

## THE IMPACT OF THE NEW TAX EVASION REGULATIONS ON ESCROW AGREEMENTS

To counteract tax evasion, Polish authorities have recently introduced legislation<sup>1</sup> (the **Act**) and digital systems allowing tax authorities to analyze banking systems, search for potential fraud, and block suspicious bank accounts. Effective 30 April 2018, the new rules may have an adverse effect on escrow accounts, M&A closings, and real estate transactions in Poland. This Client Alert explains how the Act works and suggests workarounds to help avoid its potentially negative effects.

The Act introduces a computerized clearing house system (the **System**) under which banks and credit unions are obliged to report information regarding the accounts they maintain (e.g., openings, changes, and transactions) to the System on daily basis. Using algorithms that take into account risk criteria (e.g., economic, geographical, behavioral, and business connections), the System calculates a risk ratio for each entity and passes that information on to the Head of the National Revenue Administration (the **Head of the NRA**) who may block a bank account if the analysis indicates that there is a risk that the account holder has committed or is about to commit fiscal fraud.

A bank account can be blocked for a period of no longer than 72 hours from delivery of the Head of the NRA's decision to the bank. Although the decision is discretionary, it should be justified by past tax performance of the account holder, and, based on such performance, an assumption that the account holder may use the account for fraud related purposes, and that the blockage of the account is necessary to counteract fraud. The initial 72-hour blockage may be extended to three months should the Head of the NRA identify there is a risk that existing or future tax obligations of the account holder will not be performed. The blockage may be challenged by submitting an application for reconsideration to the Head of the NRA or by filing a complaint with the administrative court.

During the blockage period an affected bank account may not be subjected to a new security interest. The Act does not specify whether any existing security interest (e.g., a financial pledge) expires, is suspended or continues to apply during the blockage period.

The obligation to process bank account data in the System and the mechanism of bank account blockage concern only one type of bank account set out in the Banking Law, namely settlement accounts (*rachunki rozliczeniowe*).

<sup>1</sup> Ustawa z dnia 24 listopada 2017 r. o zmianie niektórych ustaw w celu przeciwdziałania wykorzystaniu sektora finansowego do wyłudzeń skarbowych.

The risk of a bank account being blocked under the Act may have an effect on the escrow accounts commonly used in financing, real estate and M&A transactions. Escrow accounts are typically opened with banks by buyers as settlement accounts used to centrally clear various (and often numerous) payments associated with a transaction. The sources and uses of these payment arrangements can be very complex and under such circumstances the tax authorities may consider the payments into or from an escrow account as having the potential of financial fraud.

In the worst-case scenario, money could be blocked in a buyer's account even though title to shares or real property had been transferred.

The risk of an escrow account being blocked may be minimized if the buyer is a newly created company without any outstanding tax liabilities. The seller can also mitigate risk by conducting a tax due diligence on the buyer (the escrow account holder), which should include:

- (a) obtaining tax clearance certificates in order to make sure the account holder has no tax arrears, and, most importantly,
- (b) checking the account holder's VAT status on a web site maintained by the Polish Ministry of Finance to determine if the account holder is likely to be subject to a VAT fraud-related inspection.

While these measures provide a certain degree of comfort, they do not entirely eliminate the risk of an account being blocked.

In lieu of escrow accounts, we believe that parties should consider using trust accounts (*rachunki powiernicze*) within the meaning of article 59 of the Banking Law to settle their transactions. Trust accounts are not subject to the reporting obligations of the new Act and cannot be blocked by the Head of the NRA. Furthermore, amounts deposited in trusts accounts may not be seized in enforcement and insolvency proceedings concerning the account holder. A disadvantage of using a trust account is that, under article 59 of the Banking Law, a trust account agreement is executed between a trustee and a bank and, consequently, a trustor (i.e., the seller or another designated payee) has no direct claim to the bank maintaining the trust account. We believe that there may be contractual measures between a trustor and the bank which may further enhance the trustor's position.

Finally, consideration should be given to building in contractual provisions within transaction documents that would deal with the possibility of an account blockage and prevent unintended consequences to the extent possible.

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