



Tax Alert |

Estonian CIT under the Polish Deal: changes in favor of taxpayers

KPMG in Poland

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The act introducing tax changes under the Polish Deal brings important amendments beneficial to taxpayers with regard to the scope and application of the lump-sum scheme of taxation of corporate income, commonly referred to as the Estonian CIT scheme.

Most of the changes take effect on 1 January 2022.

What is the Estonian CIT scheme about, what benefits can it bring, and who is entitled to apply it?

Below, we present a summary of the most important changes to the Estonian CIT mechanism, which can make this form of taxation much more attractive for businesses than before the amendments.

What is the Estonian CIT scheme about?

In principle, the Estonian CIT scheme consists in deferring income tax payment until the moment of distributing the entity's profits among partners. Therefore, the income tax is not paid on an ongoing basis and the funds allocated for this purpose may be reinvested. Importantly, the effective tax rate under the scheme is much lower than in the case of standard taxation.

Under the Polish Deal, the list of entities eligible to apply the Estonian CIT scheme got extended with simple joint-stock companies, limited partnerships, and limited joint-stock partnerships (up to now, the scheme could be used only by joint-stock companies and limited liability companies).

> Taxation upon profit distribution

One of the key amendments brought about by the Act in terms of the Estonian CIT mechanism application consists in deferring CIT taxation of profits until the moment they are distributed (i.e., paid out to shareholders or partners).

This means that the profits of companies using the scheme become subject to tax only when distributed. Importantly, even after opting out of the Estonian CIT scheme, the tax on profits accumulated during its application becomes due upon distributing the profits among shareholders (partners).

Thus, the new Act eliminates the disadvantage of the previous regulation, consisting in the necessity to pay the entire tax immediately after the end of the application of the Estonian CIT regime, which was one of the factors potentially inhibiting the choice of this form of taxation among companies.

> Effective tax rate

Under the amended regulations, the effective tax rate for small taxpayers and taxpayers initiating their business activities will amount to 10 percent and 20 percent for other taxpayers. Given the obligation to pay PIT (considering the deduction mechanism applicable to distribution of profit by the company, also in the case of payments made after the period of scheme application elapses), the effective tax rate, i.e., **the total rate of CIT and PIT payable on the profit – will amount to 20 percent for small taxpayers and 25 percent for other taxpayers.**

It may be also assumed that PIT should be calculated in relation to the profit reduced by the lump-sum due. In such a situation, the effective tax rate would drop to 18.1 percent and 21.2 percent, respectively. This position, however, should be verified on an individual basis and confirmed with tax authorities.

> Eligible entities

The Estonian CIT scheme can be applied also by entities with gross revenue of above PLN 100 million. Importantly, the new regulations provide for repeal of the capital expenditure requirement. At present, the fulfilment of the capital expenditure condition not only no longer determines the possibility of using the scheme but does not affect the tax rate at all.

Moreover, the requirement precluding entities with subsidiaries and shareholders or partners other than natural persons from using the scheme has been maintained. Other requirements that continue to apply relate to the minimum level of employment, i.e., the requirement to employ at least three individuals under an employment contract or other civil law contract, subject to PIT and social security contributions.

> What actions should be taken to use the scheme?

Taxpayers willing to apply the lump-sum tax scheme must notify the competent tax authority, prepare a report on the so-called transitional differences, and then settle the tax on the recognized income on general principles. Under the new regulations, the Estonian CIT scheme can be enrolled in also during the tax year, meaning that the decision to apply it may be taken after a thorough consideration.

It should also be noted that, starting from 2022, the obligation to pay tax on the preliminary adjustment of revenues and costs will expire if the taxpayer uses Estonian CIT for a period longer than 4 years. This means that another regulatory obstacle, preventing many taxpayers from applying the scheme, has been removed.

> How can we assist you?

The vast array of services provided by KPMG includes:

- verification of the taxpayer's eligibility to enrol in the Estonian CIT scheme, including performance of a profitability analysis,
- support in the process of changing the legal form of the business to benefit from the Estonian CIT scheme,
- performing an analysis of tax efficiency of the solution,
- performing an analysis of risks and benefits associated with the application of the Estonian CIT scheme,
- determining the rules of settlements between the entity and its partners and related entities,
- suggesting the best approach in individual cases.

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

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