Tax&Legal Highlights

Poland

Changes in PIT, CIT and lump-sum income tax. Material changes in remuneration of individuals

22 November 2017 The President of the Republic of Poland has signed the Act amending the PIT Act, CIT Act and the Act on lump-sum tax on certain income generated by natural persons. Amendments to the PIT Act regard tax-deductible expenses and include copyrights, taxation of share-based or derivative-based incentive schemes, allowance amounts and the tax deduction amount.

Most of these changes (except of certain exemptions and tax/income deductions) shall apply to income generated from 2018 on.

Fifty-percent tax deductible expenses

With respect to creative individuals, the cap amount allowing tax deductible expenses, equal to fifty percent of the generated income, has been increased. Effective from January 2018, the annual tax deductible cap shall equal PLN 85,528, i.e. twice as much as under the current regulations.

The list of professions allowed to apply the increased tax deductible expenses has been reduced, though. Effective from 1 January 2018, the increased tax deductible expenses apply to income derived from:

1. architectural design of buildings, interior and landscape, urban planning, fiction and poetry, painting and sculpture, music, photography, audio-visual productions, computer software, choreography, violin-making, folk art and journalism;

2. R&D, science and education;

3. acting profession, direction, dancing, circus acrobatics, conducting, singing, playing musical instruments, costume design, stage design;

4. audio-visual productions of directors, stage designers, image and sound operators, editors, stuntpeople;

5. journalism.

The changes affect creative individuals deriving income from contracts of specific work, contracts on copyright transfer and similar ones, and a large group of employees producing pieces subject to the copyright law and receiving a portion of salary for transfer of the related copyrights to employers.

Following the amendments, individuals performing work not included in the statutory list shall lose their title to the increased tax deductible expenses. The problem includes a broad group of employees, such as engineers, designers, translators, analysts, legal and economic advisors, training and marketing specialists. Also, certain products of IT specialists (non-programmers) may fall out of the scope of increased tax-deductible expenses.

Regardless of the formal change in regulations, which comes into effect as of 1 January 2018, tax authorities have frequently questioned the payroll structures based on transferring to employers copyrights to pieces produced under employment contracts.

In light of the change in regulations and the more restrictive approach of tax authorities, we recommend thorough analysis of payroll structures based on transfer of copyrights and, if necessary, introducing changes to current procedures and contracts.

Taxation of share-based or derivative-based incentive schemes

The new regulations include material changes related to incentive schemes, determine certain issues currently decided upon by courts and introduce new taxation rules. On the other hand, gaps in these new regulations will certainly cause uncertainty among taxpayers and tax remitters with regard to their application.

Share-based schemes

Pursuant to the new regulations, with regard to such schemes, the following measures have been applied:

- a definition of an incentive scheme has been introduced, understood as a remuneration system established pursuant to a resolution of Annual General Meeting, addressed to employees or individuals working under civil law agreements (except for contracts concluded in the course of ordinary business activities) by a joint stock company (e.g. an employer or client) or by its parent joint stock company as determined by relevant accounting regulations;

- revenue from participation in incentive schemes is earned only upon sales of shares under these schemes (i.e. only then the 19% tax is charged) if buying shares in companies residing in states with which Poland has concluded double taxation treaties.

The above changes extend the preference, formerly reserved for share-based schemes related to EU or EEA residents, to include many other countries, such as the U.S. and Switzerland. On the other hand, the new regulations taken verbatim disallow the preferential treatment of incentive schemes developed by Polish companies. The above change is unintentional and may be amended by the Government even before the effective date of the new law. Further, in order to qualify for the preferential treatment, incentive schemes need to be established pursuant to a resolution of Annual General Meeting, as opposite to being defined in such a resolution, as sometimes interpreted under the current regulations.

The amendments to the regulations do not eliminate certain issues, such as cases when an incentive scheme cannot be established based on an AGM resolution, since there is no such body provided for in the jurisdiction under which the scheme is being established. Further, no provisions determine taxation principles upon sales of shares whose vesting has produced taxable revenue earned by participants in another state. The new regulations do not determine whether, for a scheme to be qualified for the preferential treatment, its participants must remain employed or bound by civil law contracts for its entire duration, or just when joining a scheme.

The amendments necessitate analysis of the existing schemes for compliance with the statutory definition and the resulting qualification for the preferential tax treatment. Therefore, we recommend focusing on the form of involvement of incentive scheme beneficiaries and on capital relationships among entities participating in each scheme. In particular, changes in income qualification (if any) or in preferential treatment may affect entity’s obligations in the capacity of PIT remitter and, eventually, of Social Insurance premium payer.

Derivative-based schemes

Pursuant to the new regulations, under such schemes, revenue from the exercise of derivatives is classified as income from the same source as the obtained benefit, e.g. an employment contract or a civil law agreement.

For the existing schemes the new regulations may result in reclassification of income, and, consequently, a change in its tax treatment and in related Social Insurance charges. Therefore, it is advisable to analyze such schemes on one by one basis.

Changes in PIT allowance limits

Under the new regulations, certain PIT allowances have been increased to the following amounts:

- cash and non-cash benefits obtained from Social Benefits Fund - PLN 1,000 per fiscal year (formerly PLN 380);
- cost of a nanny, nursery, infant club - PLN 1,000 per month for children under 18 (formerly PLN 400 or 200);
- organized vacation for children - PLN 2,000 per fiscal year (formerly PLN 760);
- aid: no limit for Social Benefits Fund; for other sources - PLN 6,000 per fiscal year (formerly PLN 2,280);
- contest awards and promotional sales - PLN 2,000 (one-off; formerly PLN 760).

The above changes may improve tax efficiency of payroll and employee benefits without the need to increase the spending. Employers may be increasingly interested in these issues in light of growing tax attractiveness of certain forms of employee support. Therefore, employers should review currently offered employee support forms and incentive schemes to take the most advantage of the current changes in regulations.

Tax deduction amount

Effective from 2018, the PIT deduction amount shall change.

The maximum limit shall be increased from PLN 1,188 to PLN 1,440; consequently, the annual income of PLN 8,000 (formerly PLN 6,600) shall be progressive tax-exempted.

The income threshold with the ‘traditional’ tax deductible amount of PLN 556.02 shall be increased as well; at present being PLN 11,000, from 2018 on it will grow to PLN 13,000.

Individuals generating income in excess of PLN 13,000 will not be affected by the amended regulations. Their tax deduction amount will remain flat (PLN 556.02) up to the annual income up to PLN 85,528. For income ranging from PLN 85,528 to PLN 127,000 it will be reduced to zero. No deduction is applicable to annual income in excess of PLN 127,000.

Other changes in PIT and lump-sum income tax

Other amendments included in the new regulations:

- revenue derived from controlled foreign corporations (CFC); the minimum CFC classification criteria are reduced and related to foreign taxes actually paid as opposite to nominal tax rates; thresholds determining reporting obligations regarding CFC income are eliminated;
- a minimum commercial property tax is introduced in order to enhance the relationship between business operations and their actual location;
- the scope of property dealer entities whose revenue is taxable in Poland has been extended;

- depreciation/amortization of inherited or donated assets is not allowed; one-off depreciation/amortization limit has increased from PLN 3,500 to PLN 10,000 and the right to amortize intangible assets to those acquired from other entities has been limited;

- changes regarding debt disposal and spin-off;

- changes in specific allowances and deductions, such as training for medicine doctors, rehab allowance, blood collection related donations;

- with regard to income from leases, the former lump sum rate of 8.5% shall be maintained for revenue up to PLN 100,000, while 12% rate will be charged over that limit.

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Amendments to CIT Act: key changes affecting capital group entities. Act signed by the President of Poland

Entities operating in capital groups should pay special attention to the Act amending the PIT Act, CIT Act and the Act on lump-sum tax on certain income generated by natural persons (henceforth: the "Act") signed by the President of the Republic of Poland on 22 November 2017. The Act implements (partly) Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

It commences another stage of recovering State Budget proceeds from taxes in Poland, in particular those derived from CIT, through counteracting tax optimization and tightening the tax system to ensure that taxes paid by large international businesses are related to the actual location of their operations.

In this bulletin, we focus on issues of key importance for related parties.

Key changes
Amendments of crucial importance for entities operating in capital groups:

1) Limited deductibility of costs of intangible assets and performances: the Act tightens classification of performances purchased from related parties as tax-deductible expenses with regard to the following services:

1. advisory, market research, advertisement, management and control, data processing, insurance, guarantees and sureties, similar performances;

2. fees and charges for the use or title to use intangible assets;

3. costs of transferring the risk of default related to loans (other than granted by banks and credit unions).

The above expenses shall be classified as tax deductible only up to a 5% limit of an EBITDA-like ratio. The limit shall be applied to these costs if they exceed PLN 3,000,000 per fiscal year. Costs not deducted during a fiscal year shall remain deductible for five subsequent years, subject to the above limit. The limit shall not apply to the above expenses if incurred in a tax capital group.

The deductibility limit does not apply to the period covered by Advance Pricing Arrangements (APA), as well as in the financial year in which the APA have been issued and in the preceding one, to the extent the APA determine the correctness of calculating consideration for these performances.

2) Limited deductibility of debt financing expenses: The Act limits the deductibility of debt financing expenses (including arrangements with unrelated parties) introducing a 30% threshold on the EBITDA-like ratio. The limitation applies to all types of debt financing (including interest, commissions, fees, bonuses, interest portion of lease installments).

The above limit does not apply to the so-called excess debt financing expenses up to PLN 3,000,000 per fiscal year. Debt financing expenses excepted in a given fiscal year can be classified as tax deductible in the subsequent fiscal years (under the limit).

The deductibility limit does not apply to finance sector enterprises. The Act provides a closed list of entities classified as finance sector enterprises (among others, domestic banks and credit institutions as determined by the banking law, credit unions, open-ended investment funds and alternative investment funds incorporated pursuant to the Act on Investment Funds).

Further, pursuant to the Act, if the debt financing costs exceed the financing amount a taxpayer could obtain in the form of such financing by unrelated parties (the so-called market creditworthiness), tax authorities may assess a higher income or a lower loss than declared by a taxpayer.

3) Debt push-down: Under the Act, costs of debt financing obtained to purchase company's shares to the extent reducing its tax base that includes revenue from its continuing operations are not tax-deductible. Consequently, potential operating income of an acquiree cannot be reduced by expenses (interest) related to the purchase of its shares.

4) Amortization of intangible assets: The Act limits amortization charges on intangible assets that can be classified as tax-deductible expenses to the amount of revenue from the sale of these intangible assets previously recognized by a taxpayer. The limit applies to cases when an entity that initially owns intangible assets sells and re-acquires these assets. Similarly, if an owner has sold an intangible asset and continues to use it pursuant to concluded contracts (e.g. licenses), the surplus of any fees and charges related to such use over the revenue from prior sales of the title or intangible asset shall not be classified as tax-deductible expenses.

5) Business combinations and spin-off: The Act assumes amendments to regulations regarding business combination and spin-off, for example referring the taxable revenue and tax-deductible expenses to the issue (market) value of shares as opposite to their face value. Principles of allocating tax-deductible expenses related to shares following a spin-off will change as well (the proportion shall be based on the value of assets as opposite to the face value of the divided business).

6) Contributing an enterprise or its organized part: The Act extends the so-called small tax circumvention clause regarding contribution. The amendment will enable tax authorities to undermine tax neutrality of contribution of an enterprise if it lacks economic substance, regardless of anti-tax avoidance measures included in the Tax Ordinance.

7) Controlled Foreign Companies (CFC): The Act amends regulations regarding CFC. An effective tax rate shall be introduced as a CFC evaluation criterion (as opposite to the current nominal rate); interest in the capital / voting rights in CFC shall be increased (from the current 25% to 50%) and the share of passive income in total income of CFC shall be reduced (from the current 50% to 33%). Further, the list of passive income types has been extended and includes: (1) income from insurance, banking and other finance sector operations; (2) income from related party transactions if no or insignificant added value is generated on these transactions. These changes may result in an extended list of entities classified as CFC.

8) Tax capital groups (TCG): The Acts simplifies the procedure of establishing tax capital groups: (1) the average share capital ratio is reduced; (2) the minimum parent's share is reduced; (3) the minimum group profitability is reduced. As a result, establishing of a TCG shall be easier. At the same time, certain limitations regarding TCG are introduced: (1) in the case of breaching the terms of TCG operation, it will be dissolved and its member companies obliged to settle their income tax for prior years; (2) transfer pricing regulations (except for the documentation obligation) will apply to transactions concluded within TCG. In practice, TCG operation may be charged with additional risk.

9) Classifying State Treasury entities as unrelated parties: The Act disallows application of transfer pricing regulations and the documentation obligation in relation to entities classified as "related parties" only based on the fact that their shares are held by State Treasury or local authorities.

10) No obligation to document transactions included in Advance Pricing Arrangements. The obligation to prepare transfer pricing documentation for transactions included in APA is eliminated for the period covered by these APA.

The above changes come into effect in January 2018.

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Tax Ordinance reform: new bodies

The Ministry of Development and Finance has presented draft Tax Ordinance that provides for bodies formerly absent from the Polish tax law. These bodies are to implement key assumptions underlying the work on the draft, adopted by the General Tax Law Codification Committee, which is the restoring of confidence in relations between tax authorities and taxpayers.

Below please find a brief description of draft provisions related to the new bodies. Bearing in mind the legislation path preceding the effective date of the act, though, these provisions may be altered or eliminated.

Simplified procedure
Authors of the draft have pointed out that certain types of tax-related cases are simple in terms of nature and actual status; therefore, there is no need to carry out in-depth legal analyses or complex evidentiary proceedings. In light of the above, if a ruling may be issued based on evidence provided by a party, including a motion to institute proceedings, and on facts known to the public or ex officio to the competent body, or determinable based on documents or records held by the body; and if the projected assessment amount does not exceed PLN 5,000, a simplified procedure will be allowed upon taxpayer's consent (or motion).

Such proceedings, similarly to other simplified procedures, will be less formal. Among others, the evidentiary proceedings will be limited and a decision may be issued without any factual or legal justification.

Cooperation agreement
The new Tax Ordinance shall provide for a cooperation agreement to be concluded by and between an taxpayer of economic significance and a competent tax authority, under which:

- the tax authority undertakes to adjust the form and frequency of tax and customs audits of the correctness of the taxpayer's tax settlement and to provide it with consulting support without undue delay, expressing its opinions on material tax issues indicated by the taxpayer;

- the taxpayer undertakes (among others) to maintain relevant internal control procedures regarding the correctness of tax settlement as agreed with the tax authority and to disclose any important information regarding its business to the tax authority without undue delay.

The agreement, to be concluded upon taxpayer's motion, is to ensure taxpayers' compliance with tax regulations based on mutual trust, transparency and understanding of taxpayer's business specifics by competent tax authorities.

Pursuant to the draft justification, the Tax Ordinance will include only framework regulations regarding the cooperative compliance. Based on the idea, the Tax Ordinance (along with secondary legislation thereto) shall include only key provisions, with the final form depending on practices developed by tax administration.

Consulting tax impact of transactions
Under the procedure, an applicant and tax authorities can agree tax impact of acts performed by the applicant to prevent a dispute (if any).

A tax impact decision may refer in particular to transactions resulting in transfer of ownership or usufruct title to assets, granting loans or credit facilities, restructuring or joint ventures.

The consulting is limited to tax impact of transactions concluded prior to the application date.

Tax agreement including mutual decisions and concessions, concluded by and between a taxpayer and tax authority under tax proceedings
According to the current version of the draft, tax agreements concluded in the course of tax proceedings between tax authorities and taxpayers are voluntary and can be entered into both upon taxpayer's motion and consent.

These agreements may include mutual concessions and legally binding decisions regarding the factual status of a given case, nature or value of transactions, acts or events, tax allowance etc.

They may not include, though, decisions or concessions directly regarding the assessed amounts.

Mediation
Pursuant to the current draft, mediation can be carried out if a tax agreement may be concluded, both upon taxpayer's motion and consent.

One or more hearings will be held under mediation proceedings, participated by a competent tax authority and a taxpayer, in a mutually convenient time and place. Mediators can assist the parties to develop the contents of a tax agreement, if they manage to conclude any.

The mediation must be held within two months of the date of a decision referring a given case to mediation. It will be held by mediators included in the record maintained by the Head of National Tax Administration, who will be obliged to remain unbiased and neutral in the course of the proceedings.

Pursuant to the draft, documents and information previously not included in the case file, and delivered to mediators by tax authorities or taxpayers, shall not be included in the file. Similarly, neither the tax authorities nor the taxpayer can refer to conciliation, concession offers or other statements made in the course of mediation.

According to the draft, the new Tax Ordinance shall come into effect on 1 January 2019.

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Sunday trade ban as of 1 March 2018

The Parliament has passed the act restricting trade on Sundays, holidays and on certain other days. The ban shall come into effect on 1 March 2018

The ban shall apply both to retail and wholesale trade. In the first year, it will apply (on average) to two Sundays a month (the first and third one). In 2019, the ban will be extended to three Sundays a month, **and in 2020,** in principle, no trade will be allowed on Sundays.

The ban shall not apply to Internet shops and platforms since a notification of the European Commission is required in this respect.

Despite the ban, small sole-proprietorship shops can be open on Sundays provided their owners will do the selling; further, the ban does not include flower and candle shops at cemeteries; fuel stations; bakeries; ice-cream shops; pharmacies and drug wholesalers; shops located at bus and railway stations, airports, seaports; selling souvenirs and devotional items; and shops located at hotels, hospitals, sanatoria, cultural, sports, educational, tourist and leisure facilities (the list of exceptions includes 23 items).

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What can render loan-related promissory notes invalid?

Providing information that allows identification of a collateralized agreement on a promissory note is a common practice. For example, it may read: Promissory Note to Loan Agreement no. 123/2017. In light of recent rulings, can the practice produce adverse legal effects for its users and result in a promissory note being considered invalid?

Promissory notes are a popular form of collateral for loan agreements, allowing banks to easily collect amounts owed by debtors in default.

An unconditional promise to pay a certain amount of money **is a necessary component of a promissory note**. Since the note is by its nature unconditional, the payment cannot depend on any uncertain future events. A note that makes the payment depend on a condition or mutual performance is, therefore, invalid.

Providing information that allows identification of a collateralized agreement on a promissory note is a common practice. For example, it may read: **Promissory Note to Loan Agreement no. 123/2017.**

In light of recent rulings, the practice can produce adverse legal effects for its users, resulting even in a promissory note being considered invalid. Such information has been recently analyzed by the Warsaw Appellate Court, which has decided that since it referred to an agreement concluded by the parties, i.e. to another document, **it made the promissory note conditional**, thus rendering it invalid. Based on the opinion, the court canceled an appropriate payment order issued by a lower instance court.

Had the opinion been maintained by a higher instance, it would have had an enormous effect on common business practices, since, as indicated above, nearly all promissory notes bear such information.

A cassation appeal (prepared by a lawyer cooperating with Deloitte Legal) was made against the decision of the Appellate Court. A decision issued by the Supreme Court has been completely different from that of the Appellate Court. With regard to the above issue, the Supreme Court has indicated that the **reference to the loan agreement made in the title of the promissory note had no effect on the note itself**, since it did not affect the correct promise of payment included in the document, and thus did not render it invalid. According to the Supreme Court, such information, whose sole purpose is to indicate the performance received or receivable by the maker from the remitter, is irrelevant from the viewpoint of the promissory note law and does not affect the unconditionality of payment of the promised amount.

Thus, the Supreme Court decided that **validity of a promissory note is unaffected by additional information put on its face**, if the information is a pure description of its economic background and does not undermine the obligation to pay.

Although the opinion expressed by the Appellate Court has been denied by the Supreme Court, we recommend prudence when putting any additional information on the face of promissory notes. Since doubts regarding the validity of the note have been raised, it is better to provide such additional information in a separate document.

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