

The Participation of Tax Authorities in Insolvency Agreements¹

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Abstract: The contribution deals with a problem if and when Polish tax authorities should support insolvency agreements. Tax authorities are bodies of public law; however, they have to act within insolvency agreement proceedings as a private law subject, e.g. participate in negotiations. It creates many legal problems. The aim of the contribution is presenting possible guidelines which should allow tax authorities to make a decision if and when to support insolvency agreements. Additionally, it presents a possible amendment of the Polish law (*de lege ferenda*) on the basis of German experience.

Keywords: insolvency agreement; tax law; restructuring law; fiscal principle; internal administrative guide

1. Introduction

Insolvency agreement as an institution of the insolvency law that has existed in many legal systems for many years. It was already regulated e.g. in paragraph 160 et seq. of the German Bankruptcy Law (*Konkursordnung*) from 1877² and in Article 171 et seq. of the Polish Insolvency Law (*Prawo upadłościowe*) from 1934.³ It allows the bankrupt and non-secured creditors to sign an agreement about the bankrupt's debts. According to Article 161 of the German Insolvency Law from 1877, the insolvency agreement has to regulate at what rate obligations would be paid by the bankrupt and which securities would be provided by the bankrupt. However, the insolvency agreement does not require consent of all non-secured creditors what has been the hallmark of this institution. The insolvency agreement requires consent only from (some), the majority of non-secured creditors. Therefore, it is possible to reach the insolvency agreement in spite of the opposition of some creditors, e.g. tax authorities.

The issue became more important after preference of public debts in insolvency (liquidation) proceedings was cancelled. Nowadays, private and public law debts are in principle equally paid in the insolvency proceedings. It was introduced in Germany by the new Insolvency Law Act⁴ in 1999 and in Poland by the Restructuring Law Act⁵ in 2016, which regulates the insolvency agreement in Poland now. Therefore, tax authorities are imposed to join negotiation of insolvency proceedings. Liquidation proceedings do not provide them the preference in payment as it was before.

If only the majority of creditors is required to reach the insolvency agreement, there is a place for negotiations. Of course, the insolvency agreement has a frame of formal proceedings. Under insolvency law, there are formal regulations for: filling insolvency agreement proposal, conduct a general meeting to vote on the proposals, legal control of insolvency agreement provided by court and fill a complaint to court against the insolvency agreement. However, creditors decide to support or reject the insolvency agreement proposals after negotiations with the bankrupt and each other, not after legal subsumption that is typical for tax authorities' activities.

The Polish law does not define what negotiations mean, but it is said that negotiations are a reciprocal impact (communication interaction) between parties with the aim to sign a contract. Unlike offer negotiations, they do not constitute any specific shape or resolutely decision.⁶ Additionally, the core of any acts in law, including the support of insolvency agreements is the declaration of intent (*Willenserklärung*). Irrespective of the dissonance between legal theories about the declaration of intent which concentrates on its interpretation, initially, the declaration of intent derives always from the internal intent of man.⁷ Tax authorities, as legal bodies, do not have such internal intention. In tax law, acts of law stipulate specific precondition and specific content of tax decision for any specific facts of the matter.⁸

In fact, tax law, as well as administrative law, does not provide a general regulation how tax authorities shall act if they have to act as subjects of private law. The position of administrative authorities as a subject of private law is regulated in many particular regulations, like public procurement law or public-private partnership, but there is no such regulation regarding the participation of tax authorities in insolvency agreements, especially in the Polish Restructuring Law Act or in the German Insolvency Act. Therefore, the question if tax authorities should support particular insolvency agreements remains unanswered in acts of law. The Author presents below four possible guidelines which should allow tax authorities to make a decision.

2. Market Economy Creditor Principle

First of all, tax authorities may act in the insolvency agreement proceeding according to the principle of market economy investor. The principle was introduced by the European Commission in 1984 to allow better control of state aid in the EU and it has been developed by further European Commission texts, decisions and the EU Court of Justice. According to this principle there is no state aid, if "public authorities invest on terms and in conditions which would be acceptable to a private investor under normal market economy conditions".⁹ The principle of market economy investor was also extended to situations when the state is a creditor, i.e. the state claims pay back of arrears – market economy creditor principle.¹⁰ Pursuant to the principle of market economy creditor tax authorities should act the same as private law subjects which want to get back its liabilities taking into consideration the taxpayer's financial problems.¹¹ Moreover, tax authorities should try to actively recover at least a marginal amount of unpaid taxes in the insolvency

agreement.¹² The principle takes as a dogma that a private investor is looking for profits and it is his basic criterion for any decision.¹³

Following the principle of market economy, creditor tax authorities should act as private law creditors what would solve the problem. However, the principle is only a theoretical construction for EU aid law. In fact, if tax authorities followed the principle, they would not be private law creditors. They are always public law subjects. Additionally, there are two arguments against using the principle as a solution in the analysed case.

First, the aim of the principle is to create limits for the state's activity, not be a guide for such an activity. EU state aid law was created as a means of protection for market competition against the state's negative effect,¹⁴ public expenditures self-restraint.¹⁵ Therefore, the principle stipulates only limits which tax authorities should not exceed. However, tax authorities should know what to do, but the principle said only what not to do. Second, the principle is a part of the EU state aid law, not the Polish tax law, so it cannot be formally a legal basis for acts of Polish tax authorities. Therefore, as far as the Author is concerned, the market economy creditor principle should not be used as a guide for tax authorities in insolvency agreement proceedings. Of course, the principle should be used to determine if the participation of tax authorities in insolvency agreements complies with EU state aid law, but it is another issue.

3. Fiscal Principle

Tax obligations are not anonymous obligations. They belong to the State Treasury which is represented by tax authorities. Therefore, the State Treasury may have also its own subjective interest in restructuring proceedings. Identification between the State Treasury participation in insolvency agreement proceedings and larger and faster fulfilment of tax obligations express the principle of fiscalism. In fact, tax authorities must follow a fiscal principle, which ensures the proper functioning of the state.¹⁶ The importance of this principle for tax law is emphasised in the Polish legal doctrine. R. Mastalski pointed out that the main reason to introduce taxes was a fiscal aim. Other reasons have an extraordinary character.¹⁷ The principle is based on article 220 point 1 of the Polish Constitution. According to this article the Government is responsible for budgetary discipline.

Primarily, the insolvency agreement may provide a larger or faster fulfilment of tax obligations than it would be in liquidation or enforcement proceedings. This point of view is based on the principle that no creditor may be detrimental by the introduction of an insolvency agreement in comparison to liquidation proceedings. If the creditor may achieve more in liquidation proceedings, the insolvency agreement proceedings should not be commenced. On the other hand, if an insolvency agreement provides larger fulfilment of tax obligations than liquidation proceedings, tax authorities should support the insolvency agreement. Tax authorities should take fiscal interests of the State Treasury into consideration when they take part in insolvency agreement proceedings.

4. Economic and Social Aims

Following the only fiscal principle by tax authorities in insolvency agreement proceedings would be easy and convenient. Nevertheless, the explanatory memorandum to the Restructuring Law Act indicates that a direct increase of the State Treasury's incomes was not the aim of the Act. The aim was the "introduction of an effective instrument which allows to carry out restructuration of debtor's company and to prevent its liquidation".¹⁸ In further parts of the explanatory memorandum, non-fiscal aims of the insolvency agreement are also emphasised. It also includes notes about tax annulment and instalments scheme. The legislator states that the decrease of the State Treasury's direct incomes from not-paid tax obligations due to the insolvency agreement are compensating with interests by the increase of incomes from taxes paid by the debtor and its contractors and by the general benefits for economy due to higher efficiency of insolvency proceedings. The introduction of a new insolvency agreement in the Restructuring Law Act should help preserve workplaces in the debtor's company and its cooperators' companies. As a consequence, the State Treasury should decrease its expenditures related to unemployment benefits or social services.¹⁹

Moreover, taking part in the insolvency agreement proceedings, tax authorities should not be guided only by the fiscal principle because it is against the principle of social market economy stipulated in article 22 of the Polish Constitution. According to this principle, it is not allowed to follow only the fiscal principal. Tax authorities should take into consideration if support to the insolvency agreement, i.e. support for tax annulment or instalments scheme makes more positive or negative results not only for the state budget, but also for the society.²⁰ According to a prevailing part of the Polish legal doctrine, the state should not only play a role of regulator, coordinator and stabilizer of economy, but it should, by way of exception and in frames provided by acts of law, admit running business activities with the aim of protecting overriding public goods.²¹

These aims look ambitious and the legislator's actions for more competitive economy should be positively appraised. However, as far as the Author is concerned, tax authorities should not follow them taking part in the insolvency agreement proceedings, especially these aims should not be decisive if tax authorities support tax annulment and instalments scheme in the insolvency agreement. It is because these aims have a general and policy character. In case of a broad understanding of these aims, tax authorities would support any insolvency agreement, including tax annulment or instalments scheme. In the majority of cases, it is possible somehow to demonstrate that long term cost including indirect costs of the debtor's company liquidation (incomes from taxes paid by the debtor's cooperators and costs of social services) would be higher than the costs of the insolvency agreement implementation. Such demonstration is possible, because long term costs, as well as indirect costs are imprecise expressions which could be interpreted flexibly.

Insolvency agreements should not only provide higher incomes for the State Treasury in the long term, but it should help to reduce its expenditures on social services. However, it is worth emphasising that according to the principle of unity of budget expenditures on social services are realised separately from particular incomes. Therefore, profits from

increasing incomes or decreasing expenditures may also not be associated directly with each other. Moreover, the State Treasury's profits from increasing incomes and decreasing expenditures do not concern particular subjects, but all its cooperators or even the whole national economy.

The analysed aims also look partly incomprehensible with tax law. In legal doctrine several aims of tax law are presented. Fiscal aim is a main aim of tax regulation. Besides, taxes may realise economic and social aims, however these aims should be realised almost supplementary.²² Tax annulment in the frame of insolvency agreement may drive to increase the budget's income in the middle or long term, but in the short term, it always drives to decrease the budget's incomes. The active realisation of economic and social aims is not in compliance with the principle of tax neutrality towards economy. With regard to income tax, the principle of tax neutrality is more a proposal, especially from liberal economists,²³ but in case of VAT tax, it is a basic principle expressed in point 5 of the explanatory memorandum of the EU Directive No. 2006/112 on the common system of value added tax.²⁴

The participation of tax authorities in shaping economic and social aims of taxes also gives constitutional grounds for concern. According to the constitutional principle of parliament, exclusive right to enact taxes stipulated in article 227 of the Polish Constitution, the most important elements of tax should remain under the control of Parliament.²⁵ The Parliament should decide in the form of an act of parliament about the potential economic and social aims of tax. The realisation of these aims at the Parliament level also has technical justification. As it is emphasised in the legal doctrine, the introduction of non-fiscal aims in taxes requires the knowledge and skills of specialists to provide a holistic analysis of such an introduction.²⁶ There are many institutions better prepared for such an instruction than tax authorities, e.g. the Legislation Council working under the Prime Minister.

5. Tax Ordinance

Following non-fiscal aims by tax authorities in the insolvency agreement proceedings may be justified alternatively by Article 67a of the Polish Tax Ordinance. According to this article, tax authorities may annul a tax or introduce instalments scheme if it is substantiated by an important interest of a taxpayer or public interest. It is possible to show many similarities between recourse to economic and social aims and recourse to public interest and important taxpayer's interest, however, tax proceedings under Article 67a of the Polish Tax Ordinance and insolvency agreement proceedings are two different, separate proceedings.

In accordance with the judgement of the Voivodeship Administrative Court in Gliwice of 27 January 2010,²⁷ only regulations included in the Insolvency Law Act decide about sequence, rules and conditions of fulfilment of tax obligations including interest for late payment. Therefore, if tax authorities used Article 67a of the Polish Tax Ordinance as a guideline in the insolvency agreement proceedings, it should not have any influence on the course of the proceedings.

6. Internal Administrative Guides

In opposite to the above, the analysis problem if tax authorities should support particular insolvency agreement was solved in Germany many years ago when the new Insolvency Law Act took action in 1999. The Federal Minister of Finance published its internal administrative guide regarding the treatment of tax obligations in insolvency proceedings on 17 December 1998.²⁸ According to point 9.2. of the guide, tax authorities are obliged first of all to assure that tax obligations will not be disturbed in the insolvency agreement proceedings which is a support of the fiscal principal. Then tax authorities should follow regulation aims stipulated in § 163, 222 and 227 of the German Tax Ordinance which are at a rough estimate equivalent of Article 67a of the Polish Tax Ordinance.

The Federal Minister of Finance also put further hints for tax authorities involved in insolvency agreement proceedings. Before a tax authority decides to support an insolvency agreement, it should always test if the insolvency agreement is profitable for the tax authority. If a draft of insolvency agreement provided worse financial conditions for the tax authority than liquidation proceedings, the tax authority has to object the agreement and if it were passed, the tax authority has to file a complaint against the agreement in court.

The participation of tax authorities in pre-court insolvency agreement proceedings for consumers was regulated similarly. The Federal Minister of Finance published its internal administrative guide regarding the participation of tax authorities in the settlement of debts in pre-court proceedings on 10 December 1998,²⁹ which was replaced by a new internal administrative guide on 11 January 2002.³⁰

7. Conclusion

Taking part in the insolvency agreement proceedings, especially voting on the approval of an insolvency agreement or presenting own proposals regarding an insolvency agreement, the Polish tax authority should follow the fiscal principle. There are no legal grounds to allow tax authorities to follow other aims in the insolvency agreement proceedings or market economy creditor principle. It is especially not indicated to allow tax authorities in place of the parliament to share non-fiscal aims of taxes. Which time perspective is appropriate for implementing the State Treasury's fiscal interest remains open. In the Author's opinion, appropriate time perspective is term, in which the insolvency agreement will be carried out.

On the other hand, this analysis would be superfluous if there were similar internal administrative guides like in Germany. The guides solve the problem. Therefore, it is advisable to introduce similar guides in Poland. The guides emphasise that the fiscal principle is the most important for tax authorities in the insolvency agreement proceedings. Additionally, tax authorities should follow the regulation of the German Tax Ordinance. It is also advisable to use the auxiliary Article 67a of the Polish Tax Ordinance in case of the Polish tax authorities, but nowadays, there is no legal basis for it.

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- 1 The article was prepared in the frame of the project *Annulment of Tax Obligations – A Comparative Study*. The project is realised at the Faculty of Law and Administration, Silesia University in Katowice, Poland. I am the manager and sole performer of the project; its research supervisor is Dr. hab. Marek Zdebel. The project is financed by the National Science Centre (Poland) under Decision No. 2016/23/N/HS5/00157.
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