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Sustainability reporting as part of the obligatory reporting procedure: scope and time horizon

EU is pursuing the Green Deal, which is to achieve the net zero level in line with the Paris Agreement.The programme goal is to define the climate-related challenge and turn it into a new opportunity determining the target to reduce CO2 emission by 55% until 2030 and becoming climate-neutral in 2050. Therefore, intensive regulatory and legislation work has been performed to appropriately adjust EU Directives and Regulations in all economy sectors. Recently, the regulatory changes have helped to define the current real estate sector, and the EU has adopted an action plan to fund the transition to carbon-neutral technologies. Additionally, among others it introduces the following regulations to help achieve the goal:

CSRD will replace **NFRD**, which has been in effect since 2018 and proven to be insufficient in the context of the current challenges faced by business entities. The new Directive will apply to a considerably wider range of enterprises: approximately 50,000 in the EU, including about 3,000 in Poland. CSRD determines general expectations regarding non-financial disclosures. Details shall be determined in a set of standards (ESRS) that will soon come into effect „in form of the delegated acts".

The Directive should be transposed into national law by the middle of 2024, but the first reports will have to be published in 2025 for the financial year starting already in 2024. Initially, the scope will include just entities to whom NFRD applies, i.e. PIE employing more than 500 people and meeting one of the two financial criteria (the balance sheet total above PLN 85m, or net revenue above PLN 170m). A year later, the group of enterprises to whom the Directive applies will be joined by large businesses, i.e. the ones meeting two of the three criteria: employment above 250 people; the balance sheet total above EUR 20 million; and net revenue above EUR 40 million. A year later, the Directive will include listed SME, although the reporting procedure for these entities will be simplified, with an option to depart from the requirements for two years. Non-EU enterprises will be the last to join the list in 2028, provided they generate net revenue above EUR 150m in the EU and have at least one subsidiary subject to CSRD or a branch with a net turnover of more than >EURO 40 million. They will be governed with a separate standard including a specified reporting scope.

Another new legal act that regards ESG and has already came into force is the Regulation of the European Parliament and of the Council of June 2020, which introduces a sustainable business classification system, aka Taxonomy. It applies to financial market participants who fall under SFDR and large companies governed first by NFRD and soon by CSRD. First disclosures determined by Taxonomy were required when preparing non-financial statements for 2021 (identification of Taxonomy-eligible activities). The scope of obligatory disclosures regarding non-financial statements for 2022 is extended by identification of Taxonomy-aligned activities.

The third legal act related to ESG, which came into force in March 2021, is Regulation of the European Parliament and of the Council on sustainability related disclosures in the financial services (SFDR). Its goal is to improve transparency of risk analyses concerning sustainable development carried out by financial market participants and financial advisors.

NFRD:

WHO: PIE employing over 500 people and meeting one of the two financial criteria (the balance sheet total above PLN 85 million or net revenue above PLN 170 million)

About 11,000 businesses in the EU

WHAT: business model, policies regarding e.g. employee, social, environmental and corruption aspects, key risks and due diligence procedures, KPIs

WHERE: statement on non-financial information as part of the management board's report or a separate non-financial report

WHEN: Since 2018 (for the financial year beginning in January 2017)

CSRD:

WHO: 1. All large businesses; 2. All SME listed on EU regulated markets; 3. non-European businesses

About 50,000 businesses in the EU, including 3,000 in Poland

WHAT: Business model and strategy; role of governance bodies; sustainability due diligence process; material sustainability impacts, risks and opportunities identified through dual materiality process; policies, activities and resources, targets and metrics for identified material topics

WHERE: annual management board's report, statutory digital ESEF-format reporting system

WHEN: (for 2024): businesses governed by NFRD; 2026 (for 2025): other large businesses; 2027 (for 2026): listed SME; 2029 (for 2028): non-European entities

EU TAXONOMY:

WHO: Financial market participants (governed by SFDR) and large companies (governed by NFRD/CSRD)

WHAT: percentage of sustainable business activities based on technical screening criteria for one of the six environmental objectives and minimum safeguards

WHERE: regular reports, ESG reports, non-financial statements

WHEN: from 2022 (FY2021) (Taxonomy-eligibility)

from 2023 (FY2022) (Taxonomy-alignment reporting by non-financial undertakings)

from 2024 (FY2023) (Taxonomy-alignment reporting by financial undertakings)

SFDR:

WHO: PIE Financial market participants and financial advisors

WHAT: how ESG-related risks are included in the process of investment decision making

WHERE: regular reports, pre-contract disclosures on websites

WHEN: disclosures from 10 March 2021

from 1 January 2023 (RTS – Regulatory Technical Standards specifying the scope of presented pre-, post- contractual information and website disclosures)

Impact on real estate organisations

Under the CSRD, real estate organisations can no longer report on their financial status without disclosing their environmental and social impact. In order to do so, it is essential to follow the materiality concept when determining which ESG topics to report. When introducing the concept of "**double materiality**", organisations need to consider the impact of both climate-related risks and opportunities on the company's value ("financial materiality" or "inward impact"), and the external impact of their business activities on the environment and social matters („impact materiality"). In addition to mandatory requirements, CSRD will be a major game changer for the industry in terms of transparency and insight into sustainability risks and opportunities. In order to comply with the CSRD, real estate organisations will need to develop a long-term sustainability strategy and extend their sustainability management to include both inward and outward sustainability risks and opportunities. Since the real estate market is stimulated by funds and investments originating from a wide range of investors, clear understanding of sustainability performance and strategy, as well as sustainability-related risks and opportunities for will become increasingly important as a means to attract capital, gain competitive advantage and achieve sustainability goals.

The CSRD will have far-reaching implications for the real estate industry in terms of corporate ESG reporting. Real estate organisations, investors, regulators, auditors and other stakeholders will need to devote significant time and resources to duly prepare for implications of the CSRD. Given the significance of the Directive and the time needed for effective preparation in 2023, **each enterprise should consider the following key topics**:

- Perform a double materiality assessment to determine which ESG issues are material for the organisation from both inward and outward perspective. Perform an ESG baseline assessment for material ESG issues to determine the starting point.
- Set measurable ESG goals in line with the EU Green Deal and UN Sustainable Development Goals.
- Develop a future-proof ESG strategy that includes the purpose, vision, objectives, performance indicators, a strategic roadmap and policies required to comply with EU legislation and mandatory third party limited assurance with effect from 2024.
- Set up reporting and monitoring procedures in order to keep track of the ESG goals over time and to reassess material ESG issues.

Challenges related to reporting

Each company is required to comply with non-financial reporting requirements, taking into account specific employment and financial criteria, and thus disclose information related to sustainable development. Such additional information reflects the rising expectations of investors and the growing public interest in the impact businesses have on the climate.

Below please find possible business and accounting risks that may arise from ESG requirements i.e.

- Impairment of assets: they may be impaired as a result of their inability to generate sufficient economic benefits (regards such assets as coal-fired power plants, or gas infrastructure);

- The economic useful life of assets: it may change as a result of strategy modification or other operating decisions caused by climate-related requirements or imposed by legal restrictions;

- Financial ratios in loan agreements / bond issue terms: an entity may be unable to meet the financial ratios required by the concluded loan agreements or related to the issue of bonds;
- Financing costs: an entity may face increased interest rates on bonds/loans resulting from its poor ESG rating;

- Compliance risk: an entity may fail to provide disclosures required by the EU Taxonomy /CSRD and be fined by a regulator.

As we see, ESG has become part of reporting procedures raising considerable interest of investors and of the public. Further, we can clearly see the growing scope of EU non-financial reporting requirements, meaning that achieving compliance with the reporting requirements of the CSRD will be neither easy, nor fast.

If you need assistance in identifying areas to which the reporting requirements apply, in defining reporting tools and regular performance of reporting obligations, our multidisciplinary team is ready to offer solutions.

If you need more information, you are welcome to contact the authors of the article:

Sylwia Toczyska
Partner Associate, Deloitte Tax
Email: stoczyska@deloittece.com

Damian Zwara
Senior Manager, Deloitte Assurance
Email: dzwara@deloittece.com

Marta Górecka
Manager, Deloitte Risk Advisory
Email: mgorecka@deloittece.com

Magdalena Osowiecka
Manager, Deloitte Risk Advisory
Email: mosowiecka@deloittece.com

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Changes in regulations regarding wind farms: new tasks for local authorities

As of 3 April 2023, the Act of 9 March 2023 amending the Act on investing in wind farms and certain other acts came into force (henceforth: the "Act"). The amendments have raised considerable controversies in mass media and resulted in a political discussion.

Under the amendments, the statutory requirements regarding the minimum distance of a wind farm from a residential building or a mixed-use facility have been maintained. Thus, the distance cannot be less than ten times the total height of the windmill structure (the "10h principle"), measured up to its highest point, including the rotor and blades. However, under the amendment, the local spatial plan can determine another distance between the wind farm and a residential building, not less, though, than 700 metres, considering the range of the farm's influence, among others based on the results of analyses carried out as part of planning procedures, noise measurement, strategic assessment of environmental effects, motions, comments, arrangements and approvals (including those of neighbouring municipalities), outcome of consultations with inhabitants and local conditions.

Further, the amendment has introduced changes regarding the location of residential buildings in proximity of wind farms, as well as determining the distance between the farms and protected areas (natural reserves) and the highest voltage grid. The amendments also indicate how consultations with local communities regarding the location of wind farms should proceed and the share of such communities in benefits of such location.

New definitions introduced as part of the amendments

The amended Act has introduced new definitions (Article 2.3 to 2.10 of the Act), which must be considered by municipalities in the course of spatial planning, issuing administrative decisions and determining the amount of real property tax. The most important ones include:

- The total height of a windmill (the new item 3 added in Article 2 of the Act): under the new definition, the distance from a wind farm to other facilities is measured from the ground level to the highest point of a windmill, including the maximum elevation of the rotor blade. The definition confirms that the construction part of the wind farm, such as the foundation and the windmill tower, qualify as a structure under the Construction Law of 7 July 1994, while technical equipment, including the propeller and generator, does not qualify as a structure, which means it is not charged with the real property tax;

- Adjacent municipality (the new item 5 added to Article 2 of the Act): the provision states that if the municipality area, in whole or in part, is located at a distance less than ten times the total height of a wind farm located in another municipality, the municipality qualifies as "adjacent" based on the 10h criterion. If several municipalities are located at the 10h distance, even if they are not adjacent to the one where a wind farm is located, all of them qualify as adjacent municipalities;

- Under the amendments, the highest voltage grid includes not only the existing connections, but also the projected ones.

Obligations a municipality must fulfil when designing the local spatial plan

In the amended Act, the principle of locating wind farms based solely on local spatial plans has been maintained. The distance measuring approach has been determined in the new Article 5 of the Act, including exceptions regarding the highest voltage grid and protected areas (natural reserves). The principle provides for including the propeller in the calculation of the minimum distance from a wind farm to prevent its protruding beyond the minimum distance measured. When developing a local spatial plan, a municipality must indicate places where wind farms may be located and borders of protection zones for land development and use, so as to propellers do not protrude beyond the minimum distance measured. No wind farms can exist beyond the designated area since no environmental decisions or construction permits will be issued for facilities that do not meet the criteria determined in the Act. The amended Article 15.3.3a of the Act clarifies that the areas intended for investments in renewable energy sources, along with protection zones as determined in the local spatial plan, must be located within areas designated for such investments in line with the study of spatial planning conditions and directions applicable to the area. Moreover, upon the effective date of the amendment, the obligation to adopt a spatial plan will include the entire area within a municipality where a wind farm construction is planned, located at the statutory distance (Article 4.1 of the Act). The justification of a resolution on the commencement of the preparation of a spatial plan providing for a wind farm location should be supplied with calculations of its maximum height, the diameter of rotor with blades and the maximum number of such wind farms as determined in the plan.

The amended Act introduces an obligation to obtain an opinion of the adjacent municipality/town/city mayor if a local spatial plan includes a wind farm location. The obligation applies to adjacent municipalities located at a distance from 700 metres to 10h from the planned wind farm location. The adjacent municipality/town/city mayor in charge of issuing such opinion must announce the planned issue date at least 30 days in advance, and then publish the contents in line with statutory provisions.

The minimum distance from residential buildings: easing the 10h principle

Bearing in mind the importance of housing construction, the lawmakers have decided it needed separate regulations. The minimum distance of a wind farm from residential buildings will be determined based on consultations and the strategic assessment of environmental effects, which is obligatory for the preparation of local spatial plans. The same absolute minimum distance will be binding for the construction of other residential buildings in proximity of the existing wind farms. The minimum distance applicable to the location of residential buildings in proximity of a wind farm is at least 700 metres. Therefore, the 10h principle will not apply to the construction of residential buildings near the existing wind farms.

The minimum distance from a wind farm to residential buildings may differ depending on a municipality, or even on the area within the same municipality, but in no event can it be shorter than 700 metres. If an existing residential building is remodelled or refurbished, or the use of its part is changed, the minimum distance criterion does not apply.

Minimum distance from power grid and protected areas (natural reserves

In order to prevent adverse effects of wind farms on the highest voltage power grid, the minimum distance has been introduced. The minimum distance must be at least equal to three times the maximum diameter of the rotor with blades, or at least two times the maximum total height of the wind farm, whichever of these figures is higher. Wind farms constructed prior to the effective date of the new regulations regarding the distance from the power grid are subject to certain limitations. They can only undergo refurbishment or other necessary maintenance procedures provided they do not increase their capacity or adverse environmental effects. When issuing administrative decisions regarding refurbishment or maintenance, the minimum distance conditions as determined in the new Article 4a of the Act are not considered.

Changes have been introduced regarding the location of wind farms near protected areas (natural reserves). Wind farms cannot be located in national parks, reserves, landscape parks and areas qualified as Natura 2000; the minimum distance obligation has been maintained in relation to national parks (the 10h principle) and reserves (the minimum distance of at least 500 metres).

Obligation to carry out a public debate and provide benefits for inhabitants

The flexibility provided to municipalities when determining the minimum distance from wind farms results in additional obligations to consult, such as organising public debates. Under the new regulations, a municipality must organise such debates for the interested inhabitants to participate. The purpose of such debates is to make sure that decisions on the location of wind farms include needs and interests of local communities. Parties obliged to participate in public debates regarding the location of a wind farm under a local spatial plan include municipality authorities, the investor (if any) and representatives of the municipality's planning and architectural committee.

The obligatory public debate on projections and assumptions of the local spatial plan is to provide information on the planned investment scope, details and subsequent stages of the planning and environmental procedure to the inhabitants of the municipality who may be affected by the existence of the wind farm.

Further, the amended Act provides solutions aimed at ensuring the participation of local communities in benefits of the location of a wind farm in their proximity. Under the new regulations, an investor building such wind farm are obliged to spend at least ten percent of its installed capacity for the municipality inhabitants to allow them gaining the status of a virtual prosumer. Owing to the amendments, all inhabitants of such municipality who consume electricity in their households will be able to conclude an agreement with the investor in line with the Act on renewable energy sources to gain the status of a virtual prosumer.

New principles vs already issued permits and processed notifications

Under the amended Act, construction permits regarding residential buildings issued prior to 23 April 2023 will remain valid. Procedures of gaining construction permits or decisions on environmental conditions commenced prior to the date shall be regulated by the prior version of the Act.

Further, notifications of the construction of single-family houses whose impact area entirely fits the plot(s) of their design remain valid, provided the competent administrative authorities did not file an objection prior to 23 April 2023. The pending procedures regarding these facilities must be completed in accordance with the unmodified version of the Act.

Importantly, proceedings regarding decisions on the development conditions or on the location of public purpose investment for residential buildings commenced but not completed prior to 23 April 2023 are ruled by the amended Act.

Please note that the new provisions of Article 9 allow locating a wind farm based on the existing local spatial plan being in force before the effective date of the amendments. This means that the existing spatial plans may be used to determine a wind farm location without the necessity to make any amendments, provided that the minimum distance of at least 700 metres from residential buildings is kept.

If you need more information, you are welcome to contact the authors of the article:

Marta Bijak-Haiduk
Partner, Head of Real Estate,
Deloitte Legal
Email: mbijakhaiduk@deloittece.com

Enrika Gawłowska-Nabożny
Associate, Real Estate,
Deloitte Legal
Email:
egawlowska@deloittece.com

Deloitte.

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End of the state of epidemic emergency

In the beginning of May 2023 a draft regulation was published under which the state of epidemic emergency would be repealed as of 1 July 2023. If the regulation comes into force, it will bring several changes for taxpayers regarding certain fiscal deadlines, currently suspended or extended in relation to COVID-19.

Reporting of domestic tax schemes (MDR)

The repeal of the state of epidemic emergency ends the period of relief regarding reporting of tax schemes classified as domestic ones introduced in the end of March 2020 (the suspension regarding cross-border ones was cancelled much earlier). **After 30 days** from the date following the date of cancellation of the epidemic emergency, **the formerly suspended deadlines to fulfil obligations regarding domestic schemes will be restored**.

The above means that in many cases, in order to avoid potential penalties under the Fiscal Penal Code, the time to report tax schemes that benefited so far from the "COVID-related suspension" **will end at the end of July 2023**. In practice, the fulfilment of MDR-related obligations in the above period should allow for a significant reduction of the inconvenience related to the entire process (reporting of schemes "in arrears" often involves the necessity to multiply the filed reports and to precede them with voluntary disclosure (in Polish: "czynny żal"), which makes the process considerably longer and more complex.

Restoring of the reporting deadlines for domestic tax schemes coincides with the increased activity of tax authorities, which verify the correctness of fulfilling MDR-related obligations. Thus, prompt identification of potentially unfulfilled obligations in this respect becomes crucial.

The repeal of the state of epidemic emergency will among others also result in the following changes:

1. **Validity of tax residence certificates**: after 2 months following the date of epidemic emergency repeal, i.e. as of 1 September 2023, tax remitters using both certificates for 2019 or 2020, and certificates that do not contain a validity period, for which a period of subsequent 12-month period elapsed during the state of epidemic emergency, **should obtain valid certificates of tax residence**.

2. **Change in the deadline for filing ZAW-NR form**s: as of the repeal date, the deadline to file ZAW-NR form i.e. the notification of payment to a bank account not included in the "white list" of VAT payers **will be shortened to 7 days** (during the state of epidemic emergency the deadline was extended to 14 days).

3. **Deadline to issue individual tax rulings**: as of the repeal date, the basic deadline of **3 months** for issuing individual tax ruling will be restored. Please remember that under Article 14o of the Tax Ordinance, if the Director of the National Fiscal Information fails to issue a tax ruling within this deadline, the taxpayer obtains the so-called "silent tax ruling", being protected with the position presented in its motion, provided that the taxpayer complies with it.

4. One year after the repeal date, the traditional form of stationary hearings should be restored in administrative courts. However, currently some court departments declare to resume online hearings from July 2023 (in the "hybrid" version).

If you need more information, you are welcome to contact the author of the article:

Maciej Mucha
Partner Associate, Deloitte Tax
Email: mamucha@deloittece.com

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Withholding tax (WHT): has there been a revolution in practice applied by tax authorities and administrative courts with regard to opinions on the preferential treatment?

As a recollection – since 2022, a new WHT collection mechanism (**pay&refund**) has been introduced, under which the preferential WHT treatment (based both on the Polish CIT Act as well as applicable double tax treaties) for the so-called passive payments (dividends, interest, license fees and intangible services fees - among other payments) in excess of PLN 2 million during a given year may be relied on provided that:

1. the remitter (or taxpayer) obtains a tax authority clearance opinion confirming the applicability of the preferential WHT treatment
2. the taxpayer files-in a special WHT statement (**WHT Statement**) with the tax authority (which involves a risk of imposing a material penal fiscal sanction against its signatories).

Motions for an opinion regarding the preferential treatment – current practice

A practice has been observed so far where for the purpose of issuing the opinions on the preferential treatment ("**WHT Clearance**") both – the tax authorities and administrative courts focused primarily on the analysis of the status of the beneficial owner of the payment recipient. In particular, it was confirmed whether the payment recipient:

1. actually "automatically" transfers the received payments to other entities;
2. has sufficient resources (such as employees, bank account, office and other assets etc.) to carry out independent business activity within the state of its residence, i.e. if the payments recipient has the so-called "business substance".

Nevertheless, recent judgements of the Voivodship Administrative Court (**VAC**) in Lublin as well as approach of the tax authorities in the course of ongoing procedures for the purpose of issuing WHT Clearance has now expanded onto additional aspects of WHT exemption reliance.

Judgements of VAC in Lublin – is this a new jurisprudence trend?

At the turn of 2022 and 2023, within its judgements, VAC in Lublin begun referring to the judgement of the European Court of Justice of no. C-448/15 dated 8 March 2017 (regarding a background where the entire income of the payments recipient was taxed with 0% rate).
As a result, a jurisprudence line of VAC has emerged with regard to dividend and interest payments, under which:

1. **firstly**, the legal and technical condition necessary to allow for the exemption of dividend / interest payment from WHT under the CIT Act must be satisfied, i.e. ***The recipient does not rely on an exemption from income tax*** *on its worldwide income (wherever it arises)* - it is satisfied **only when the recipient pays income tax within its country of residence**. In order for the condition to be met the tax must actually be charged on the payment recipient. Up to now, this condition has been understood as a lack of full tax exemption relied on by the payment recipient (e.g. as available to open-end investment funds).

2. **secondly**, VAC seems to suggest that **tax exemption of received dividend / interest in the payment recipient's state of residence** with no occurrence of other CIT-taxable operations **may disallow to rely on a WHT exemption**. It should be pointed out that in course of pending proceedings regarding the WHT Clearance issue, the tax authorities begin to verify whether the dividend / interest to be covered with a WHT Clearance is subject to tax in the payment recipient's state of residence.

As an example, the above-described line has been demonstrated in the following judgements: no. I SA/Lu 100/23 dated 05.04.2023; no. I SA/Lu 136/23 dated 05.04.2023; no. I SA/Lu 279/22 dated 28.10.2022; no. I SA/Lu 316/22 dated 21.09.2022.

It should be pointed out that the above judgements have not been issued based on backgrounds where:

1. dividend / interest was tax-exempt in the payment recipient's state, however

2. the payment recipient paid effectively income tax from other titles / streams.

Furthermore, Lublin VAC judgements do not seem to refer directly to such backgrounds.

What these judgments mean in practice and what measures should be undertaken?

Taking the above judgments and their arguable claims into consideration, prior to submitting a motion for a WHT Clearance (or before the WHT Clearance is issued) or prior to signing a WHT Statement, it should be verified whether these may affect the tax treatment of interest / dividend payments and asses possible risk related to WHT settlement.

Feel free to contact us to discuss shared experiences regarding WHT.

If you need more information, you are welcome to contact the author of the article:

Maciej Mucha
Partner Associate, Deloitte Tax
Email: mamucha@deloittece.com