Bloomberg Tax

TAX PLANNING INTERNATIONAL

EUROPEAN TAX SERVICE

International Information for International Business

JANUARY 2018

www.bnai.com

Significant Changes to Polish CIT Regulations Coming into Force in 2018

Piotr Wyrwa
RSM Poland

The beginning of the upcoming year will be marked—as usual—by taxpayers' hectic preparations for the changes in tax law. The number of changes is so considerable, that it is impossible even to list them all here. Nevertheless, from the CIT perspective, the most substantial amendments seem to be those which will influence mainly the largest companies.

As a result of the government systematically introducing its tax system-sealing policy, taxpayers should not be surprised that these new regimes tend to further limit tax optimization schemes. At least, that is what the government claims. Entrepreneurs may have a different opinion in this matter. In fact, those who will have to accustom to all amendments may find that the outcome is a substantial increase of their tax burdens.

Piotr Wyrwa is a Tax Advisor at RSM Poland

New Thin Capitalization Rules

The thin capitalization has been included in the CIT Act for almost 20 years and effectively limits the taxpayers' right to treat costs of intra-group debt financing as tax-deductible costs. Still, the legislator decided to take a radical step and erased all existing regulations in this respect. New rules have very little to do with the old ones. Why then bring in such far-reaching changes?

The government states that the excessive interest payments mechanism is commonly used by the international businesses to reduce their global tax liabilities and should be deemed as aggressive tax planning. The current thin capitalization rules, which apply only to intra-group loans, have been touted by taxpayers. Consequently, they have learned ways to bypass these provisions, for example by using back-to-back loans. The very idea of new thin capitalization rules is based on the Council Directive (EU) 2016/1164, laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

According to the new restrictions, CIT-payers will be entitled to treat as tax-deductible costs the surplus of borrowing costs only if those costs will not exceed 30% of their EBITDA ratio. In this case, the surplus of borrowing costs is the amount by which the borrowing costs exceed the interest revenues.

New thin capitalization rules will apply both to the loans drawn from the related entities as well as third parties (such as banks). This is a fundamental change, taking into account that, until now, thin capitalization applied to those entities whose share in the capital of another entity was equal to 25 percent at least. Good news is that the non-deducted interests may reduce CIT-payer's tax base in the next five following tax years. Current regulations in this area did not allow this and interest-related costs that were not deducted in a given year were irretrievably lost.

The described restrictions will not apply to the surplus of borrowing costs not exceeding 3 million zloty in the tax year. This is good news for small businesses. On the other hand, it is also a clear sign which group of taxpayers the rules are aimed at. They are about to have the most considerable impact on large entities, often ones that belong to international groups. At the same time, the broadly understood financial institutions (such as banks, investment funds or insurance companies) do not have to worry about the new regulations, as these entities are excluded from the new thin capitalization restrictions.

Intangible Services

For a long time tax authorities have shown a particular interest in transactions concluded between affiliated/group entities. Despite the increase in the scope of information reported on transactions with related entities (e.g. recent implementation of OECD's BEPS), authorities still have some difficulties with effectively undermining the marketability of these transactions. A solution to this problem may be the newly introduced provisions severely limiting the deductibility of expenses incurred for intangible services.

The essence boils down to the obligation to exclude expenses from tax costs, if those expenses are paid to related entities or entities from the tax havens and incurred for certain categories of intangible services and the statutory limit is not exceeded. The fulfilment of those conditions may result in a given expense not reducing the taxpayers CIT tax base.

The limitation will concern only the amount of expenses exceeding 5 percent of the CIT-payer's EBIDTA ratio. In addition, the restrictions will apply only to the costs exceeding 3 million zloty in the given tax year. The amount of costs not deducted in a given tax year will not be lost in a definitive way (as a rule, may be deducted in next five years).

Expenses may be excluded from the tax costs, if they are incurred—directly or indirectly—for the related entities or for the entities seated in the tax havens. Taxpayers should not have a problem identifying these entities, as they are commonly known and explained in the CIT provisions.

The catalogue of expenses included in the discussed restriction covers three categories: intangible services, fees for usage of the rights or intangible assets and costs for transferring the risk of the debtor's insolvency. Intangible services are defined as advisory, market research, advertising, management and control services as well data processing, insurance and guarantees and sureties as well as benefits of a similar nature to those mentioned.

"Minimum Tax" on the Owners of Valuable Commercial Real Estates

Another change is the introduction of a minimum income tax, which will be paid whether or not the property owner is receiving income. However, this should concern only the owners of real estates located in Poland of a tax initial value exceeding 10 million zloty. Still, not every such valuable real estate falls into the scope of the new provisions. Additional tax affects specific commercial buildings (such as shopping centers) and office buildings only. Thus, objects not explicitly indicated in the provisions (factories, plants, warehouses, etc.) shall be excluded.

Technical aspects seem to be simple at first glance. The tax base is the initial value of a real estate lower than the amount of 10 million zloty. This surplus is charged with a 0,035 percent tax rate on a monthly basis. Taxpayers may deduct the due "minimal tax" from monthly advances for CIT and finally, in the annual CIT return, yearly "minimum tax" is deducted from the due CIT. Thus, theoretically, property owners generating "sufficient" income should be at ease.

One can have the impression that the introduction of a "minimum tax" will compensate for the unsuccessful attempt to tax large-scale stores, popularly referred to as the hypermarket tax. The introduction of this burden by the government was successfully restrained by the European Commission in 2016.

2018 Will Not Be Easy Year for CIT-payers

Still, mentioned amendments are not the only ones introduced in 2018. It is also worth mentioning new operating principles of tax-consolidated groups, separation of income / loss sourced from capital transactions from other income / loss sources (thus, income tax will be levied on the income derived from one source and will not be reduced by the loss incurred on the other source) as well introduction of more thorough inspections of tax havens and Controlled Foreign Companies ("CFC").

Nearly all of the recent changes have common that they will result in increasing taxes without raising the CIT rate itself. This seem to be a real "magic trick" of the Polish Ministry of Finance.

Piotr Wyrwa is a Tax Advisor at RSM Poland.