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REal Knowledge Newsletter

Changes triggered by Fit for 55 – why is it so important to reduce emissions from buildings?

Buildings are responsible for nearly 40 percent of global CO_2 emissions. It is estimated that the total floor area of buildings in use will increase by 75 percent in the period 2020–2050. As in other sectors, there is a need to raise the reduction targets from well below 2°C to 1.5°C.

In Poland and all throughout Central Europe, the energy performance of buildings poses obstacles. A significant portion of buildings in Poland (75 percent) is not energy efficient, as is the case in the entire region. Furthermore, over 85 percent of buildings in our country were erected before 2001 which creates additional challenges in terms of their modernization and adaptation to new ecological standards.

The transformation of public and historic buildings will be particularly difficult. There is also the risk of stranded assets, which can lead to a decrease in property values. At the same time, the demand for green buildings is visibly growing.

In the near future, many changes are expected regarding new standards for the real estate sector. In addition to the Fit for 55 package, new SBTI Buildings guidelines will be introduced in the second quarter of 2024 and they will require setting ambitious emission reduction targets for both the use stage and the embodied emissions. The key Taxonomy-based requirements also impose strict standards on new buildings and renovation processes. Specifically, taxonomy-compliant buildings need to be more energy-efficient and use circular materials. In the case of renovations, primary energy demand should be reduced by at least 30 percent.

Implementing the new Fit for 55 requirements will impact building managers both directly and indirectly. Given their significant share in the overall CO_2 emissions, reduction of emissions from buildings will be a key objective. Hence, the Fit for 55 package introduces a number of regulations aimed at increasing energy efficiency of buildings and reducing emissions.

In line with the new regime, fossil fuels will need to be eliminated within the next five years, which may in turn increase building owners' capital needs, especially between 2027 and 2030. Landlords will also be affected by the rising costs – in consequence, detailed analyses of the impact on landrords' budgets and investments in building assets may be necessary.

What changes are in store for the real estate sector following the introduction of the Fit for 55 regulations?

The new laws applicable to both new and existing buildings are as follows:
A new Emissions Trading System (ETS2) covering buildings, road transport and small industry (revision of the ETS Directive) – already adapted and coming into force as from 2027; Energy Performance of Buildings Directive (EPBD); Energy Efficiency Directive (EED); Renewable Energy Directive (RED); and Energy Taxation Directive (ETD).

New Emissions Trading System

According to the latest amendments to the ETS Directive, a new Emissions Trading System (ETS2) will apply to buildings, road transport and small industry. The new system, expected to enter into force in 2027, will address the CO2 emissions from fuel combustion in sectors not covered by the existing EU ETS.

The key element of EST2 is the introduction of fossil fuel price increases without the need for building owners to purchase ETS allowances. The system will also take into account the Market Stability Reserve (MSR) designed to mitigate the risk of price surges. If prices are doubled, the plan is to release an additional 50 million allowances, and if they rise threefold – 150 million allowances. Moreover, if the price of allowances exceeds EUR 45 (adjusted for inflation), additional 20 million of allowances may be released. There is no fixed price cap which opens up the possibility to exceed EUR 45, especially if there is sufficient demand. The proposed system assumes an increase of the costs of using fossil fuels in the construction sector, especially in the context of, for example, gas heating. ETS2 is expected to become operational in 2027, unless the average gas price in January–June 2026 exceeds €106/MWh, in which case the system launch will be postponed to 2028. In practice, such a scenario would entail a significant increase in costs, similar to the one observed in 2022, even though gas prices in Europe have now stabilized below €30/MWh.

Energy Performance of Buildings Directive

The proposed wording of the Energy Performance of Buildings Directive (EPBD), which is currently under trilogue negotiations, aims to spark an ecological revolution in the building sector.
The new directive proposes a number of new standards that will help with the energy assessment of buildings and will enable their owners to control compliance with the new regulations.
One of new measures is the zero-emission buildings standard (ZEB) that precisely defines the maximum levels of primary energy consumption depending on the climate zone. Its introduction is aimed at minimizing carbon dioxide emissions and increasing the use of renewable sources. EPBD also includes the Minimum Energy Performance Standards (MEPS) which provide for a new system of classifying buildings at EU level, to be implemented by 2025. Zero-emission buildings will be assigned the highest class (A) which will serve as a label in national energy certificates. The Directive also introduces Energy Performance Certificates (EPCs) – it will be possible to sell or lease only those buildings that hold such certificates at the moment of sale/leasing. In addition, inclusion of the information about the building's energy performance class in all sale and lease advertisements will be mandatory. EPBD also regulates a gradual phase-out of fossil fuels used in heating and cooling systems (to be completed by 2035, with a possible extension of the deadline until 2040 in exceptional cases); introduction of solar energy in buildings (promoted through the mandatory installation of solar panels on the roofs of new public and commercial buildings, as well as existing buildings during major renovations); and automation of building control systems (lower thresholds for the installation of automation systems in non-residential buildings beginning from 2030, and mandatory installation in new residential buildings as from 2025). The directive provides for the expansion of charging infrastructure for electric cars and bicycles in buildings, covering new buildings and buildings subject to deep renovations.

Renewable Energy Directive

The new Renewable Energy Directive (RED) sets the target of at least 49 percent renewable energy share in buildings by 2030, with a gradual increase of the proportion of renewable energy used for heating and cooling. In addition, it provides for a legally binding 0.8 percent annual increase of the renewable energy share at national level until 2026, followed

by 1.1 percent increase from 2026 to 2030. Furthermore, each Member State will have its own additional growth rates set.

Energy Efficiency Directive

The proposed Energy Efficiency Directive (EED), scheduled to come into effect in 2024, introduces an obligation to retrofit at least 3 percent of the total floor area of public buildings per year. These renovations must comply with the nearly zero-energy or zero-emission standards. The 3 percent ratio is calculated based on the total usable area of buildings that meet two criteria: their total usable area exceeds 250 m² and they do not fulfil the zero-energy standards as at 1 January 2024.

Energy Taxation Directive

The Energy Taxation Directive (ETD) is currently being negotiated. It concerns adjustment of fuel taxation depending on the level of emissions, as well as the change in EU tax rates on fuel by 2033.

The new directives set ambitious energy efficiency and emission reduction targets for building owners and public institutions. These regulations are often detailed and complex which makes their interpretation rather difficult. Even though many of them are still being negotiated at the legislative level, it may prove helpful to get to know the proposed requirements early and adapt the sustainable development goals to the proposed changes in advance. It is only a matter of time before those regulations are implemented into our domestic law, as the European Union has clearly defined the goals for 2030 and will try to make a clear difference in the emission performance of buildings by that date.

Adhering to these requirements can be challenging, but at the same time, it may give us all an opportunity to create a more sustainable environment and by implication – a more efficient construction sector. The journey towards sustainable development has already started, and keeping up with the latest requirements imposed by EU regulations will help us satisfy them and properly prepare for the upcoming changes.

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Deferred tax in the financial statements of a real estate company

With the financial year coming to an end, businesses might want to look into the deferred tax, which is an important topic for real estate entities. There are issues specific to that industry and business events can be accounted for differently depending on whether they are recognised for accounting or tax purposes.

In Poland, the rules of calculating deferred tax are governed in the Accounting Act and Polish Accounting Standard 2 "Income Tax", in the international law — in International Accounting Standard 12 "Income Tax". Income tax that is charged to the accounting profit comprises:

– current tax – arising from annual corporate income tax calculations, payable to the tax office (fiscal);
– deferred income tax.

Current income and deferred taxes have become distinct accounting categories.

Current income tax is calculated for a given period in accordance with the tax laws in place. It is a tax liability for a given period payable on the taxable income stated in the tax return.

Deferred tax is the potential income tax arising from current period events that will be paid or deducted in future. Deferred tax is used to recognise the tax effects of a transaction and the transaction itself in the same period. Because of differences in tax laws and accounting rules, often a transaction is recognised in one period, and tax is chargeable in another.

Regulations require that deferred tax be calculated using the co-called balance-sheet treatment in which the carrying amount of assets and liabilities is compared with their tax base and temporary differences are calculated. There are revenue and expenses which – when recognised in the balance sheet – are not taxable, but become so once certain conditions have been met. As far as the balance sheet is concerned, they mainly arise from the obligation to follow overarching accounting principles: accrual accounting, the matching and prudence principles, which are not mentioned in tax regulations.

As at the end of the reporting period, the carrying amount of assets and liabilities is calculated in accordance with the accounting principles

The carrying amount of an asset reflects the benefits that an entity expects from the asset. The tax base of assets represents the amount which reduces the income tax base (tax basis), if such assets bring, directly or indirectly, economic benefits to an entity. This is how the tax base of assets the benefits of which are taxable is determined. If such benefits do not reduce the income tax basis, then the tax base of the asset is equal to its carrying amount. Such a situation has no consequences for the deferred income tax.

The carrying amount of a liability represents the expected reduction in future benefits. The tax base of a liability is its carrying amount less any amounts that in future will reduce the income tax basis (after deductions). If, as a result

of past events, future settlement of the entity's liabilities will increase the tax basis, the tax base of the liability will be the carrying amount increased by such amounts.

Under IAS 12, deferred tax assets/liabilities are recognised for temporary differences. Temporary differences are differences between the carrying amount of an asset or liability and its tax base. Where there are no differences in the tax and accounting treatment of a given transaction, there are no temporary differences and there is no basis for recognising deferred tax assets/ liabilities. There are the following types of temporary differences:

– taxable – that increase the taxable income;
– deductible – that decrease the taxable income.

Taxable temporary differences are the differences between the carrying amount of an asset or liability and its tax base that will increase the tax basis in the future. This will happen when the carrying amount of an asset is realised or that of a liability is settled, i.e. when the carrying amount of assets is higher or when the carrying amount of liabilities is lower than their tax base.

Deductible temporary differences are also differences between the carrying amount of an asset or liability and its tax base, but they will decrease the tax basis in the future. This will happen when the carrying amount of an asset is realised or that of a liability is settled, i.e. when the carrying amount of assets is lower or when the carrying amount of liabilities is higher than their tax base.

When there are taxable temporary differences, an entity recognises a deferred tax liability. When there are deductible temporary differences, an entity recognises a deferred tax asset. A deferred tax asset is also recognised for the carryforward of unused tax losses and unused tax credits.
Under the Accounting Act, the deferred tax assets and liability are calculated by reference to the income tax rates effective in the year when the tax liability arises (i.e. in future). Under IAS 12, deferred tax assets and liabilities should be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability settled, based on the tax rates (and laws) enacted or substantively enacted by the balance sheet date.

Under the current legal framework, the basic corporate income tax rate is 19 percent; small taxpayers can benefit from a lower, nine-percent rate and those using the lower rate should analyse future tax liabilities and the rate to be applied in future years when the temporary tax differences are realised. Moreover, deferred tax assets and liability are not discounted.
Notably, under the Accounting Act, a company can apply a simplification – opt not to calculate deferred tax, if its figures for the prior financial year do not exceed certain levels in two out of the three: carrying amount, revenue from sales of goods/products and financial revenue, and average annual number of staff.

Entities that will decide not to apply the exemption from recognising a deferred tax asset/liability may wish to analyse the following examples which often result in deferred tax:

Balance-sheet and tax valuation of investment property

Measuring assets at cost both for accounting and tax purposes can lead to temporary differences. Most often, unrealised foreign exchange differences on liabilities are recognised as at the date a fixed asset is put into use, and the differences cannot be considered to constitute the tax base of the real property. Under the tax law, foreign exchange differences will be considered to be tax differences when realised, i.e. when the liability is paid. Therefore, depending on whether capitalised unrealised foreign exchange differences are gains or losses, the tax base will be higher or lower than the initial amount of the investment.

Another situation that results in a difference between the carrying amount and the tax base of a real property are various depreciation rates used for balance sheet and tax purposes. Real property in the balance sheet includes fixed assets classified to various groups. Real property, depending on its classification, is depreciated: for balance sheet purposes — over its estimated useful life, and for tax purposes — using the rates set out in appendix 1 to the tax law. Useful lives may be shorter or longer than or the same as the periods used for tax purposes. Following the restrictions on tax depreciation of buildings and with the land (in general) not being depreciable, a temporary difference will arise when there are various rates applied for other fixed assets that make up a real property, such as structures, fixtures and fittings.

As at the end of the reporting period entities test their assets, including real property, for impairment. If as at the end of the reporting period the book value of real property is higher than the expected economic benefits, this means that the real property has lost all or some of its potential to provide economic benefits to the entity. An impairment loss is then recognised to reduce the asset's carrying amount down to its real value. The cost of the impairment loss is not tax deductible so the carrying amount and the tax base will differ.

Many property businesses have an accounting policy in place by which they classify their property to investment property measured at fair value.
Such property is not classified as fixed asset and is not depreciated for accounting purposes. Until 2022 investments in a building were considered to be fixed assets and depreciated using the rates set out in the appendix to the Corporate Income Tax Act (for buildings at 2.5 percent). From January 2022, it became unclear whether the restriction on depreciation of Group 1 fixed assets also applies to the companies that classify real estate property to investment. Tax offices in their tax rulings pointed that tax depreciation is not possible when the real estate property is measured at fair value. The beginning of the year 2023 saw rulings of the Regional Administrative Courts favourable to the taxpayers, in which the courts found the new regulation that capped the tax depreciation expense to lack precision and ruled that tax depreciation of investment property should not be disallowed. The case has not been finally determined. Many entities remain cautious and do not classify depreciation charges on a building to tax-deductible expenses.

This way the tax base of a real property reflects its initial amount less any accumulated depreciation of fixed assets other than buildings, at the rates set out in appendix 1 to the Corporate Income Tax Act.
The carrying amount is the fair value usually determined by a property valuer.

This way as at the end of the reporting period, measuring an asset at fair value results in a temporary difference that will lead to deferred tax assets or liability.

Rent-free periods and fit-outs included in rental agreements

Rent-free periods or any types of fit-outs must be recognised on a straight-line basis over the term of the agreement and as such constitute prepaid expenses.
An important issue to consider is different accounting for rent-free periods under the tax and accounting laws.

Property developer's capitalisation of costs

If a property developer capitalises costs as inventory, a cost capitalised in the balance sheet becomes a tax-deductible expense when it is incurred.

Tax losses

Property development companies incur tax losses when the project is being carried out, because they generate profits only when the project has been completed and individual apartments/building are sold. Tax losses can be set off against future profits, so a deferred tax asset must be recognised on a tax loss. However, entities must exercise caution in recognising

deferred tax assets, because it must be highly probable that the asset will be realised, namely profit must be generated in future so that any losses can be deducted from the taxable profit.

The examples show that calculating deferred tax is a critical step in calculating a company's bottom line. We said that in the beginning: deferred income tax is highly informative and has a decisive role in evaluating an entity's financial and economic situation.

If you need help with identifying economic events that could give rise to deferred tax, our multidisciplinary team is here to help. We have extensive, practical experience in calculating deferred tax both for companies following the Accounting Act and the International Accounting Standards.

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16. Edition of

REal Knowledge Newsletter

Deadlines for CIT returns

A number of mandatory CIT deadlines expire at the end of March, so it might be beneficial to prepare all required documents in advance.

CIT-8 declarations – will the filing deadline be extended this year too?

CIT-8 return should be filed by the end of the third month following the tax-year end. Taxpayers whose tax year ends together with the calendar year are to submit CIT returns on the amount of income earned or loss incurred (CIT-8) by 1 April 2024, as 31 March falls on a Sunday this year. Although in 2023 this deadline was extended by 3 months, this year an analogous extension does not seem likely. Still, it may be useful to keep an eye for updates published on the website of the Ministry of Finance, because in recent years the announcement on extending the time limit for CIT-8 filing was made only in March (in 2023, Regulation on the extension of deadlines for the fulfilment of certain corporate income tax obligations was published in the Official Journal on 21 March 2023). At the moment however, there is no information on the Ministry's website about potential postponing of the deadline, so it is recommended not to leave CIT-8 filing till the last minute.

Tax on shifted income – reporting obligations to confirm that no tax is chargeable

The tax on shifted income is settled once a year and paid together with CIT-8, i.e. by 1 April 2024. It is applicable to taxpayers that fulfil the conditions listed in the CIT Act. Please note that as of 1 January 2023, the burden of proof that a given expense does not meet the definition of shifted income rests with the taxpayer making payments to foreign related entities.

Hence, if – following analysis of the regulations – the Polish taxpayer concludes that it is not obliged to pay any tax on shifted income because of not meeting the statutory criteria, they should take reasonable efforts to properly document that fact so as to be able to produce the appropriate evidence to tax authorities in Poland when necessary.

In particular, this concerns the conditions linked with the foreign recipient of payments (e.g. the share of passive payments from Polish related companies constituting at least 50 percent of total revenues, transfer of at least 10 percent of such payments to another entity, and taxation at a rate equal to or higher than 14.25 percent).

The above can be documented in the form of statements obtained from foreign entities and other relevant documents (such as financial statements, tax returns, etc.) based on which the revenue threshold and the applicable tax rate can be verified.

Next, bearing in mind that the obligation to pay tax on shifted income does not apply when passive payments are made to a related entity which pays tax

on all its income in a member state of the European Union or the European Economic Area and which conducts substantive economic activity in such a member state, the Polish taxpayer should hold documents confirming verification of the so-called business substance of the foreign payment recipient in the EU or EEA. If the passive payments are e.g. interest payments and the taxpayer applied for a ruling on the application of preferential WHT treatment in that respect, the documentation collected in the course of the ruling procedure as well as the ruling itself may serve as evidence of conducting substantive economic activity.

Reporting the shareholding structures of real estate companies – if there are changes, it is crucial to obtain relevant information early

Real estate companies are obliged to report ownership structures in 2024. They should submit the following forms by the end of the third month following the tax-year end:

- CIT-N1 – information about entities holding rights to the real estate company (to be submitted by the real estate company);
- CIT-N2 – information about the rights to the real estate company and about intermediary entities (to be submitted by taxpayers).

An entity holding shares in a real estate company must report all changes in its structure as compared to previous reporting. The shareholding structures should be verified as at the last day of the real estate company's tax year. Hence, if the real estate company has foreign shareholders, it is crucial to consult and obtain all required information in advance, especially in the event of changes in the shareholding structure or changes in the identification data of the entities to be reported on. Please note that in order to effectively submit CIT-N2, a foreign taxpayer required to file the form must hold a Polish tax identification number (NIP). Obtaining a Polish NIP for a foreign taxpayer is often a lengthy process (the appropriate documents and their sworn translations into Polish must be submitted to authorities in due course), so timely completion of all formalities is crucial.

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16. Edition of
REal Knowledge Newsletter

Minimum corporate income tax

Beginning from 1 January 2024, the exemption (which was introduced via a regulation in 2022) from the new minimum corporate income tax, as governed by the CIT Act, is no longer valid. The said minimum CIT amounts to 10 percent of the tax base. It is applicable to corporate income taxpayers that incurred a loss from operating activities and those whose break-even point, i.e. share of income in operating revenues, was not more than 2 percent during a tax year. It should be pointed out that the minimum CIT is yet another levy on taxpayers not reporting income and those reporting it in a minimal amount (real-estate sector taxpayers have been paying the tax on revenues from buildings, which actually is a tax on property, for several years now).

The provisions introducing the minimum CIT pose a number of interpretative problems, the first of which is determining whether an entity is subject to that levy or not. Certain doubts arise concerning the method of calculating the criterion of losses and the 2 percent break-even point – the imposed method leaves out many items, which necessitates preparing separate calculations only for the purpose of that tax. Moreover, in order to determine whether the obligation to pay the minimum CIT has arisen, after calculating the profitability threshold for a given year, the levels of profitability in three previous tax years must be verified as well.

Correct calculation of the tax base can also prove difficult. As a rule, the tax base consists of: (i) 1.5 percent of the value of income other than capital income, (ii) the amount of debt financing costs incurred for related entities and exceeding the 30 percent tax EBITDA limit, and (iii) costs related to the acquisition of among others, advisory services or fees for the use of copyrights or related property rights incurred for the benefit of related entities to the extent that they exceed the PLN 3m limit + 5 percent of tax EBITDA.
The correct calculation of the above-mentioned values may generate additional administrative burden and will certainly be time-consuming. In view of this complication the legislator has provided for a simplified solution, but taxpayers who opt for it must determine the tax base at the amount of 3 percent of the value of generated revenues.

The new minimum CIT will be settled for the first time in 2025 (as part of the settlements pertaining to 2024). Taxpayers need to bear in mind that it is parallel to the "ordinary" CIT, so the two levies may potentially overlap. However, if the current income tax turns out to be higher than the calculated minimum tax, then as per the CIT regulations, the company will not be obliged to pay the minimum tax, and if it does, it will be able to deduct it from CIT over the following three years. Even though the minimum CIT obligation will arise only in 2025, we believe that taxpayers should start monitoring this matter today so as to avoid any unpleasant surprises after the tax-year end.

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