



Implications of the CJEU ruling in the case Nordcurrent Group (C-228/24) for the Polish practice of withholding tax

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Factual circumstances

Nordcurrent – A Lithuanian company that develops and publishes video games established a subsidiary in the United Kingdom (**UK Subsidiary**) in 2009 for the purpose of selling and distributing games due to restrictions on the sales of games via mobile applications from Lithuania.



Factual circumstances

The UK Subsidiary generated profits in the UK, which were subject to local CIT. In 2017–2018, Nordcurrent took over the functions and risks of the UK Subsidiary (distribution and advertising purchases remained in the UK). A few years later, the UK Subsidiary was dissolved because it had not been operational since the end of 2019.

Nordcurrent applied Lithuanian tax exemption to dividends received from UK Subsidiary in 2018 and 2019. Following an tax audit for those years, the Lithuanian tax authorities concluded that that UK Subsidiary did not have a office, employees or assets during that period and deemed it to be a “non-genuine arrangement” (just one director in the office in which 97k of companies were registered) created for tax purposes, refusing to apply the exemption in Lithuania.

An important issue in this case is the fact that:

- The reasons for establishing the UK Subsidiary are not disputed, only its status in 2018-2019 in connection with the discontinuation of its operations.
- CIT rate in the UK was higher (24%) than in Lithuania (15%), which, in the Court's opinion, should also be taken into account when examining whether the main purpose or one of the main purposes of the subsidiary's existence at the time of the dividend payment was to obtain a tax advantage.

The questions referred for a preliminary ruling



Does Article 1 (2) and (3) of Directive 2011/96 allow to refuse of exemption where the subsidiary is not an intermediary, and the income derives from its own activities?

Is it allowed to assess only the factual circumstances at the time of dividend payment, disregarding the actual business activity prior to that date?

Is the mere recognition of a structure as non-genuine sufficient to conclude that there is a tax advantage contrary to the directive?

SAAR under the Parent-Subsidiary Directive

Directive 2011/96, Article 1 (2) to (4)

2. *Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances.*

An arrangement may comprise more than one step or part.

3. *For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that **they are not put into place for valid commercial reasons which reflect economic reality.***

4. *This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse.*

Comparison of the anti-abuse clauses

Lithuanian law

„The provisions of ... Article 35(2) and (3) of this Chapter on the exemption of dividends **do not apply to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of Directive 2011/96 [...] are not genuine** having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. An arrangement or a series of arrangements **shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.**”

Polish law (Article 22c of the CIT Act)

The “exemption” does not apply **if the use of the exemption** specified in these provisions **was**:

- 1) **contrary**, in the circumstances, **to the subject matter or purpose of these provisions**;
- 2) **the main or one of the main purposes of the transaction or other activity**, or of multiple transactions or other activities, **and the manner of operation was artificial**.

The course of action is not artificial if, based on the existing circumstances, **it must be assumed that an entity acting reasonably and pursuing legitimate objectives would have adopted this course of action for predominantly economic reasons**. The reasons referred to in the first sentence do not include the objective of taking advantage of an exemption contrary to the subject matter or purpose of those provisions.

Previous version of the article 22c of the Polish CIT Act – intermediary entity

Before 01.01.2019

"1. The provisions of Article 20(3) and Article 22(4) **shall not apply if:**

- 1) **the income (revenue) from dividends and other income** from participation in the profits of legal persons is derived in connection with the conclusion of a contract or the performance of another legal act, or a series of related legal acts, **the main or one of the main purposes of which was to obtain an income tax exemption** under Article 20(3) or Article 22(4), **and the obtaining of such exemption does not result solely in the elimination of double taxation of such income (revenues), and**
- 2) the activities referred to in point 1 are **not genuine**.

2. For the purposes of paragraph 1, **an agreement or other legal act shall be considered not genuine to the extent that it is not concluded for valid economic reasons. This applies in particular to situations where, by way of the activities referred to in paragraph 1, the ownership of shares in the company paying the dividend is transferred or the company obtains income (revenue) which is subsequently paid out in the form of a dividend or other income from participation in the profits of legal persons."**

After 01.01.2019

"1. The provisions of Article 20(3), Article 21(3) and Article 22(4) **shall not apply if the use of the exemption provided for in those provisions was:**

- 1) **contrary to the subject matter or purpose of those provisions** in the circumstances;
- 2) **the main or one of the main objectives** of the transaction or other activity, or of multiple transactions or other activities, **and the manner of operation was artificial**.

2. For the purposes of paragraph 1, **the manner of operation is not artificial if**, based on the existing circumstances, **it must be assumed that a reasonably acting entity pursuing legitimate objectives would have used this manner of operation predominantly for legitimate economic reasons**. The reasons referred to in the first sentence do not include the purpose of taking advantage of the exemption provided for in Article 20(3), Article 21(3) and Article 22(4), contrary to the subject matter or purpose of those provisions."

Differences between Polish and Lithuanian clauses

Lithuanian law

The method of examining artificiality presented in this article consisting of identifying legitimate commercial reasons that reflect economic reality may give rise to significantly more doubts and questions of interpretation.

The phrase “valid commercial reasons which reflect economic reality” used in the article is not very precise.

Polish law (Article 22c of the CIT Act)

In the context of artificiality, Polish clause presents a more accurate method of examining the artificiality of a given operation - **a genuine methods of operation are those that would be reasonably chosen in the prevailing circumstances for valid economic reasons.**

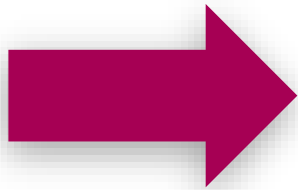
The referral to the market standards is less ambiguous.

In practice we observe that tax authorities not always have enough business experience and legal/ financial knowledge while presenting alternative scenario. Examples:

- liquidation vs merger.
- business substance.
- cost of financing.
- the way how the business prepares cash flows.

Key points of the judgment – intermediary company

The anti-abuse clause of the Directive is not limited to intermediary companies.



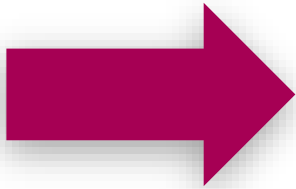
The clause applies to intermediary companies but also to companies whose profits paid out in the form of dividends derive from activities carried out on behalf of these subsidiaries.

Key points of the judgment – moment of payment vs. actual activity

The anti-abuse provisions of the Directive cannot be interpreted in such a way that the circumstances of artificiality are examined solely at the time of dividend payment, without taking into account the assumptions/circumstances existing at the time of creation (obligation to examine all circumstances).



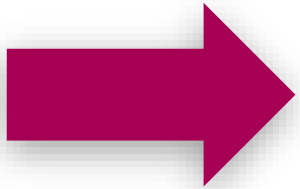
All relevant circumstances should be considered, i.e., among others, the circumstances of incorporation, changes in functions and activities over time, taking into account circumstances existing prior to the payment, not only at the time of payment.



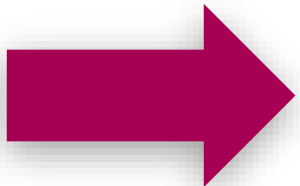
Should the paying company's past be examined (the moment when the profits were generated)? What about the future?

Key points of the judgment– tax benefit vs. tax rate

In order to apply the anti-abuse clause of the Directive, it is necessary to demonstrate not only the absence of legitimate commercial reasons, but also **that the main purpose of the arrangement was to obtain a tax advantage contrary to the objective of the Directive** (cumulative conditions must be met) – here, the obligation to take into account, among other things, the argument of a higher CIT rate in the UK than in Lithuania.



The mere statement that the structure is artificial is not sufficient – it must also be demonstrated that the aim was to obtain a tax advantage contrary to the objective of the directive.

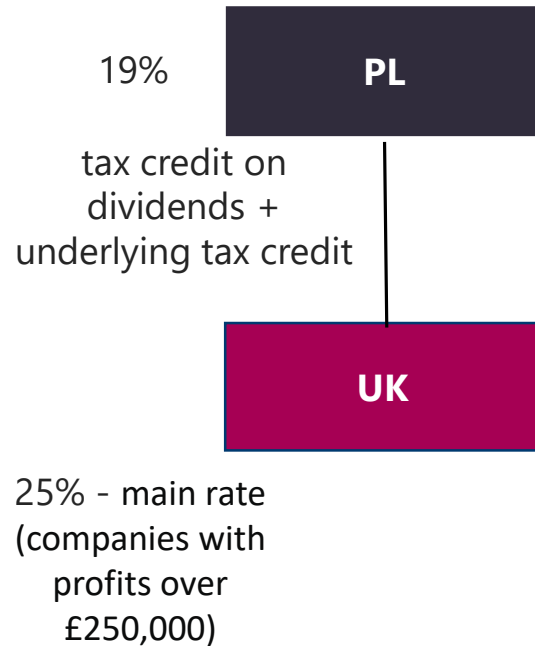


Proof of the existence of an abusive practice requires:

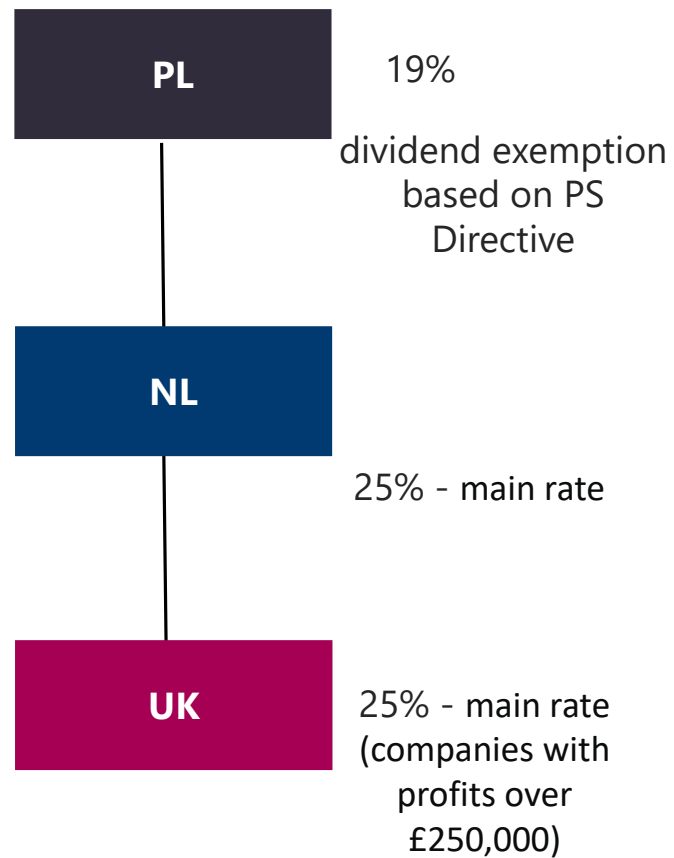
- on the one hand, the presence of a set of objective circumstances, which show that, despite formal compliance with the conditions laid down in the EU regulation, the objective of that regulation has not been achieved, and,
- on the other hand, the presence of a subjective element in the form of an intention to obtain an advantage resulting from the EU regulation by artificially creating the conditions required for its attainment (following the Danish judgments).

Subsidiary in UK

I option

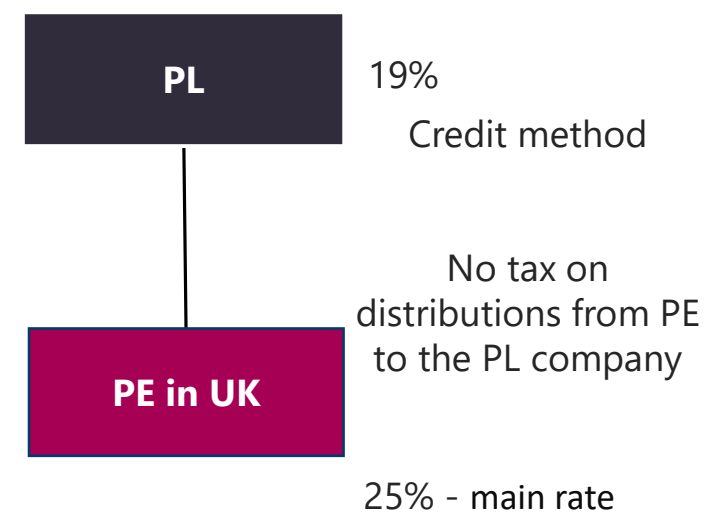


II option

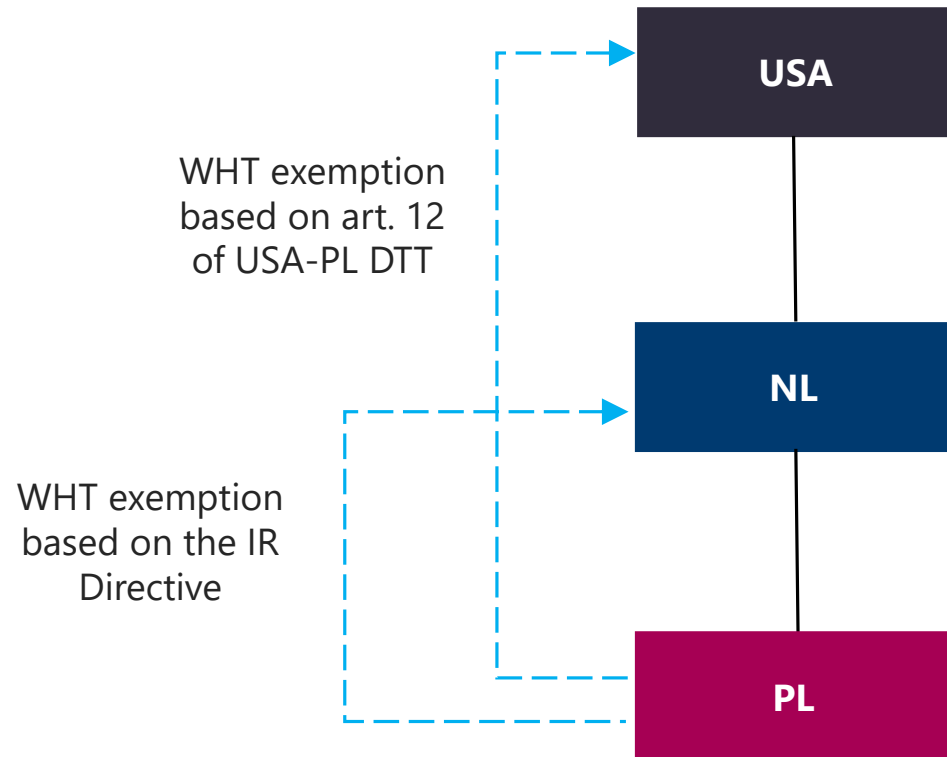


Permanent establishment in UK

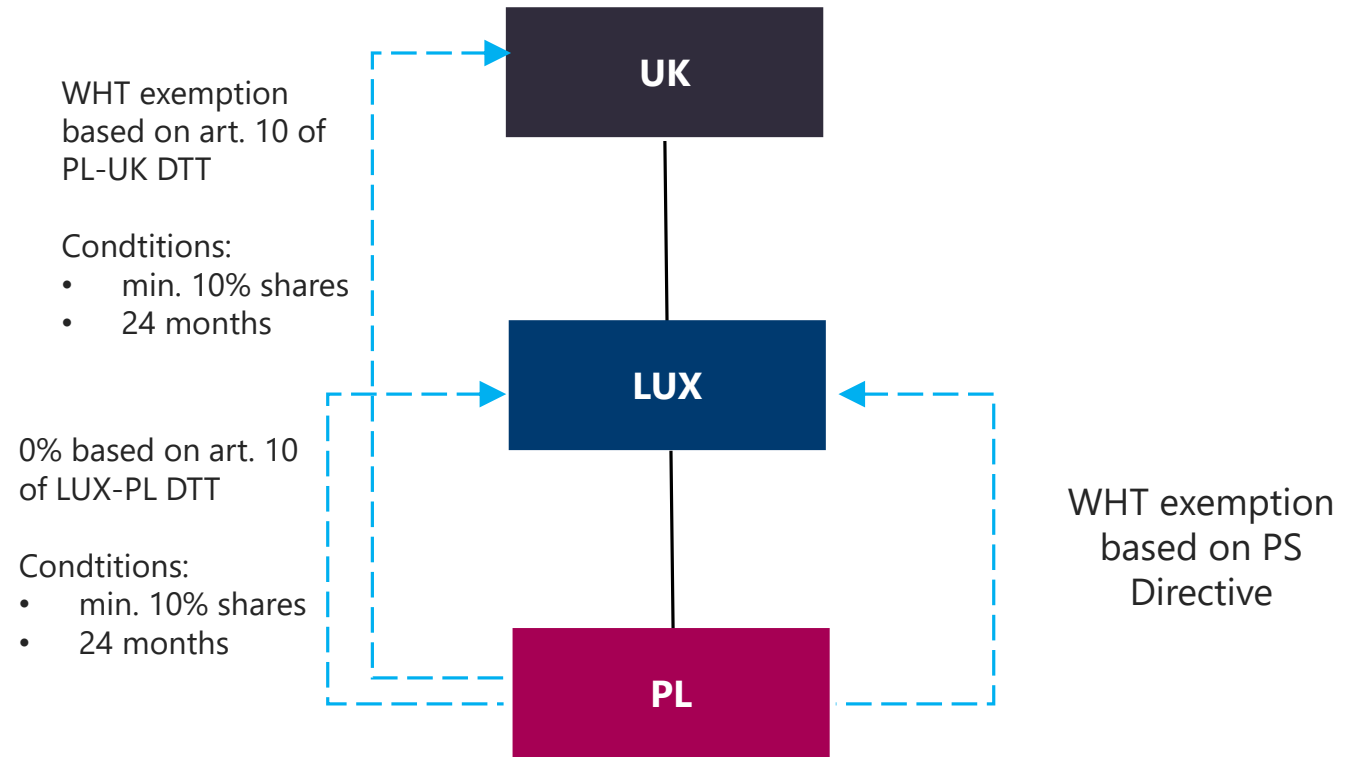
III option



Interest



Dividends



Let's stay in touch



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