see *infra* 1.5.6.1 and 1.5.6.3.

[68] See Klamert (2014), p. 4.

[69] See 270/83, paragraph 26 and C-294/99, paragraph 32.

that the hierarchy of sources of law in Poland according to the Constitution is as follows: (1) Constitution; (2) EU law; (3) tax treaty law; (4) statutes (e.g. the CFC rules); (5) regulations (e.g. regulations providing the list of tax havens).

Since CFC rules are statutory provisions, they are inferior to the Constitution, EU law, and tax treaty law respectively. They have precedence over Polish CFC rules if they cannot be reconciled with them – *lex superior derogat legi inferiori*. This does not mean, though, that CFC rules drafted contrary to superior law are automatically null and void. This can be decided only by CT or legislature. It is therefore the duty of the Polish legislature to ensure the compatibility of the CFC rules first with the Constitution, and then with EU law and tax treaties.[70]

1.5.6 Legal interpretation under canons of interpretation in Polish law

By definition and purpose, Polish CFC rules are only applicable in cross-border situations, of which there are three different constellations: (i) situations that are neither covered by EU law nor tax treaties, i.e., situations in which CFCs have their tax residence outside EU/EEA and tax treaty areas and are definitely controlled by their Polish participants, in which case the free movement of capital does not apply;[71] (ii) situations covered by EU law, i.e., when CFCs are resident within EU/EEA area; and (iii) situations covered by tax treaties, i.e., when CFCs are resident within a territory covered by the tax treaties.[72] The legal interpretation of Polish tax law in the three different situations will be discussed

[70] Administrative authorities and national courts cannot refuse to apply domestic law that in their view is incompatible with the Constitution and tax treaties. See SAC's resolution of 25 June 2012 and VAC's (Poznań) judgement of 10 December 2015. See, however, doubts related to the incompatibility of statutory law with Constitution (and indirectly with tax treaties) in Jaśkowska (2001), pp. 278–79; Wronkowska (2001), pp. 17–23; Mączyński (2000), pp. 10–14; Wasilewski (1998), p. 18. That is to say, if they are doubts as to the compatibility of CFC rules with the Constitution or tax treaties, only the CT can decide the issue and only on the request of persons entitled to it (Article 191 Constitution); by courts in a specific case brought before them via a legal question (Article 193); or by individuals via the constitutional cassation complaint if they believe their rights or freedoms to have been infringed by the application of CFC rules by tax authorities (Article 79(1) Constitution). However, the CJEU's case law implies that the tax authorities or courts may not apply domestic law that is incompatible with EU law, see the CJEU's judgements C-358/98, paragraphs 16 and 17; C-160/99, paragraph 22; and C-522/04, paragraph 70.

[71] See *infra* 16.3.

[72] In each constellation, any reference to CFCs should be seen also as referring to foreign PEs and any reference to a tax residence CFCs is to be equated with the said PE's place of location insofar the income of PEs is exempt from taxation in Poland under tax treaties. It follows from the fact that such PEs are covered by the Polish CFC rules. See *infra* 7.2.2.

in the following sections. When analyzing the Polish CFC rules, EU law and tax treaties I follow the canons of interpretation.

1.5.6.1 Legal interpretation of Polish tax law

There are no statutory canons of interpretation of Polish law. Such canons are developed rather by doctrine and case law, albeit the latter is not always consistent.[73]

First and foremost, doctrine[74] and the most of the jurisprudence[75] imply that even though linguistic interpretation is generally the prime route of interpretation in every field of law, it plays a particularly special role in the field of tax law for the following reasons. Tax law addresses obligations safeguarded by sanctions; its legal interpretation must therefore not go beyond the essence of interpreted tax law provisions – a linguistic interpretation is the most appropriate means to achieve this purpose.[76] Moreover, provisions of the Constitution[77] clearly indicate that tax can be levied only by virtue of statute such that taxpayers, again according to the Constitution, need to know the wording of statutory tax law in order to fulfill their tax liabilities, while knowledge of doctrine or case law is not required for doing so. Consequently, the linguistic interpretation of tax law ensures foreseeability of taxation for taxpayers in the best way.[78] Finally, since Polish tax law requires taxpayers to file a self-assessment tax return and correspondingly pay taxes, including tax payable under the CFC rules,[79] taxpayers must have a proper understanding of tax law provisions to calculate the tax to be paid. In that respect, linguistic interpretation ensures greatest uniformity of understanding of tax law provisions.[80]

Nevertheless, as both doctrine[81] and jurisprudence[82] have made clear, the linguistic interpretation of tax law is often not sufficient in itself to give an appropriate meaning to legal provisions. Their interpretation therefore needs be supplemented by systematic and purposive interpretation of tax law or interpretation *per analogiam*. The SAC, in one of its judgments,[83] stressed that the only criterion for applying a canon of interpretation is the appropriateness of its

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[73] See Brzeziński (2008), p. 26.
[74] See Brzeziński (2008), pp. 39–40 and 64–65; Morawski (2010), pp. 27 and 78–79.
[75] See the analysis of relevant case law in Bielska-Brodziak (2006), pp. 78–87.
[76] See Morawski (2010), p. 27; See Brzeziński (2008), p. 40.
[77] See Article 84 and Article 217.
[78] See Brzeziński (2008), p. 40.
[79] See Article 27(2a) CITA and Article 45(1aa) PITA.
[80] See Brzeziński (2008), p. 40.
[81] See Morawski (2010), p. 71; Brzeziński (2008), pp. 58–59; Płeszka (1997), pp. 71–73.
[82] See for example SAC's judgement of 23 February 1999.
[83] See SAC's judgement of 23 February 1999.

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