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Taxation of a Security Transfer of Title to a Fixed Property with the Tax on Goods and Services

Abstract

The subject of this paper is the taxation of a security transfer of title to a fixed property with the tax on goods and services. The author focuses on the interpretation of the term “paid supply of goods” in the context of a security transfer of title. The objective of the following considerations is to establish whether a security transfer of a title is a chargeable event, and to indicate the moment in which the tax becomes chargeable on the grounds of the goods and services tax and in the light of the absence of a consistent practice of the tax authorities as well as divergent judicial decisions of administrative courts on the matter.

Keywords: security transfer of title, tax on goods and services, legal trust activity, supply, transfer of title to a fixed property

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General considerations

The article discusses the significant issue of the taxation of a security transfer of a title to fixed property with the tax on goods and services. The subject matter in question is especially interesting because of no statutory specification of significant elements of the content of the security transfer of the title. The growing importance of a security transfer of a title in business transactions combined with the fiscal pressure exerted by the state's budget needs makes the subject matter of the article highly valuable in practical terms. The author also notices a limited body of analyses of the vast problem of the taxation of fiduciary activities in literature and a lack of uniform practice among the tax authorities.

Taking the above into consideration, the matter of taxation of a security transfer of title to a fixed property will be analysed with a reference to a model solution designed for the purpose of this article on the basis of the content provided in the doctrine and judicial decisions.

Security transfer of title as a trust activity

In the Polish legal system the notion of trust has been long known, but it is important to bear in mind that this is a creation of legal doctrine and practice only. There is nothing ground-breaking in saying that defining trust is not an easy task, which is proven by the number of definitions found in literature.² One of the most important issues authors need to address is to answer the question of whether one should interpret trust in a narrow sense (the Roman model) or in a broad sense (the German model). Given the various attempts to define trust, it is reasonable to follow the narrow interpretation. It makes it possible to effectively differentiate trust from other private law institutions grounded in the Polish system of law. It

² It is also reasonable to give credit to the attempts to define trust activities published in the following sources: A. Wolter, J. Ignatowicz, K. Stefaniuk, *Prawo Cywilne, zarys części ogólnej*, Warszawa 1998, pp. 306–307; A. Szpunar, *Nabywanie nieruchomości na podstawie umowy zlecenia*, [in:] *Obrót nieruchomościami w praktyce notarialnej*, Kraków 1997, p. 233; Z. Radwański, *Rodzaje czynności prawnych*, [in:] idem, *Prawo cywilne część ogólna, System prawa prywatnego*, Vol. 2, Warszawa 2008, p. 196; A. Kędzierska-Cieślak, *Powiernictwo. Próba określenia konstrukcji prawnej*, "Państwo i Prawo" 1977, 7–8, p. 50; R. Rykowski, *Pojęcie powiernictwa – konstrukcja prawna zarządu powierniczego*, Warszawa 2005, p. 174.

seems that the definition offered by A. Kappes is particularly fitting in this context: He states that “in a trust relationship, the entrusting party disposes of an object or a right for the trustee for a purpose defined in the content of the activity or an act, and the trustee is obliged to use the acquired object or right in accordance with the aim of disposing, and sometimes to dispose of the object or right for the entrusting party contrariwise.”³

Trust activities, depending on the aim of the parties, include security activities (security assignment, security transfer of title) and management activities (trust).⁴ These are types of trust originating from the Roman *fiducia*, in line with the adopted narrow definition.

The security transfer of title is an innominate contract, involving the entrusting party transferring the right of ownership of an object (or other goods) to the trustee in order to secure claims due to the trustee on the basis of another legal relationship with a simultaneous obligation of the trustee to perform a reverse transfer of the object of the transfer of ownership to the entrusting party after the claims in question are satisfied.⁵ The object of a security transfer may also include fixed property, although the issue has been highly controversial throughout history.⁶ At present, it seems to be settled once and for all, which has also been manifested in the decisions of the Supreme Court.⁷

The model solution the discussion to follow will refer to is transfer of ownership with a simultaneous reservation of the right to use the object by the limited debtor in possession within the limits set by the parties and, consequently, with the debtor retaining the right to own the fixed property. The prohibition of selling and encumbering a collateral within the term of the primary legal relationship between parties is an implication of the above construct. A significant element of the contract is the debtor’s claim for a reverse transfer of objects, which becomes due when the debt is paid off. All these points apply also to cases of a security transfer of title to the right of perpetual usufruct of land.

Literature sources argue that the legal relationship serving as the basis for a debtor to retain the right to fixed property and to be allowed to use it further for

³ A. Kappes, *Umowy powiernicze*, [in:] W. Katner (ed.), *Prawo zobowiązań – umowy nienazwane*, Warszawa 2015, p. 367.

⁴ P. Stec, *Powiernictwo w prawie polskim na tle porównawczym*, Kraków 2005, pp. 205–206.

⁵ A. Kappes, op. cit., p. 376.

⁶ An extensive discussion of arguments raised against the acceptability of security transfer of title to fixed property can be found in J. Gołaczyński’s monograph, *Przewłaszczenie na zabezpieczenie*, Warszawa 2004, pp. 42–65.

⁷ Supreme Court’s judgement of 29 May 2000, III CKN 246/00, OSNIC 2000, issue 11 with glosses: F. Zoll, OSP 2001/2, pp. 83–86, J. Gołaczyński, OSP 2001/5, pp. 227–230.

economic purposes is a usage agreement, and in the case of non-commercial fixed property – a lending contract.⁸ It seems, however, that it is more appropriate to treat a whole trust activity as a uniform activity,⁹ which also includes issues related to owning and benefitting from the ownership of objects. In such a case, the provisions concerning usage or loan may be applied in an auxiliary manner and accordingly.

Transfer of ownership as an activity subject to taxation

The tax on goods and services is a Polish element of a harmonised system of tax on added value, which functions in the European Union. The tax can be characterised, as defined by the former ECJ – now the CJEU, as universal, proportional, multi-stage, and deductible, with the latter combined with the principle of business neutrality since it is consumption that is subject to taxation.¹⁰ According to the Polish regulations on VAT, the paid supply of goods and the paid provision of services in the Republic of Poland are subject to taxation if they are carried out by taxable persons within the meaning of the act in force. Defining the idea of supply is crucial from the point of view of determining the object of taxation, and the legislator's aim is to adopt a broad interpretation, intended to encompass as wide a range of economic events as possible in the tax system. According to Article 7, section 1 of the Goods and Services Tax Act, the supply of goods means a transfer of the right to dispose of tangible property as an owner. Neither the Polish act nor the EU directive define the idea of disposing of tangible property as an owner. It is stressed that such an interpretation highlights the economic aspect of the issue, and the CJEU's decisions speak even of a notion of "economic ownership", apart from or perhaps parallel to the civil law regulations of the transfer of ownership.¹¹ Literature stresses that in order to grasp the essence of disposing of tangible property as the owner, it is necessary to refer to a set of rights like the possibility to dispose of tangible property, to use it in combination with the transfer of the actual control, but it does not have to equal the transfer of ownership within the meaning of civil law.¹² Other authors argue that the content of the idea in question will not only include the right to dispose of tangible property, including selling it, divesting oneself of it, or disposing of it *mortis causa* but also the right to encumber it, profit

⁸ J. Gołaczyński, *Przewłaszczenie...*, Warszawa 2004, pp. 203–204.

⁹ A. Kappes, op. cit., p. 388.

¹⁰ J. Zubrzycki, *Leksykon VAT*, Vol. 1, Wrocław 2017, pp. 51–52.

¹¹ T. Michalik, *VAT. Komentarz*, Warszawa 2017, a commentary to Article 7, theses 2–6.

¹² *Ibidem*, a commentary to Article 7, thesis 10.

from it, or own it.¹³ The supply will thus always be an act of sale but including an actual handover of fixed property, without concluding an agreement in the form of a notarial deed.¹⁴ The question is therefore whether a security transfer of title, being a transfer of ownership in the civil-law sense, an unconditional and absolute transfer, is an instance of supply within the meaning of the Goods and Services Tax Act.

The matter has been analysed by the Supreme Administrative Court many times, but since the SAC has offered divergent conclusions, it seems reasonable to look into it again in more detail. The body of the existing judicial decisions offers views according to which the notion of “disposing of tangible property as an owner” includes always a transfer of ownership in the civil law sense, but also a range of other situations where there is no transfer of ownership but there is a transfer of the actual economic control over intangible property.¹⁵ The Supreme Administrative Court, issuing a resolution adopted by seven judges, has expressed such a view quite recently: “In the light of the matter in question, it needs to be additionally stressed that the understanding of the notion of “transfer of the right to dispose of intangible property as owner” within the meaning of Article 14, section 1 of Directive 2006/112/EC and Article 7, section 1 of the Goods and Services Tax Act (introductory sentence) does not imply interpreting it only in the economic sense. The wording featured in the quoted provisions means that the supply of goods occurs not only when there is a transfer of the ownership of property, which means that the supply of goods always happens when there is a transfer of the ownership of property in the legal (civil law) sense and in any other situation in which the taxable person transfers the actual or economic control over the property to another entity, and the party purchasing the property is free to dispose of this property as if they were this property’s owner.”¹⁶ The same resolution states also that “the transfer of ownership of property in the legal (civil law) sense always results in obtaining the right to dispose of property as an owner within the meaning of Article 7, section 1 of the Goods and Services Tax Act, and taking this provision into account, the “supply of goods” shall also be understood as any instance of one party’s selling of tangible property, which entitles the other party to actually dispose of this property as if they were its owner, even if there has been no actual

¹³ J. Zubrzycki, *op. cit.*, p. 198.

¹⁴ A. Mudrecki, *Konsekwencje przeniesienia prawa własności w podatkach obrotowych w Polsce*, “Krytyka Prawa” 2009, 1, p. 345 *in fine* and p. 346.

¹⁵ The SAC’s resolution of 12 October 2015, I FSP 1/15.

¹⁶ *Ibidem*.

transfer of ownership of this property in the light of the applicable law.”¹⁷ This leads to the conclusion that a transfer of ownership, regardless of the title or the cause, will always fit within the idea of “transfer of the right to dispose of intangible property as an owner” next to other legal and actual events. I find this conclusion to be wrong.

A security transfer of title to fixed property involves a transfer of ownership, but this transfer has the nature of *causa cavendi*, which combined with the reservations of a trust contract limits the trustee’s possibilities to exercise the ownership right, and especially before the expiry of the deadline for payment of the secured obligation, the trustee may not sell the fixed property, encumber it, rent it or lease it, and even more importantly, the trustee is not its owner and may not profit from it since these rights have remained vested in the limited debtor in possession. Thus, all of the typical features mentioned in literature and constituting the content of the notion of “disposing of intangible property as an owner” are taken away from the trustee. The SAC raises this argument in its another decision, expressing a view opposing the resolution quoted before: “A security transfer of title transfers the ownership of tangible property to the creditor in the civil law sense. The owner takes advantage of the right acquired under such a contract only to the extent to which it is necessary to secure the relevant claims, letting the current owner use the property in question. The very conclusion of a contract for security transfer of title is therefore not an act of supply. Supply occurs only when the creditor actually takes over the property appropriated as a security.”¹⁸ I find this standpoint convincing and although in the situation the quoted the decision refers to the object of security transfer of title was a chattel, it remains valid with regard to security transfer of title regardless of its object.

The moment of supply in a security transfer of title

A security transfer of title to a fixed property is therefore not an instance of supply. A potential supply will take place when the entrusting party – the creditor – actually takes over the object of security of transfer of title. The issue that requires an in-depth analysis is the precise definition of the moment of supply, which translates into a tax obligation. Does supply take place:

- when the creditor, who may keep or sell the fixed property, has their claims satisfied?

¹⁷ Ibidem.

¹⁸ The SAC’s judgement of 1 June 2015. I FSK 335/14, similarly J. Zubrzycki, op. cit., p. 212.

- ❑ when the trustee takes over the ownership of fixed property?
- ❑ when the deadline for payment of the obligation expires ineffectively?
- ❑ when the claim for reverse transfer of fixed property is removed from a land and mortgage register?

The moment when the creditor's claims are satisfied can be considered the moment of supply on account of the criterion of whether the supply is paid. In the judgement referred to earlier, the court finds that if a taxable person gains any material profit in exchange for **supply**, including a reduction in their liabilities, then the condition of chargeability – referred to in Article 2, section 1 a and c of Directive 2006/112/EC and in Article 5, section 1, item 1 of the Goods and Services Tax Act – is fulfilled.¹⁹ It is important to bear in mind that liabilities are reduced, i.e. the claims are satisfied, either when *datio in solutum* (a giving in payment) takes place or when the creditor sells the object of the security transfer of title and satisfies their own claims using the amount gained. The issue seems to be of great practical significance since the business trading practice is well familiar with contracts granting creditors the right to select the way to have their claims satisfied but without setting a deadline for the satisfaction of these claims. A creditor may thus choose either to keep the object of the security transfer of title and make appropriate settlements with the debtor (return the difference between the value of the fixed property and the value of the debt) or to sell the fixed property, have their claims satisfied using the obtained amount, and provide the debtor with the remaining amount. The moment of supply will be different in each of these scenarios. It will be either the moment the fixed property is effectively kept (in the case of *datio*) or the moment of sale. In the latter case, the moment of supply may be very remote in time from the moment of the ineffective expiry of the deadline for the repayment of the loan.

Taking earlier considerations into account, it would be also good to consider one more factual circumstance, where the creditor aims to have their claims satisfied from the amount of the future sale of fixed property with the fixed property becoming owned by the creditor earlier at the same time (e.g. the property is handed over voluntarily by the debtor, and will then be shown by the creditor to potential buyers). What happens is a situation in which the creditor is the owner of fixed property, the option to claim to have the property returned has expired, the claims secured by way of the transfer of title have not been satisfied, and the trustee has been granted the possession of property with actual physical control over it at the same time. To make matters more specific, no profits are gained from

¹⁹ The SAC's judgement of 1 June 2015, I FSK 335/14.

this property. The existing judicial decisions share a view that the moment of supply will be the moment in which the property is handed over.²⁰ It seems that this view is only partially correct. It will be legitimate if the handover of property is combined with the satisfaction of the creditor's claims by way of *datio in solutum*. But it will rather not be sufficient in any other case. The aim of the transfer of ownership was to secure claims, and it was therefore performed by way of *causa cavendi*, and the contract and the factual circumstance may not be interpreted in isolation from the economic relationship at issue.

The ineffective expiry of the deadline for payment seems to be irrelevant in the context of the supply of fixed property. The very fact of the provision of a service within a given deadline only updates the catalogue of rights of the trustee's creditor and results in an expiry of the expectative of the claim for the reverse transfer to be made by the limited debtor in possession. But this does not have a major impact on the right to dispose of the property as the owner nor on the issue of chargeability analysed earlier.

Removing an earlier entered claim for the reverse transfer of fixed property from a land and mortgage register seems to be insignificant too. It is a future claim, a conditional one, that would occur in the event the loan is paid within the set deadline. If the loan is not paid, the claim never materialises, and its expectative expires, and so it is possible to remove it from the land and mortgage register.²¹ It is important to notice that the entry of such a claim in a land and mortgage register is of no importance to the economic control over fixed property, nor does it thwart the trustee's option to sell the property (although it does make it much more difficult to do so in practice). In the light of the above, it can be assumed that the issue of a claim for a reverse transfer of fixed property, of such a claim's entry into or removal from a land and mortgage register is irrelevant to the determination of the moment of supply.

Conclusion

A security transfer of title is not an instance of supply within the meaning of the Goods and Services Tax Act, despite the unconditional transfer of ownership right within the civil law framework. A precise determination of the moment of supply is crucial from the point of view of both taxable persons and state administration authorities. Taking the above into consideration, it is reasonable to bear in mind

²⁰ The SAC's judgement of 5 June 2008, I FSK 760/07.

²¹ The Supreme Court's decision of 26 September 2007, IV CSK 118/07.

the matter of chargeability of the transfer of ownership as part of a security transfer of title, as raised in both domestic and European judicial decisions. Deciding whether and when we are dealing with chargeability makes it possible, as I believe, to determine the moment of supply very precisely, is consistent with the economic background of the performed legal acts and takes their cause into consideration. The point and the aim of the security transfer of title is to transfer ownership between entities. It is not an alternative to a sale. The security transfer of title secures the performance of a service, and if such a service is not performed, it makes it possible to satisfy the creditor's claims. Such a perspective, combining the interpretation of the notion of "dispose of property as an owner" with the interpretation of the idea of chargeability and the moment in which it occurs, makes it possible to pinpoint the right moment of performance of an activity subject to taxation, which increases the certainty of transaction parties as to their public-legal obligations, causing no detriment to the interest of the Treasury.