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# SAC's resolutions on instrumental initiation of penal fiscal proceedings and qualification of letting and lease revenue

**On 24 May 2021, a bench of seven judges of the Polish Supreme Administrative Court (SAC) adopted two resolutions, initiated by the motion of the Ombudsman for Small and Medium-Sized Enterprises. The first resolution (case file I FPS 1/21) related to whether administrative courts are entitled to examine if penal fiscal proceedings initiated by fiscal authorities had for the sole purpose not commencing or suspending the limitation period for a tax liability. The second one (case file II FPS 1/21) related to the method of qualification of revenue from letting, lease and other contracts of similar type involving assets not used by the taxpayer in their business activity to the correct source of revenue in PIT.**

**The key conclusions of the resolutions can be found below.**

## Court evaluation of instrumental initiation of fiscal penal proceedings

By way of the first resolution, the SAC gave its opinion on whether courts may evaluate if the application of provisions of the Polish Tax Code providing for suspending the limitation period for a tax liability in fiscal penal proceedings, where the said proceedings are connected with the possible default on the liability, constitutes an abuse of law by the tax authorities.

Invoking those provisions constitutes a common practice among tax authorities who often launch penal fiscal proceedings regarding a tax liability in the very last months before the limitation period expires, in order to suspend the limitation period and gain more time to conduct the proceedings, thus circumventing the tax liability limitation period provisions. This method of instrumental initiation of penal fiscal proceedings, aimed solely or mainly at suspending the limitation period, has been widely criticized as an abuse of the law.

In fact, there have existed two contradictory lines of jurisprudence regarding the possibility of legal evaluation of such activities by administrative courts. The dominant practice was to find the assessment of penal fiscal proceedings to be outside the administrative courts' jurisdiction. In turn, according to the second branch of jurisprudence, court supervision over the activities of tax authorities aimed at suspending the limitation period not only should exist but take a more comprehensive form. The courts inclined to the second line of jurisprudence have attached importance to individual assessment of factual circumstances of the case and usually held that if these circumstances indicated that the launch of penal fiscal proceedings was only aimed at suspending the limitation period for a tax liability, then the administrative court may prevent such an effect from being achieved.

Through its resolution, the Supreme Administrative Court unequivocally supported the latter approach, stating that the administrative courts are entitled to assess whether the initiation of penal fiscal proceedings aims at suspending the limitation period for the tax liability.

In the oral statement of reasons, the SAC confirmed that as part of the assessment of whether the effect of suspending the limitation period for the tax liability will take place in the given case, an administrative court should also verify whether, based on the circumstances of a given case, the initiation of penal fiscal proceedings is not artificial and does not serve only to suspend the limitation period for a tax liability. Thus, an administrative court should examine whether the initiation of penal fiscal proceedings was instrumental.

The SAC's resolution is of paramount importance to all the taxpayers against whom penal proceedings have been brought and, because of the approaching limitation period for the tax liability covered by the proceedings, the tax authorities also launched penal fiscal proceedings. Pursuant to the resolution, the administrative court examining a complaint filed against the decision of the authorities issued in such proceedings is obliged to investigate whether the initiation of penal fiscal proceedings in a specific case was not instrumental, and if it decides that it was so, to state that the effect of suspension of the limitation period must not be achieved, and thus to revoke the decision of the authority and to order to discontinue the proceedings against the taxpayer due to the expiry of the limitation period.

## Qualification of revenue from letting, lease and other contracts of similar type

In the latter of the resolutions discussed, the SAC ruled that the revenue from letting, sub-letting, lease, sub-lease and other contracts of similar type should be qualified, without limitation, to the revenue source provided for by Article 10(1)(6) of the PIT Act (letting constituting a source of revenue separate from the revenue from non-agricultural business activity), unless the revenue is earned from assets owned by an individual that have been included in their business asset held in connection with the business activity performed.

According to the resolution, it was up to the taxpayer to decide whether the asset let was part of the personal property or the business assets (e.g. by entering this asset into the fixed asset register), which was decisive for choosing the applicable principles of taxation of revenues on this account.

The resolution is of importance in particular in relation to the legal status in force until the end of 2020, under which only the rental of assets classified as personal property could be taxed with a lump sum on recorded revenues, at the rates of 8.5 percent for income in the amount of up to PLN 100 thousand and 12.5 percent for income above this threshold. This meant that assets rented out as part of the business activity conducted by the taxpayer were excluded from lump-sum taxation, and the tax due was calculated based on the business taxation principles.

In practice, enforcing this kind of distinction gave rise to numerous disputes between taxpayers and tax authorities, in particular in situations where a natural person rented out several pieces of real estate, including residential and commercial premises, or simultaneously rented several pieces of real estate as part of and outside business activities.

In the oral statement of reasons, the SAC referred to the definition of business activity provided by the Polish PIT Act. The court stated that the revenues to which the resolution pertains should, in the first place, be classified as the source of revenues from contracts such as letting, sub-letting, lease, sub-lease and other contracts of a similar nature, except for assets used in business activity.

The SAC pointed to the fact that a taxable person has the right to conduct business activity involving the assets constituting part of their personal property, but they can also use them for private purposes, e.g. by letting them out. Then, real estate or premises that are not components of the company's assets, especially fixed assets, shall not be treated as assets used in business activity.

In turn, running a business requires the identification and separation of assets that will be used to conduct business activity from the property of a taxpayer who is a natural person. Therefore, if the taxpayer does not undertake activities aimed at a clear separation of the enterprise by creating an organized set of tangible and intangible assets intended for this activity, they do not build an organizational structure allowing for the management of this separated part of the property, they do not develop a strategy for their business activity, but only allocate funds for purchasing real estate, which then is rented out, such property cannot be treated as assets used in their business activity.

Thus, only when the taxpayer explicitly included real estate into their business assets, e.g. as fixed assets, the rental revenue can be taxed as revenue from business activity.

If you would like to learn more about the of issues discussed, please do not hesitate to contact us.

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