



October 2017

Planned amendments to the Corporate Income Tax Act as of 2018 – new version of the Draft Bill submitted to the Parliament

On 4th October 2017, the draft bill amending the PIT and CIT Acts as well as the Act on Lump Sum Income Tax ('the Draft') was submitted to the Parliament. Based on justification to the Draft, its main objective is to tighten the CIT system in order to ensure the link between the tax paid by large multinational enterprises to the actual place of deriving profits, in particular through preventing the use of mechanisms of the so-called aggressive tax planning.

As compared to the original draft bill presented in July the envisaged regulations have been partly liberalised (thin capitalisation, intangible services), but new provisions have been also introduced which had not been previously submitted for public consultation (e.g. regarding *debt push down structures*).

The planned amendments are expected to enter into force as of 1st January 2018.

Below we present the key amendments to the CIT Act as envisaged by the Draft:

- **Introduction of two sources of income:**

(-) income of a capital nature and (-) income of business activity and of special branches of agricultural activities. Taxable profits and costs from each source are to be separately settled in CIT return.

As opposed to the original version of the Draft, it has been decided to include in the capital income catalogue i.a. profits from sale

of receivables previously acquired by the taxpayer as well as receivables arising from profits of capital nature. Further, profits derived from financial instruments used to secure flows or revenues/costs not included in income of capital nature have been also excluded from the capital income catalogue.

In addition, special regulations for insurance companies have been introduced.

- **Changes in thin capitalisation rules:**

(-) application of restrictions to cover each debt financing (including loans granted by unrelated parties); (-) limitation of costs of surplus referring to debt financing (the difference between the interest paid by the taxpayer and the earned income on interest) to 30 percent of EBITDA;

The calculation method of EBITDA ratio has been modified as compared to the original draft. The ratio is now to be computed as the surplus of the total income from all sources less interest income over the sum of the deductible expenses decreased by depreciation on fixed and intangible assets and costs of debt financing.

The original annual limit of PLN 120 thousand of the surplus of debt financing costs over interest income below which the tax cost limitation does not apply, has been increased to PLN 3 million.

- **Exclusion from tax deductible costs interest on credits and loans incurred for the purpose of acquisition of shares in a company**, insofar as they would reduce income related to the continuation of the business of that company, in particular in connection with a merger, contribution, transformation of the legal form or establishment of Tax Capital Group (TCG). The proposed amendment is to prevent structures aimed at the so-called *debt push down* allowing to settle interest on loans/credits taken up to acquire shares against business income of the acquired company.

- **Limiting tax deductibility of payments for certain intangible services and fees for the use of copyright, industrial property rights or know-how.** According to the current Draft, the restriction is to be only applicable to services purchased from related parties and entities seated in tax havens. In addition, the following services are now to be excluded from the restricted catalogue: accounting, legal and employee or personnel recruitment services. The new Draft proposes also to limit the costs of transferring the debtor's insolvency on loans other than those provided by banks or credit unions.

In addition, the original limit has been revised and according to the new draft is set at 5 percent of EBITDA calculated in accordance with the rules

similar to those used for the purpose of thin capitalisation ratio.

The above restrictions should not apply to re-invoiced costs nor to costs directly associated with the production of goods or the provision of services.

Similarly as in the case of thin capitalisation, the annual limit of unrestricted expenses has been raised to PLN 3 million.

The above cost deductibility limitations should not apply to payments for intangible services within companies forming TCG.

- **Modification of tax regulations on Tax Capital Groups (TCGs):**
(-) decrease of threshold for TCGs,
(-) exclusion of donations from tax deductible costs. The current Draft removes the prohibition of participation in TCGs of companies operating within the Special Economic Zones.
- **Depreciation of the intangible assets.** The Draft introduces a restriction in tax depreciation of intangible assets as well as in tax deductibility of royalties charged for their use, if those assets were acquired by the taxpayer or self-developed and subsequently disposed – up to the amount of profit from their original disposal.

The new Draft clearly stipulates that the above limitation applies also to intangible assets previously acquired or self-developed by a tax transparent entity, whose partner is the taxpayer.

- **Introduction of a minimum taxation on commercial property** (malls or office buildings) of initial value exceeding PLN 10 million; the tax rate will amount to 0.42 percent of the surplus of the initial value over the amount of PLN 10 million p.a.
According to the Draft, the tax would not be levied on real estate assets used exclusively or mainly for the taxpayer's own purposes.
- **A change in CFC rules.** The Draft clarifies that, in assessing whether the genuine economic a CFC has a substantial character, the ratio of CFC profits from genuine business activity to its total profits is to be taken into account.
- **Revised rules on the taxation of demergers** regarding taxable profits and costs upon sale of shares in the demerged company following its spin-off.
- **Broadening the scope of real estate company clause** to include almost all commercial entities and their receivables.

- **The introduction of an economic substance (anti-avoidance) clause** for a contribution of business or an organised part thereof (as tax neutrality condition).

- **Increase in one-off tax depreciation threshold** from PLN 3 thousand to PLN 10 thousand.

- **Adjustment of the list of annual depreciation rates to the 2016 Fixed Assets' Classification.**

The impact of the planned amendments on the situation of taxpayers requires an individual case-by-case analysis. However, the principal objective of the Draft is to tighten the existing corporate tax system. In addition, new forms of taxation are to be introduced increasing the overall level of tax burden suffered by many taxpayers. Hence, the general effect of intended changes on taxpayers should be assessed as negative.

Please contact us if you would like to obtain more information on the draft amendments or discuss their impact on future tax obligations of your company as well as any possible changes in current business activity model to be best prepared for the new law.

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