Changes in income taxes from 1 January 2017

Tax Alert

Dear Readers,

In the latest issue of Tax Alert we would like to present you the changes in the law coming into force on 1 January 2017. Although most of those changes were already discussed in several of our articles, we are going to present them now more comprehensively. We encourage you to familiarize yourself with the new provisions of laws on income taxes which both natural persons and entrepreneurs should take into account.

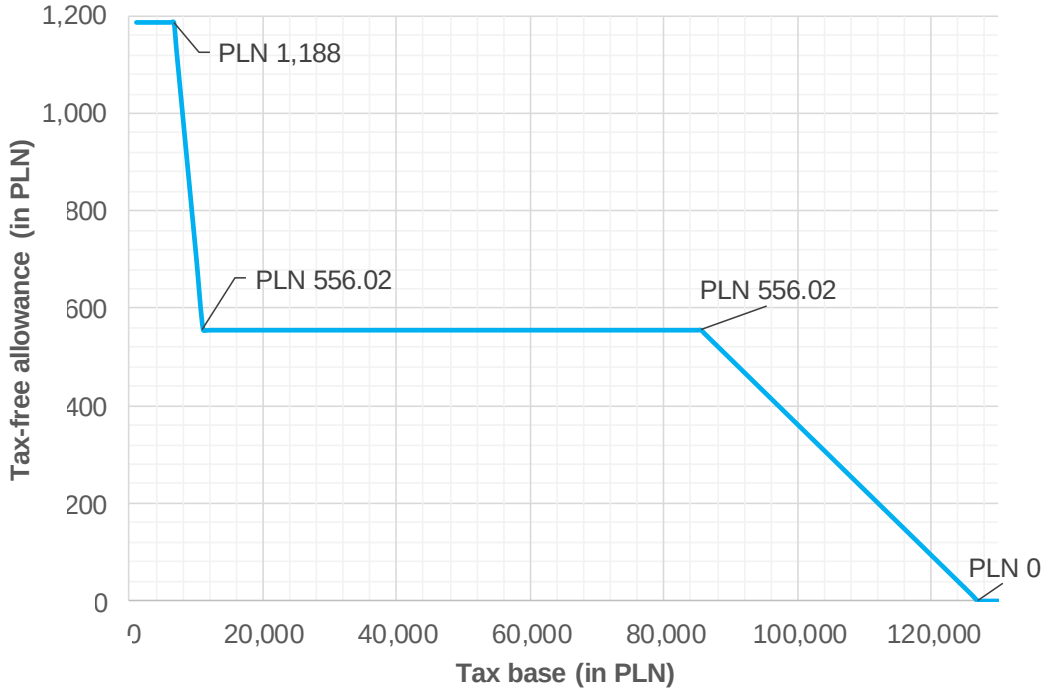
In the last days of November, both the Sejm and the Senate quickly carried out works concerning changes in the Natural Person Income Tax Act (NPITA) concerning the tax-free allowance. This amendment results from the judgment of the Constitutional Tribunal dated 28 October 2015 (case file No. K 21/14), which held that the currently applicable allowance is incompliant with the Constitution of the Republic of Poland as its constant value, unchanged for many years, fails to provide low-income taxpayers with the minimum subsistence income. The judgement repealed the provisions regulating the tax-free allowance on 30 November 2016. In this case it was necessary to introduce a new mechanism of determining the said amount, presented in the table below.

The Act dated 29 November 2016 Amending the Natural Person Income Tax Act, Corporate Income Tax Act and Act on Amending the Tax Act and Certain Other Acts (Journal of Laws of 2016, item 1926)

Provision	Explanation of the change
S. 27(1) NPITA – amended S. 27(1a-1d) NPITA – added	The said changes were introduced in the Senate amendments to NPITA which provide for increasing the tax-free income to reach the minimum subsistence income of PLN 6,600. The tax-free allowance which is tax-deductible is of a degressive nature, which means that it decreases proportionally to the increase of the income earned by the taxpayer. Its amount is calculated as follows:

Tax base (in PLN):	Tax-free allowance (in PLN):
0 – 6,600	1,188
6,600 – 11,000	1,188 - (631.98 × (tax base – 6,600) ÷ 4,400)
11,000 – 85,528	556.02
85,528 – 127,000	556.02 - 556.02 × (tax base – 85,528) ÷ 41,472
powyżej 127,000	0

The change of the tax-free allowance depending on the amount of the tax base is depicted in the chart below:



Those changes will mostly benefit people working seasonally or part-time. Taxpayers whose annual tax base fits within the range of PLN 11,000 – PLN 85,528 will in fact be unaffected by this amendment. Taxpayers who exceed the tax threshold will be entitled, in line with the increase of the income, to proportionally lower the tax-free allowance which is going to be abolished in case of people with a tax base exceeding PLN 127,000.
In answer to the assertions put forward by the Constitutional Tribunal, the legislator introduced the possibility for the tax-free allowance to be changed by the Minister of Finance. He is obliged to verify it annually and may increase it in case the minimum subsistence income increases significantly.

The change in this scope will affect both the method of computation and the amount of the income tax advance payments during the tax year (irrespective of the fact whether it is computed by the taxpayer himself or by the tax withholder) as well as the final tax amount in the annual tax return. Technical provisions in this scope are ambiguous and are likely to raise numerous doubts.

The said provisions are going to apply to income generated from 1 January 2017 and this means that the first deduction of the new tax-free allowance cannot be made until the submission of the tax return in 2018.

The Act on Amending the Natural Person Income Tax Act (hereinafter called: NPITA) and Corporate Income Tax Act (hereinafter called: CITA) was also published in the Polish Journal of Laws. The table below presents the most important changes in force from the beginning of 2017.

The Act dated 05 September 2016 Amending the Natural Person Income Tax Act and Corporate Income Tax Act (Journal of Laws of 2016, item 1550)

Provision	Explanation of the change
S. 3(3-5) CITA – added S. 3(2b) NPITA – amended	In CITA the legislator introduces a list of income of non-residents deemed to be generated in Poland. In NPITA the list of circumstances in which the income of non-residents is deemed to be explicitly generated in Poland is extended. The extended list in particular includes income from securities admitted to public trading in the Polish regulated market. In addition, transfer of ownership inter alia of shares in companies in which real estate properties located in Poland constitute at least 50% of the value of assets, directly or indirectly, will be subject to taxation in Poland. Both acts contain a new provision saying that receivables paid by the Polish taxpayers irrespective of the fact where the contract was concluded or where a given service was provided will also be deemed to be revenue generated by non-residents in Poland. This provision applies inter alia to licence royalties and interest, which in practice will impose on the Polish tax withholder the obligation to withhold the tax even in case of services provided fully outside Poland.
S. 4a(29) CITA – added S. 21(3)(4) and S. 26(1f) CITA – amended	The definition of a *beneficial owner* was added to the glossary of terms. In the previous wording of the provisions regulating the exemption from the withholding tax in transactions with related entities, the legislator used the term "the recipient of the receivables" who in fact was understood as the entity to the benefit of which the remuneration was paid. The amended provision unambiguously determines that the company generating income from licence royalties and interest has to be their beneficial owner to be eligible for exemption, which means that it receives them for its own benefit and does not act as an agent for other entities. We should also remember to update in 2017 the content of the declarations submitted by foreign taxpayers entitling them to the exemption from withholding tax. Such taxpayers must also obtain a confirmation that the entity making such a declaration is the beneficial owner of the receivables.
S. 10(4) and 10(4a) CITA – amended and added S. 24(19 and 20) NPITA – added	Application of preferential taxation to the so-called exchange of shares will depend on the existence of well-grounded economic reasons. This provision also introduces the possibility of assuming that if amalgamation, division or exchange of shares cannot be economically justified then it is deemed that the main or sole purpose of those transactions was to evade or avoid taxation.
S. 12(1)(7) CITA – amended S. 17(1) NPITA – amended	The currently applicable law provides that the nominal value of the shares is deemed to be the revenue of the taxpayer contributing to the company in-kind contribution in the form other than an enterprise or its organized part. From 1 January 2017 the value of the contribution defined in a Company's Memorandum and Articles of Association or another document will be deemed to constitute revenue with a provision that if this value does not reflect the market value, the revenue should be so defined as to reflect the market value of the contribution. It means that in such circumstances the amount of the share premium will also be deemed the revenue of shareholders.
S. 16(1)(63)(d) CITA – repealed	From 2017 the depreciation/amortization charges on the historic value of fixed assets and intangible assets acquired by the taxpayer in the form of in-kind contribution will not be excluded from costs of revenue with respect to such part of their value which was not transferred for the establishment or increasing a Company's share capital. As a result of repealing this provision, the full amount of the depreciation/amortization of these assets will be treated as tax expense.

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S. 19(1) CITA – amended S. 19(1a and 1b) CITA – added	The new provisions decrease the corporate income tax rate for small taxpayers from 19% to 15%. An entity which generated sales revenue including VAT not exceeding in 2016 the amount of PLN 5,157,000 (EUR 1,200,000) will be treated as a small taxpayer in 2017. The reduced rate applies also to taxpayers starting their business. The preferential rate will not apply to tax capital groups in the whole period of running a business and some entities undergoing transformation - in the year of starting the business and in the following year.

The changes indicated in the said table not only expand taxpayers' rights but also impose new obligations on them. Although the reduced tax rate may arouse satisfaction, taxation of the receivables paid to non-residents irrespective of the place of contract conclusion or service provision may undoubtedly create numerous additional problems and formalities for taxpayers. If you are interested in the details of the said changes, please read our Tax Alerts 9/2016 and 23/2016.

On 4 November 2016 the Sejm passed an act on the amendment of certain acts regulating the conditions for running innovative business, which introduced new regulations, inter alia, in tax acts. Those changes are introduced to encourage entrepreneurs to spend more on research and development through, inter alia, the increase of limits defining the amount of eligible deductible costs or extension of the period in which the costs of research and development activity are deductible. The table below presents the most important changes in this scope.

The Act dated 4 November 2016 Amending Certain Acts Defining the Conditions for Running Innovation Business (Journal of Laws of 2016, item 1933)

Provision	Explanation of the change
S. 12(4)(25) CITA – added S. 17(1e) NPITA – added	The list of exclusions from tax revenue was extended. From 1 January 2017 the market value of the contribution will not be treated as taxpayer's revenue if the commercialized intellectual property contributed by the commercializing entity constitutes an in-kind contribution made for the benefit of a company.
S. 18d(2)(5) CITA – added S. 26e(2)(5) NPITA – added	From the new year the eligible costs will also include expenses connected with the process of obtaining and retaining patents for invention, utility models or rights of industrial design registration. The said expenses will constitute eligible costs only for micro, small and medium-size entities as defined by Freedom of Economic Activity Act.
S. 18d(7) CITA – amended S. 26e(7) NPITA – amended	The amended provisions regulate new limits for deduction of expenses for research and development depending on the taxpayer type. Micro, small and medium-size entrepreneurs will be able to maximally deduct 50% of eligible costs in a given tax year irrespective of the type of expenses. Other taxpayers are entitled to deduct 30% or 50% of the value of the eligible costs depending on the type of costs incurred.
S. 18d(8) CITA – amended S. 26e(8) NPITA – amended	If the taxpayer incurred a loss or the amount of the income generated did not let him fully deduct the amount of the R&D tax relief to which he is entitled, he will have the right to settle the remaining part of the relief in the subsequent years. So far this period lasted only 3 years. Pursuant to the new regulations, the right to deduct eligible costs has been extended to last 6 tax years.

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S. 18da(1-5) CITA – added S. 26ea NPITA – added	Newly created enterprises (except for taxpayers starting a business, inter alia, as a result of transformation, division or amalgamation), which generated a loss or income not allowing them to deduct R&D tax relief will be entitled to receive from the tax office an amount equal to the product of multiplying the relevant tax rate and the non-deducted R&D expenses, taking into account the limits provided for in the Act. Micro, small and medium-size entrepreneurs may receive the refund also in the year following the year in which they started their business if they are still unable to fully settle the R&D tax relief to which they are entitled. The said refund will be treated as overpayment and will constitute *de minimis aid*. If the taxpayer receiving the refund is adjudged bankrupt or enters into liquidation before the lapse of 3 years starting from the end of the tax year in which he received the bank transfer into his account, he will have to reimburse the amount paid to him.

Those changes should be considered as beneficial for taxpayers, especially for those who are micro, small or medium-size entrepreneurs. Undoubtedly, taxpayers will benefit from the longer period for deducting the tax relief which was not fully accounted for and from the extended list of eligible costs. The changes concerning R&D tax relief are also described in detail in our Tax Alert 28/2016.

Some taxpayers may have already forgotten about the Act passed in 2015 amending numerous provisions concerning the obligations to document transactions with related entities, which will come into force on 1 January 2017. The regulations applicable from 2017 define in a completely different way the entities obliged to prepare tax documentation and the criteria for selecting transactions for which such documentation must be prepared have also changed. For most medium-size and large entities operating in capital groups those obligations will be of high importance. The table below presents the most important of them.

The Act dated 09 October 2015 Amending the Natural Person Income Tax Act, the Corporate Income Tax Act and Certain Other Acts (Journal of Laws of 2015 item 1932)

Provision	Explanation of the change
S. 9a (1 - 1g) CITA – amended and added S. 25a (1 - 1g) NPITA – amended and added	Pursuant to the new regulations, those entities which generate a total revenue or costs according to the accounting legislation exceeding the amount equivalent to EUR 2,000,000 in the preceding tax year will be obliged to prepare the documentation. Exceeding this threshold will impose the obligation to prepare the documentation also in the next tax year, irrespective of the amount of the generated revenue or incurred costs in the previous year. The documentation will have to be prepared for the transactions and also other events recorded in the tax year in the books of account which have a significant impact on the amount of the income (loss). The transactions/events having a significant impact should be understood as those concluded with related entities or other transactions of one type whose value exceeds EUR 50,000. The threshold for transactions for which the documentation has to be prepared increases proportionally to the revenue generated by the taxpayer and may reach maximally EUR 500,000 for entities generating revenue exceeding EUR 100,000,000.
9a(2b-2i) CITA – added S. 25a(2b-2i) NPITA – added	Taxpayers will be obliged to prepare transfer price documentation with various informative scopes, depending on the amount of balance sheet revenue or costs. Local file Each taxpayer whose revenue / costs exceed EUR 2,000,000 will be obliged to prepare this documentation. The documentation needs to contain the key information on a given transaction, inter alia stating its type, together with the history of a given transaction, the related entity and a description of method and mode of calculation of taxpayer's income in the documented transaction.

	If taxpayers exceed the threshold of EUR 10,000,000 of revenue/costs, the local file must contain also the analysis of the comparative data. A detailed description of the elements which are to be included in the local file and also in the comparative analysis will be defined in the regulation of the Development and Finance Minister. Currently the draft of such a regulation has not been signed yet and is subject to public consultations. Undoubtedly it will come into force at the beginning of 2017. <u>Master file</u> Taxpayers whose balance sheet revenue or costs exceed the threshold of EUR 20,000,000 for the previous tax year are obliged to submit the master file in addition to the local file. The information contained in this report must mainly concern the manner of functioning of the whole capital group as a part of which the taxpayer operates, together with a description of its structure, types of business operated by the remaining entities in the group or the method of determining transfer prices. Detailed elements of this documentation are also to be found in the regulation of Development and Finance Minister which is being drafted. It should be noted that the provisions allow for submission of the group documentation prepared by a different related entity than the taxpayer, so the master file prepared by another entity from the capital group can be used for this purpose.
S. 9a(7) CITA – added S. 25a(7) NPITA – added	Each entity obliged to prepare the documentation will also have to make a declaration on the preparation of tax documentation. This document is aimed at confirming that the taxpayer met his obligation and prepared the required reports. The said declaration must be submitted not later than upon submission of the tax return and this deadline will also be the deadline for drafting the documentation.
S. 11(5a) CITA – amended S. 25(5a) NPITA – amended	In the new regulations the legislator significantly changed the definition of capital-related entities. In the light of the regulations those entities whose direct or indirect interest in the capital of another entity is not less than 25% are deemed to be related entities.
S. 27(5) CITA – added S. 45(9) NPITA – added	Taxpayers obliged to prepare the transfer price documentation whose amount of balance sheet revenue/costs exceeds EUR 10,000,000 will also have to fill in an additional annex to the annual tax return in the form of CIT–TP/PIT-TP, which will constitute a simplified report on transactions with related entities. Currently, the Finance Minister is working on the final content of this annex whose draft is subject to public consultations. This form will constitute the basic source of information about transactions with related entities thanks to which, undoubtedly, the tax authorities will be more apt at selecting taxpayers for inspection.
S. 27(6) CITA – added S. 45(10) NPITA – added	From the start of 2016 new regulations have been in force saying that in case of national parent companies, consolidating financial statements, where the value of the consolidated revenue exceeds EUR 750,000,000 and the taxpayers also have an establishment or a subsidiary abroad, such entities are obliged to submit a report on the amount of revenue and tax paid and the place of running the business by such foreign entities (Country-by-country reporting, CbC). The first report of this type was supposed to be prepared within 12 months from the end of the tax year, so at the end of 2017 at the earliest. Currently works are pending on the draft of the Act on Tax Information Exchange in accordance with which abolishment of those regulations from CITA and NPITA is planned. The obligation to submit CbC will be included directly in the drafted Act and presently it is not known precisely how the said report will be submitted and when the first deadline for its submission will be. However, the entities meeting the said criteria must take into account the additional documentation obligations which will sooner or later be imposed on them.

New regulations on transfer pricing applicable as at 1 January 2017 will lead to the situation where the obligation to prepare transfer pricing documentation will have to be analysed taking into account a new criterion - EUR 2,000,000 of revenue/costs. This means that the volume of operation in 2016 will determine whether in 2017 the entity will have to prepare the transfer pricing documentation with the same deadline as the one for submitting the annual return, namely at the end of March 2018. As it was in the past, the taxpayer will have to submit the prepared tax documentation at the request of the inspection body within 7 days. If you are interested in details of the said changes, please read our Tax Alert.

To sum up, like every year, at the beginning of January the legislator introduces changes in income tax acts. This time a few of them are welcomed, such as, inter alia, the reduction of CIT rate or the amendment to the principles governing R&D tax relief. Numerous new regulations, however, will impose new obligations and subsequent formalities on taxpayers. The said changes are worth analysing with respect to their influence on your business. In case of any doubts or queries, please contact us.

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