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Changes to taxation of restructuring transactions

The amended tax laws coming into effect on 1 January 2020 are to introduce a raft of important changes to the Polish PIT and CIT regimes, such as extending CIT obligations to limited partnerships and certain general partnerships, along with implementation of the solution commonly referred to as "Estonian CIT", i.e. flat rate on income in capital companies for certain taxpayers.

However, the amendments included therein will also cover the principles of taxation of restructuring transactions, giving rise to multiple tax consequences and thus significantly affecting the taxpayers' choice of the method of carrying out such transactions and the amount of tax due.

Information on the key restructuring-related mechanisms brought by the amendments to the tax laws can be found below.

Deducting loss on acquisition of an enterprise or an organised part of an enterprise

The new regulations, introduced as of 1 January 2021 by way of amendment to the CIT Act, preclude the possibility to deduct the tax base for the taxpayer's loss on acquisition of an entity, an enterprise or an organised part of an enterprise, including acquisition through in-kind contribution, or reception of a cash contribution, for which the taxpayer purchased the enterprise or an organised part of the enterprise, and as a result:

- following such purchase or acquisition, the scope of the core business activity actually carried out by the taxpayer became different, in whole or in part, from the scope of the core business activity actually conducted by the taxpayer prior to such purchase or acquisition;
- at least 25 percent the taxpayer's shares are owned by the entity or entities that did not have such rights at the end of the tax year in which the taxpayer incurred a loss.

These regulations heavily impact tax consequences of acquisitions, limiting the ability of the acquirer to settle its tax losses from previous years upon acquisition of another company.

This is because under the new regulations, in order to settle tax loss incurred in the previous years, the taxpayer who acquired (purchased) another entity, an enterprise or an organised part of an enterprise must demonstrate that the core business activity actually carried out remained unchanged upon the transaction.

Thus, the discussed legislative changes are to ensure that the taxpayer's losses may be settled only if the business activity in relation to which they were incurred remains uniform with the currently conduced one.

However, the condition of uniform core business activity may be impossible to meet, given that in many cases the business objective behind such purchase or acquisition transactions is to extend the scope of activities previously carried out by the taxpayer.

Downstream merger

One of particular forms of merging companies, often used in restructuring transactions, is downstream merger in which a subsidiary takes over its parent company (substantial owner or shareholder).

CIT Act amendments limiting settlement of loss on acquisition, applicable as of 1 January 2021, will also impact tax consequences for restructuring transactions involving downstream merger. This is because it usually leads to acquisition of at least 25 percent of shares in the acquiring company by an entity which until the moment of acquisition did not hold such rights.

This means that the acquiring company loses the right to settle the tax losses, even if the core business activity actually pursued by the acquiring company from that moment on remains uniform with the one carried out prior to the transaction, and regardless of whether the restructuring, under which the acquisition transaction takes place, is economically viable.

The amendments may result in different treatment of regular acquisition transactions and downstream merger transactions in companies as to the possibility of settling losses by the company continuing the business.

New tax obligations of real estate companies

The new regulations are to introduce the definition of a real estate company to CIT and PIT. Under the provisions applicable as of 1 January 2020, a real estate company shall mean an entity, other than a natural person, obliged to prepare a balance sheet on the basis of accounting provisions, in which:

- as at the first day of the tax year, at least 50 percent of the market value of assets (directly or indirectly) was real estate located in Poland or rights thereto, with the value exceeding PLN 10m - for entities starting their business activity; or
- in the case of other entities - as at the last day of the year preceding the tax year, at least 50 percent of the book value of assets (directly or indirectly) was real estate located in Poland or rights thereto, with the book value exceeding PLN 10m or an equivalent amount determined according to the relevant exchange rate, and in the year preceding the tax year, taxable revenues (revenues included in the net financial income) from: letting, subletting, lease, sublease and other similar contracts, and from the transfer of ownership to real estate or rights thereto, and from shares in other real estate companies, constituted at least 60 percent of total taxable revenues.

Moreover, the amendments bring new rules of settling income tax on the sale of shares, and rights of a similar nature in real estate companies. The obligation to settle the tax is to be shifted from the real estate company, provided that the seller is not a Polish resident.

In such a situation, the real estate company, acting as the tax remitter, will be required to calculate the tax in the amount of 19 percent, collect it from the seller and make an advance payment to the account of a competent tax office.

Thus, in order to fulfil its tax-related duties, the real estate company must know the details of the transaction. In the absence of such knowledge, the real estate company will be obliged to settle the tax based on the market value of the said shares or rights.

Importantly, in the event of problems with obtaining the funds to cover the transaction tax from the seller, the real estate company will be required to pay it by itself.

Taxpayers should also keep in mind that real estate companies and taxpayers owning directly or indirectly shares, general rights and obligations, participation units or rights of a similar nature, giving at least 5 percent of the voting rights or rights to participate in the profits of the real estate company will be required to provide information about entities holding directly or indirectly shares or the said rights in a real estate company to the Head of the National Revenue Administration, by the end of the third month after the end of the tax year.

Correct fulfilment of the reporting obligation may pose a challenge, given that information on the entities with least 5 percent voting rights is frequently unavailable to real estate companies. Moreover, identification of transactions on which the tax is due may be difficult for companies with extensive shareholdings (e.g. publicly traded companies).

The amendments to the Polish income tax acts supplement introduction of a solution commonly referred to as 'real estate clause' to a growing number of bilateral double tax treaties signed by Poland.

The clause is to ensure that profits obtained through alienation of shares or similar rights in companies with real estate for main assets will be taxed in the country where the said real estate is located.

Under the amending protocol signed on 29 October 2020, the real estate clause was introduced to the Polish-Dutch double tax treaty. This may have a significant impact on tax consequences, especially for restructuring transactions involving entities from these countries, if the assets of one of these entities consist mainly of real estate.

Anti-avoidance clause

When assessing the tax consequences of transactions carried out by taxpayers, one should also consider the content of the applicable anti-abuse clauses, i.e. General Anti-Avoidance Rule (GAAR) and special clauses.

GAAR may be applied if the taxpayer uses an artificial legal structure with the primary or important purpose of obtaining substantial tax benefits, against the object or the purpose of a tax act or a tax provision.

In addition to GAAR, Polish tax regulations include a number of specific, 'minor anti-avoidance clauses', which may also be used by tax authorities to challenge tax consequences of activities carried out by taxpayers, including restructuring transactions.

Under one of such clauses, provisions on the tax neutrality of transactions relating to mergers, divisions, exchange of shares or in-kind contributions shall not apply where the primary or one of the main purposes of these activities is tax avoidance or evasion.

Furthermore, the CIT Act includes a special clause to prevent abuse of tax exemptions on revenue from dividends and other revenue from shares in profits of legal persons, including interest and royalties.

Under the clause, the use of exemption on revenue earned in this way is precluded if it goes against the object or the purpose of a tax provisions providing for the exemption and/or if the primary or one of the main purposes of entering into transaction(s) or performing action(s) was to obtain a substantial tax benefit, and if the taxpayer uses an artificial legal structure.

Such anti-avoidance clauses should be taken into consideration especially by taxpayers willing to engage in restructuring transactions. In practice, such transactions are of particular interest to the tax authorities.

Additionally, extending CIT obligations to limited partnerships (and certain general partnerships) from 1 January 2021, means that transactions involving those entities - including restructuring transactions - may be meticulously examined by the tax authorities against the possibility of application of new regulations.

If you would like to learn more about the issues discussed, please do not hesitate to contact us at: mampytanie@kpmg.pl

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