Taxation of Limited Partnerships and Other Revolutionary Changes in CIT and PIT To Take Effect in 2021

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After many weeks of heated debates over proposed amendments to the income tax system, new regulations were adopted by the Lower Chamber of the Polish Parliament (Sejm) on 28 November 2020, signed into law by the President and published in the Official Journal on 30 November 2020. By and large, they are scheduled to take effect in 2021.

Below are the most important changes. Please also feel welcome to attend our webinar we will hold to discuss these recent changes on 10th of December 2020 at 9:30. You can enroll by clicking here.

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1. Limited partnerships and (some) general partnerships as CIT taxpayers

From 2021 onwards, all limited partnerships having their registered office or management board in Poland will become CIT taxpayers, regardless of their scale of operations, ownership structure or partner status.

Most importantly, in the course of parliamentary work on the bill, limited partnerships have an option to become

subject to CIT as of 1 May 2021 on condition that they close their accounts as at 30 April 2021.

As a rule, limited partnerships will be required to adhere to all the regulations provided for in the CIT Act with respect to companies limited by shares. Hence, it can apply a reduced CIT rate of 9% on revenues below €2 million per year.

As a result of limited partnerships being now subjected to the CIT regime, profits generated by the partnerships will be subject to double taxation – first at the time of generating profits and then at the time of distributing them to partners. Admittedly, the new law provides for a tax exemption of 50% of the limited partner's revenues earned through the limited partnership (up to PLN 60,000 in a tax year, separately for profits from each limited partnership in which the taxpayer is a limited partner). That said, the exemption will not apply to limited partners owning more than a 5% stake in the company limited by shares acting as the general partner of the limited partnerships, acting as board members of the general partner or those who are their related entities.

As far as distributions of profits are concerned, general partners will be able to reduce taxes they pay on profits by deducting a pro-rated portion of the tax already paid by the partnership (to the extent corresponding to the general partner's share in the partnership's profits).

Under the transitional provisions, the payment of future profits earned by limited partnerships before the day they become subject to CIT should continue to be made under the existing rules.

According to the new law, general partnerships will not become CIT taxpayers if all their partners are natural persons. In the case of general partnerships failing to meet this criterion, CIT exemption will be available provided that they report to the competent tax office information on all PIT and CIT taxpayers who have—whether directly or through tax-transparent entities —the right to participate in the partnership's profits.

2. Tightening up tax rules on sale of shares in real estate companies

The new law contains a new definition of a real estate company. Namely, a 'real estate company' means any entity, other than a natural person, required to draw up a balance sheet under accounting regulations, in which as at the last day of the directly preceding year at least 50% of the balance sheet value of assets consisted, whether directly or indirectly, of the balance sheet of real estate located in Poland or any rights to Polish real estate, where the balance sheet value of the real estate exceeded PLN 10 million. Moreover, the new regulations apply to situations where proceeds from rental, subletting, lease, sublease, financial lease or any similar agreement, or alienation of real estate or rights to real estate and shareholding interests in other real estate companies represent 60% or more of total income.

As regards companies which only start their business (i.e. in the first year of conducting business activities) a real estate company will mean an entity, other than a natural person, required to draw up a balance sheet under accounting regulations, in which as at the first day of the tax year at least 50% of the market asset value consisted, whether directly or indirectly, of market value of real estate located in Poland or rights to such real estate and the market value of such real estate exceeded PLN 10 million.

The tax settlement obligation on the disposal of shares in a real estate company will shift from the seller to the real estate company. In principle, this is aimed at increasing the efficiency of income tax collection.

Consequently, the function of the taxpayer will be performed by real estate companies with their registered office or management in Poland or with a permanent establishment in Poland. Such companies will be obligated to pay a 19% tax advance on the shareholder's capital gain by the 20th day of the month following the month in which the

shareholder earned income (the company's shares were disposed), and if the real estate company has no adequate information to calculate the tax base, the 19% tax advance will be paid on the market value of the shares being disposed. The obligation to collect/pay the tax advance will lie with the real estate company if the seller is a non-resident and the transaction is effected on shares or shareholding interests carrying at least 5% of voting (or similar) rights in the company. The above will also apply to situations where one entity, within the space of no more than 12 months, effects several real estate company share sale deals with respect to at least a 5% stake.

A taxpayer will be obligated to forward to the real estate company a tax advance by the 20th day of the month directly following the month in which the income was earned, whereas the real estate company will prepare and issue the taxpayer with a dedicated form confirming the tax advance so paid.

Real estate companies from outside the EU / EEA are additionally obligated to appoint a tax representative in Poland to discharge remitter duties. The representative will discharge the taxpayer's duties if shares in the company are sold and be jointly and severally liable with the real estate company in this regard. Failure to appoint a representative may attract a maximum penalty of up to PLN 1 million.

Real estate companies and taxpayers holding directly or indirectly a stake carrying at least 5% of voting rights in a real estate company will be required to provide the Head of the National Revenue Administration (KAS) by the end of the third month after the tax year end (and in the absence of a tax year – by the end of the third month after the end of the financial year), by means of electronic communication, information on:

1. the entities holding directly or indirectly shares in the real estate company – in the case of information reported by real estate companies;
2. the number of shares or shareholding interests held, whether directly or indirectly, in the real estate company – in the case of information reported by taxpayers who are real estate company shareholders,

– as at the last day of the tax year of the real estate company, and if the real estate company is not an income tax payer – as at the last day of its financial year.

3. New obligation for CIT taxpayers to prepare and publish a report on the implementation of tax policy for the tax year

This obligation will apply to taxpayers whose income in the previous tax year exceeded the equivalent of €50 million and to tax corporate groups.

The information shall include:

- information on the taxpayer's processes and procedures for managing the performance of tax law-related obligations ensuring compliance, and on voluntary forms of cooperation with KAS;
- information on the taxpayer's compliance with tax liabilities in Poland, including information on the number of notifications of tax schemes provided to the Head of KAS with a breakdown into different tax types,
- information on transactions with related entities with a value exceeding 5% of the balance sheet total of assets within the meaning of accounting regulations, as determined on the basis of the company's most recent approved financial accounts,
- information on restructuring activities planned or undertaken by the taxpayer likely to affect the amount of tax

liabilities of the taxpayer or related entities,

- information on general or individual tax ruling applications filed by the taxpayer, binding VAT rate excise duty information,
- information on making tax settlements in territories or countries applying harmful tax competition.

Information constituting commercial, industrial, professional or production secrets will not be published.

Information on the tax policy implemented must be published on the website of the taxpayer (or related entity, if the taxpayer does not have its own website).

In the event of a failure to meet the new obligations, taxpayers may face a maximum penalty of up to PLN 250,000.

4. Limiting the possibility of tax loss deduction

The new laws limit the possibility of settling tax losses in a situation where the taxpayer has taken over another entity or acquired an enterprise or an organized part of an enterprise, including by way of an in-kind contribution, or has received a cash contribution for which it acquired an enterprise or an organized part of an enterprise.

In these cases deduction of tax losses would be precluded in specific circumstances which, if occurring, will confirm – in the legislator’s opinion – that the primary goal of the transaction was not legitimate with respect to loss deduction. Loss deduction will thus be precluded if:

- the subject of the basic business activity actually conducted by the taxpayer after the takeover or acquisition is wholly or partially different from the subject of the basic business activity actually conducted by the taxpayer before the takeover or acquisition,

or

- at least 25% of shares/shareholding interests in the taxpayer are owned by an entity or entities which – as at the last day of the tax year in which the taxpayer incurred the loss – did not have such rights.

In the course of legislative work, transitional regulations were proposed whereby limitations on tax losses deductibility would only apply to taxpayers who executed the transactions with the exclusive aim of gaining a tax advantage after the effective date of the new law.

This proposal was rejected by the legislators who concluded that there was no basis to insert any grandfather clauses to protect any “rights acquired” or “interests in progress” arising as a result of the above. Consequently, taxpayers ought to check if they will be eligible to deduct historical tax losses in 2021.

5. The transfer by a liquidated company of tangible property to its shareholder by way of division of property is subject to CIT at the level of the liquidated company

This regulation explicitly indicates that a transfer by a liquidated company (cooperative) of tangible property to its

partners (shareholders, members of the cooperative) as a distribution of the assets of the liquidated legal person is also subject to CIT taxation. In the legislator's view, this change is meant to offer a precise clarification, although jurisprudence was dominated by the opposite view – one much more favorable to taxpayers.

6. Restriction on the possibility of determining the depreciation rate in a situation where the taxpayer benefits from CIT exemption

The taxpayer—in the period when it benefits from a CIT exemption—cannot apply reduced or increased depreciatio rates on fixed assets used in the business activities qualifying for the CIT exemption. This primarily impacts entities operating in the Polish Investment Zone (Special Economic Zones) undertaking or finalizing new investments after 2020. Under transitional provisions, this limitation will apply to fixed assets and intangible assets entered in the register of fixed assets and intangible assets after 31 December 2020.

7. Restriction of the right to set individual depreciation rates for used fixed assets

A fixed asset may be considered a second-hand fixed asset only if, before its first entry in the taxpayer's records, it was used for the period specified in the Act by entities other than the taxpayer. For example, a taxpayer who uses a brand new fixed asset under a leasing contract, and then buys it and enters it in the fixed assets register, cannot apply increased depreciation rates to that fixed asset.

8. Higher threshold for the 9% CIT rate

The 9% CIT rate will apply to revenues up to €2 million (current threshold: €1.2 million).

9. Extension of the minimum CIT exemption

The current exemption from tax on revenues from buildings (known as 'minimum CIT') runs out on 31 December 2020. The new law will allow taxpayers to continue claiming this exemption depending on the situation with SARS-CoV-2.

10. Limiting the abolition allowance in PIT

Restrictions will be placed on the 'abolition allowance' for taxpayers working abroad. This allowance enables Polish tax residents obtaining certain income from specific countries to claim tax exemptions on this income in Poland, although under double tax treaties Poland could also tax this income (allowing the taxpayer to deduct the tax paid on it abroad). Under the new regulations, the maximum 'abolition allowance' from 2021 onwards will be capped at PLN 1,360.

Transfer pricing regulation change

1. Facilitations for taxpayers due to COVID-19 – changes applicable already for 2020

Pursuant to the CIT Act, one of the conditions for making a transfer pricing adjustment is to have, at the time of the adjustment, a declaration of a related entity (the other party to the transaction affected by the adjustment) that it made an adjustment of the same amount. The recent amendments stipulate that it will not be necessary to have this declaration in place if the correction is made for the tax year or while Poland is in the state of epidemic danger or the state of COVID-19 epidemic.

The new laws will also make it possible for the person / persons authorized to represent the entity to sign declarations on the preparation of transfer pricing documentation and the application of market prices if the declaration is submitted for a year or while Poland is in the state of epidemic danger or the state of COVID-19 epidemic. That said, proxies are still not allowed to submit this declaration.

It will be possible to claim exemptions from the obligation to prepare transfer pricing documentation for domestic transactions by entities suffering a tax loss in the year in which the state of epidemic danger or epidemic state was effective throughout Poland, provided that this year the entity which incurred a loss generated total revenues at a level at least 50% less than in the corresponding period of the previous year.

2. Tightening up transfer pricing for transactions with tax havens – changes applicable from 2021

The definition of entities from "tax havens" has been extended by specifying that if the beneficial owner of an entity has a place of residence, registered office or management in a tax haven, the entity should be considered as resident in a “tax haven”. In this context, we note that under the new regulations, transfer pricing documentation will have to be drafted for any transaction executed with an entity whose beneficial owner has a place of residence, registered office or management in a tax haven if the transaction value exceeds the PLN 500,000 threshold. Until now, for the obligation to document a transaction to arise, a given entity had to have a place of residence, registered office or management in the tax haven. In the latter case, any transaction with a value in excess of PLN 100,000 must be reported.

The obligation to document transactions with entities from tax havens also extends to partnerships that are not legal persons.

The obligation to prepare transfer pricing documentation was extended to all transactions concluded with entities from tax havens, including transactions generating income for the Polish entity.

An additional mandatory element of transfer pricing documentation for transactions with entities from tax havens was introduced in the form of economic justification for the transaction, in particular a description of the expected economic benefits, including tax benefits.

As of 1 January 2021, joint stock companies and limited liability companies with natural persons as their only shareholders will have an option to defer CIT payments until the company has made a profit distribution (known as the ‘Estonian CIT’), however subject to a number of conditions. In particular, only companies with annual gross income of up to PLN 100 million, generating income from operating activity higher than passive income, employing at least 3 employees and incurring certain investment outlays will be eligible to this option. A company subject to

Estonian CIT will not be allowed to own shares in other entities. A taxpayer will be able to make a tax election and choose the Estonian CIT for a 4 year term, subsequently renewing the term for consecutive 4 year terms. Under the Estonian CIT, as an alternative to deferred tax payments, eligible taxpayers will also be able to deduct write-downs they made to a dedicated investment account.

The draft laws also contain transitional provisions that are important for taxpayers already conducting operations and for business projects that have already started.

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