

November 2021

Tax changes in the Polish Deal affecting the real estate market

On 29 October 2021, the amendment to the Polish tax law called “Polski Ład” (“Polish Deal”) was passed by the Sejm. The bill was submitted for the President’s signature. Some of the amendments brought by the bill may have negative impact on the real estate market.

Please find below summary of the adopted changes, which may particularly affect the real estate industry.

Limitation of tax depreciation in real estate companies

The amendment includes limitation of the deduction of tax depreciation write-offs of real estate assets in real estate companies. Under the new rules, the tax deductibility of tax depreciation write offs in real estate companies will be limited up to the value of accounting depreciation.

The main purpose of this amendment is to reduce the differences between the tax and accounting result reported by the real estate companies in a given year. However, neither the amendments nor the explanatory memorandum provide further information on interpretation

of this rule for real estate companies recognizing the real estates as investment for accounting purposes in the fair market value where no accounting depreciation is being claimed.

The new rule may mean that effectively no tax depreciation may be claimed, what will negatively impact the returns on assets.

Disallowed tax depreciation of residential real estates

According to the proposed amendment, residential real estates should not be subject to tax depreciation. The taxpayer will be entitled to recognize costs incurred for acquisition of this asset upon disposal.

This amendment has significant impact on the profitability of Private Rental Sector projects.

Under transitional provisions, the taxpayers will be still entitled to depreciate residential real estates for tax purposes until the end of 2022 provided that such residential real estate was acquired or created before 1 January 2022.

Minimum tax

The amendment provides for a new minimum income tax of 10 percent of the tax base. It will apply to CIT taxpayers, including tax capital groups and foreign entities with a permanent establishment in Poland, which:

- suffer losses from source of income other than capital gains; or
- show a low profitability ratio within source of income other than capital gains (i.e. the share of income in revenues constituting no more than 1 percent).

However, to determine whether an entity is subject to a minimum tax, the tax loss or tax income should be adjusted by the value of expenses or depreciation write-offs for fixed assets.

The tax base will consist of an amount corresponding to:

- 4 percent of revenues other than capital gains;
- excess debt financing from related entities exceeding the statutory deductibility limit (exceeding 30 percent of tax EBITDA);

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- costs of intangible services acquired directly or indirectly from related entities or entities based in a country that uses harmful tax competition (exceeding 5 percent of tax EBITDA plus PLN 3m); and
- the value of deferred income tax resulting from the disclosure of non-amortised intangible assets in tax settlements to the extent that it results in an increase in gross profit or a decrease in gross loss.

The regulations provide that taxpayers will be able to deduct the minimum income tax from CIT calculated in accordance with general principles in the following tax years.

There are also exemptions from the application of the minimum income tax to taxpayers:

- starting a business, in the year of commencement of operations and in the next two tax years immediately after the year of commencement of operations;
- that are financial companies;
- if in a given tax year their revenue was lower by at least 30 percent compared to the previous tax year;
- whose stockholders, shareholders or partners are natural persons and at the same time the taxpayer does not have shares/other property rights in another entity (i.e. a company, investment fund participation titles or rights to receive a benefit as a founder / founder of a trust or other entity of a fiduciary nature);
- that derives revenue from source other than capital gains mainly from mining of specific minerals or operating in international transport of vessels and aircrafts;
- the companies belonging to a group of at least two companies, in which one company has a direct 75 percent share in a capital of the other

companies belonging to the group, the tax year of the companies covers the same period, and the share of the total income of the companies in their total revenues calculated for the tax year is more than 1 percent - however, while determining the conditions of the exemption, only companies which are the Polish tax residents can be taken into account.

Hidden dividend

Under implemented changes the costs incurred by a taxpayer in connection with a service provided by a related entity (within the meaning of transfer pricing regulations) to the taxpayer or to a shareholder should not be considered as tax deductible costs if such cost constitutes a hidden dividend.

Costs constitute a hidden dividend if:

- 1) the amount of these costs or the date of their incurring in any way depend on the profit made by the taxpayer or the amount of this profit; or
- 2) the taxpayer acting reasonably would not incur such costs or could incur lower costs if a comparable service was performed by non-related entity to the taxpayer; or
- 3) these costs include remuneration for the right to use the assets that were owned or jointly owned by the shareholder or an entity related to the shareholder prior to the creation of the taxpayer.

The cases described in points 2) and 3) do not apply when the sum of the costs incurred by the taxpayer in the tax year is lower than the amount of gross profit within the meaning of accounting regulations obtained in the financial year in which these costs were included in the financial result taxpayer.

The main purpose of this amendment is to prevent recognizing as tax deductible costs payments that may be classified as hidden dividends.

The new rules in this respect will enter into force from 1 January 2023.

Thin capitalisation rules and interest deductibility restrictions

According to the adopted change with regard to thin capitalization rules, it is intended to make it clear that any net financing cost resulting from the thin capitalization rules would be deductible to the higher of 30 percent tax EBITDA or a PLN 3M.

Additionally, the changes will disallow the tax deductibility of interest on debt received from related party to the extent such debt was purposed for capital transactions, in particular acquisition of shares (including interest in partnership), increase of share capital or surcharges as well as for buyback of own shares.

Withholding tax

The amendment narrows the scope of the WHT refund mechanism to payments mainly made as interest, dividends and royalties only to a related entity (according to the meaning of transfer pricing rules). The act also provides for the exclusion of dividends paid to Polish residents from the WHT mechanism.

According to the amendment, the "pay and refund" mechanism will also apply to receivables which, without justified economic reasons, were not classified as receivables covered by this method of settlement. It can be assumed that this regulation would apply to payments that have been artificially structured.

The regulations assume that the requirement to present the documents required in the WHT refund procedure in terms of the status of the beneficial owner and conducting real business activity applies when separate provisions of law or DTT agreements require the examination of the fulfilment of the conditions referred to in these provisions.

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In addition, the amendment act also extends the scope of the opinion on the application of the exemption to DTT agreements. It assumes that the tax authority, upon an application submitted by a taxpayer or remitter, issues an opinion on the application by the remitter of WHT exemption or the application of the tax rate resulting from the relevant DTT agreement, provided that the application shows compliance with the conditions set out in the relevant provisions of the CIT Act (resulting from the provisions implementing EU Directives) or the conditions for the application of the DTT agreement.

Effective place of management

The amendment implements to the Polish CIT law the concept of effective place of management.

According to the amendment, the taxpayer has a management board in the territory of the Republic of Poland, inter alia, when the current affairs of this taxpayer are conducted in an organized and continuous manner on the territory of the Republic of Poland, based in particular on:

- an agreement, decision, court decision or other document regulating the establishment or functioning of this taxpayer; or
- granted powers of attorney; or
- connections within the meaning of the provisions on transfer pricing.

"Conducting the current affairs of the taxpayer" should be understood primarily as the actual making of the most important management and economic decisions necessary for the functioning of the taxpayer. To determine where these management decisions are actually made, it is also important where they were actually prepared by professional personnel and where data were collected and processed or analyses made to make these decisions, i.e. in practice the place of the actual decision-making process.

The main goal of adopted changes is to prevent the practice of incorporation of foreign entities by the Polish residents, which are effectively managed from Poland, but income is taxed in the country of the entity's seat. In case the company would be regarded as a Polish tax resident under effective place of management, it should be subject to taxation in Poland on its worldwide income.

Polish holding company

The amendment introduces to the Polish law new rules on taxation of holding companies seated in Poland.

In case certain conditions are met, Polish holding company would be tax exempt on:

- dividends received from its subsidiary up to 95 percent of its amount (i.e. only 5 percent of received dividend will be taxed in Poland);
- capital gain realised on disposal of shares in the subsidiary to non-related entity.

However, this rule will not be applicable to the exemption of the capital gains on the sale of shares in the real estate companies.

The amendment will be an alternative for the current exemption for dividends under EU Parent-Subsidiary Directive. It means that in case the taxpayer applied tax exemption based on EU Parent Subsidiary Directive for dividend distribution, disposal of shares in a subsidiary will be then taxed under general rules.

The changes are intended to enhance foreign and Polish investors to incorporate holding entities in Poland.

The consolidation relief

The consolidation relief is purposed to encourage Polish taxpayers to expand their business activity through domestic and foreign

acquisitions. Based on the amendments, taxpayers will be entitled to deduct so-called "qualified expenses" associated with the acquisition of shares from the tax base in the year of acquisition up to the amount of PLN 250k. The following costs should be considered as "qualified expenses": costs associated with legal services, valuation (due diligence), interest, transaction taxes, notary and court fees (purchase price for shares is excluded from "qualified expenses").

Consolidation relief will be available only in case:

- the acquired company is seated in Poland or another country which signed a double tax treaty with Poland that has a basis for exchange of tax information;
- the core activities of the acquired company correspond with the scope of business activity of the Polish taxpayers or could be considered as supporting for the Polish business and such activity was carried out for both companies for at least 24 months prior to the acquisition;
- the companies were not related parties in the period of 2 years prior to the acquisition;
- the transaction involves acquisition of absolute majority of votes.

Restructuring

According to the proposed changes, the restructuring regulations are to be significantly changed. Especially:

- only the first exchange of shares could be neutral if the conditions for tax neutrality are met. It should be noted that these changes may have a significant impact, in particular, for foreign investors whose asset value results, directly or indirectly, from the value of real estates located in Poland;

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- the neutrality of mergers and demergers is to depend on whether the shares in the acquired or divided entity were acquired as a result of an exchange of shares or another merger or demerger.

Other amendments

Moreover, the Polish Deal is intended to repeal Article 15e of the Polish CIT law that provided tax deductibility limited on intangible services acquired from related parties. However, as mentioned above such costs may be captured by the regulations of Minimum Tax.

The amendments brought by the bill will enter into force mainly on 1 January 2022 with some exceptions indicated above.

If you would like to learn more about the issues discussed, do not hesitate to contact us.

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