



INDIVIDUALS AND FAMILY COMPANIES

INTERNATIONAL TAXATION

– 1/2022 NEWSLETTER

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CHANGES IN THE LAW

1. The Polish Deal

As of 1 July 2022, an amendment to the personal income tax and health contribution regulations comes into force. The amendment will be relevant for individuals earning income from Polish sources. Many changes are positive for taxpayers, but some may cause a number of the structures in place to lose their efficiency and popularity.

The legislation is intended to 'fix' the provisions in force in this regard from 1 January 2022 under the so-called 'Polish Deal'. It introduces, among other things, a fixed tax-free amount of PLN 30,000 for all taxpayers, but removes the possibility to deduct health contributions from PIT, as well as subjecting practically all income of individuals to health contributions. Some changes will be retroactive from the beginning of 2022.

The main change will be a reduction in the lower tax rate from 17% to 12%. This rate will apply to income of PLN 120,000. However, this involves the removal of the complicated mechanism of the so-called Middle Class Relief, introduced from January 2022. The effect of this change will have a positive impact on the net income received by some taxpayers. However, when comparing the net income of taxpayers earning more than PLN 17,000 gross per month to the previous year, their net income will be lower than in 2021.

The changes also include reinstatement of the single parent settlement with a child, giving a saving of up to PLN 27,000 in place of the relief that provided a tax saving of PLN 1,500.

The new legislation will cover the income of general partners of a limited joint-stock partnership and proxies, omitted from the previous amendment, subject to the health contribution. As a reminder, from the beginning of 2022, the health contribution is subject to income of board members and members of audit committees.

From July 2022, taxpayers who have opted for a flat rate tax or a lump sum tax will be entitled to partially deduct health premiums from tax base (rather than from tax as until the end of 2021).

The changes are particularly important for sole traders, as they affect the efficiency of the various forms of business taxation and allow the chosen form to be changed to the general rules with the submission of the annual return. In this case, we recommend analysing the efficiency of the solution chosen so far. This is particularly important in the case of a flat rate tax, as a change in the form of taxation may require evidence of costs.

TAX PRACTICE

2. Tax residence

Tax residency is a way of determining where a person is obliged to fulfil their tax obligations.

Under current legislation, Polish tax residence is acquired by a person who:

- has a centre of personal or economic interest (centre of vital interests) in Poland or
- stays in Poland for more than 183 days in a tax year.

There has been considerable doubt as to which premise is decisive and what follows in a situation where a taxpayer has been deemed to be a local resident under foreign regulations. The existence in Poland of a centre of vital interests means having close personal or economic ties with Poland. The centre, or 'concentration' of personal interests, should be understood as the place with which the taxpayer has close personal ties.

The criterion of the length of stay should be regarded as met after exceeding 183 days of stay on the territory of Poland in a given calendar year. Failure to exceed the specified length of stay on the territory of Poland in a given calendar year results in failure to meet this criterion. The condition of staying in Poland for more than 183 days in a calendar year does not mean that it has to be an uninterrupted stay.

The Supreme Administrative Court, in a case under case number II FSK 2692/19, in a judgment of 14 June 2022, clearly stated that the basic premise conditioning tax residency is family ties and the related centre of life interests. Even a concluded employment contract connecting the taxpayer with the Polish state, in the court's opinion, was not a sufficient reason to recognise the taxpayer as a Polish tax resident.



3. Information obligations of real estate companies

As of 1 January 2022, the concept of a real estate company has been introduced into the income tax laws. In addition to the establishment of special tax rules on the disposal of shares in such a company by a non-resident, additional reporting obligations have been imposed on real estate companies and their shareholders, which should be implemented from January 2022 onwards.

In order for an entity to be recognised as a real estate company, a number of conditions need to be met, which will vary depending on whether the entity is just starting out or is already operating.

A start-up entity meets the definition of a real estate company if:

- on the first day of the year, at least 50% of the market value of its assets was, directly or indirectly, represented by the market value of real estate located in Poland or rights to such real estate, and
- the market value of these properties exceeds PLN 10 million or the equivalent in other currency.

An additional requirement to be recognised as a real estate company has been established for companies operating prior to the introduction of the disclosure obligation, namely:

- in the preceding year, its income from leases, subleases, subtenancies, subtenancy agreements, leases and other contracts of a similar nature or from the transfer of ownership, the subject matter of which is immovable property or rights to immovable property, and from interests in other real estate companies, accounted for at least 60% of its total income.

Under current legislation, the obligation to settle tax on income from the disposal of shares has been transferred if the party making the disposal is an entity that does not have its registered office or management in the territory of the Republic of Poland or a natural person who does not have a place of residence in the territory of the Republic of Poland.

The disposal transaction is taxed:

- shares (stocks) carrying at least 5% of the voting rights in a real estate company;
- all rights and obligations conferring at least 5% of the right to share in the profits of the company which is not a legal person;
- 5% or more of the total number of units or rights of a similar nature in a real estate company,

At the same time, the legislator has set out an obligation to provide additional information in relation to taxpayers holding, directly or indirectly, in such a company:

- shares carrying at least 5% of the voting rights;
- the totality of rights and obligations conferring at least 5% of the right to share in the profits of a company that is not a legal person;
- 5% or more of the total number of units or rights of a similar nature

The information on ownership structure includes information as at the last day of the tax year (financial year, in the case of a company that is not subject to income tax) and is submitted by electronic means.

The real estate company and the partners fulfilling the above requirements are obliged to submit to the Head of the National Revenue Administration by the end of the third month after the end of the tax year of the real estate company. However, this year, according to the regulation of the Minister of Finance, the deadline has been postponed to 30 September 2022.

4. Relief for monuments

With the introduction of the Polish Order, a so-called historic buildings relief was added. Given the possible scale of the deduction, this is an allowance that is worth looking into when you plan to invest in the coming years.

The legal basis for the monuments relief is Article 26hb, introduced as part of the Polish Deal to the Personal Income Tax Act. Pursuant to its provisions, individuals may deduct the following groups of expenses from the tax base:

Payments made by the owner or co-owner of an immovable monument to the renovation fund of a housing association or housing cooperative established for that monument.

Expenses incurred by the owner or co-owner of an immovable monument for conservation, restoration or construction works in the monument. However, it should be emphasised that such works must take place on the basis and within the scope of the permission of the regional conservation officer (monuments from the register of monuments) or conservation recommendations (monuments from the register).

For both groups of expenditures, the monument to which the works relate must be entered into the register of historic buildings or in the municipal register of historic buildings, which significantly increases the availability of the relief. In both cases, up to 50% of the documented expenditure can be deducted. The lack of an upper limit of deduction adds to the attractiveness of the relief.

The last group of expenses eligible for the deduction is the acquisition of an immovable monument entered in the register of monuments (monuments from communal records have already disappeared from this group) or an interest in such a monument. An additional condition necessary to take advantage of this option is to incur expenditure on the conservation, restoration or construction works described above. However, no minimum amount of such expenditure is specified. The deduction related to the purchase of real estate cannot exceed the product of the amount of PLN 500 and the sum of the usable area in square metres of the real estate, with the upper limit of the deduction for this purpose being PLN 500,000.

In all of the cases above, no minimum time of ownership or use of the property after the deduction is specified. The disposal or donation of a monument, even if in a subsequent year, will therefore not result in tax ramifications.

Another incentive to take advantage of the historic buildings allowance is that it can be used in six consecutive years, as long as the amount of the deduction exceeds the taxable income in the year of deduction.

Although investment in monuments may seem to be burdened with a large number of formalities (the requirement to obtain a permit from the provincial conservator of monuments or conservator's recommendations), taking into account the significant possibilities of tax deductions, it is definitely worth considering investments in the pearls of Polish architecture. Owning or restoring a monument can bring immense satisfaction, especially if it allows saving a part of the property from the tax authorities' inclinations.



JURISPRUDENCE

5. Donation to a non-resident from personal property exempt from so-called Exit Tax

The applicant, who is subject to unlimited tax liability in Poland, wished to make a donation of shares in a company with a value in excess of PLN 4 million to her son who is resident outside the Republic of Poland and not subject to unlimited tax liability in Poland.

The court stated that the statutory definition of assets indicates that these are assets related to the taxpayer's business activity. The NSA emphasised that the notion of 'asset' as well as 'personal property' have their normative meaning resulting from legal definitions, pointing out that the term 'asset' refers exclusively to property that is connected with the exercise of economic activity.

In view of this, it cannot be assumed that, by way of an appropriate application of the rules, it is possible to impose tax on income from unrealised gains from a gratuitous transfer, i.e., a transfer to another entity from another EU country of a personal asset located in the territory of the Republic of Poland, while this is possible only in the case of a change of residence by the taxpayer, and not in the case of a mere transfer of assets on any basis.

6. Establishment within the meaning of the so-called Exit Tax provisions

A Polish tax resident taxpayer with unlimited tax liability was planning to change his tax residence to the Netherlands, while at the same time establishing a civil partnership in Poland to organise and expand his assets, qualified as holding services excluding financial holdings.

The main questions subject to the individual interpretation related to the potential recognition of a civil partnership as a permanent establishment within the meaning of a double tax treaty (hereinafter: DTA) and the possibility of taxing the taxpayer's assets with so-called exit tax.

In an individual decision, the National Revenue Information unequivocally held that a civil partnership, actually operating in the territory of the Republic of Poland, is a permanent establishment for the taxpayer within the meaning of the DTT. The taxpayer's economic activity in the form of a civil partnership, which is a permanent establishment, entitles him to exemption from exit tax, as the company's assets will be subject to taxation in Poland and thus there will be no potential depletion of revenue to the Republic of Poland.

As an aside, The National Tax and Customs Information Office (KIS) noted that if a company carries out its activities in the form of a company or other arrangement which is treated as tax transparent under the tax law of a Contracting State, that State, will be able to tax in the hands of the non-tax resident partners of such an entity the profits derived from the sale.

INTERNATIONAL TAXATION

7. Unshell Directive

Significant changes are planned at EU level regarding the taxation of so-called shell companies. The legislation could prove to be an earthquake for some cross-border holding structures.

The draft directive envisages the creation of an elaborate system for verifying entities for having a minimum level of substances.

The Directive's provisions will apply to all economically active entities, irrespective of legal form, having their tax residence in a Member State. Outside the scope of the Directive will be:

- a) holding structures that are tax resident in the same country as their beneficial owner and operating subsidiaries (no cross-border element);
- b) financial institutions regulated by EU law as listed in the Directive;
- c) companies listed on EU financial markets;
- d) entities with a minimum of five full-time employees who perform, exclusively, tasks generating so-called substantial income.

The inclusion of an entity in any of the above groups will exclude any further obligations of the entity. However, if it is not possible to apply the exemption, it will be necessary to go through the next phase, i.e., self-auditing of the entity for the reporting obligation, which we describe in the following paragraphs.

A key issue in the whole mechanism of the directive is the concept of qualifying income (relevant income), which, in simple terms, is passive income.

In this phase, the entity will be required to check for itself the three criteria determining its classification as a high-risk entity and activate the reporting obligation.

The indicators that determine the status of a high-risk entity are:

- a) more than 75% of the entity's revenue in the preceding two tax years was qualifying revenue;
- b) more than 60% of the entity's qualifying revenues are derived from cross-border transactions or
- c) more than 60% of the value of the immovable or movable property from which the entity derives qualified income was located outside the entity's country of tax residence during the preceding two tax years; during the preceding two tax years, the entity outsourced the administration of its day-to-day operations and decision-making processes for essential functions abroad.

Entities meeting all three criteria together, as high-risk entities, will be required to report minimum substance ratios in their annual tax returns. In addition, they will be subject to a system introduced by the Directive for the automatic exchange of information between Member States on entities obliged to report. Taxpayers who do not comply or who comply incorrectly with this obligation will face an administrative penalty equivalent to at least five per cent of their annual turnover.

However, a temporary exemption from this obligation will be possible by submitting an appropriate application to the tax authorities. The taxpayer will have to prove that the existence of the holding company does not reduce the tax burden of the beneficial owner or the group of which the holding company is a part. The exemption will be able to be granted for one year, renewable for up to five years provided there are no changes in the structure of the group and the beneficial owners. However, the reporting exemption will not affect the automatic exchange of information concerning the holding company.

The minimum substance statement made in the tax return will refer to the following circumstances:

- a) the subject's ownership of the premises or the exclusive right to use the premises in their country of tax residence,
- b) having their own active bank account in one of the Member States,
- c) employing at least one person as a director who is tax resident in the entity's country of tax residence, or employing a majority of full-time employees who are tax resident in the entity's country of tax residence.



Positive self-reporting of information confirming that all three conditions are met will result in a presumption of having a minimum level of the substance for one year. This status will conclude the verification of the entity, but will not exclude the obligation to self-report in subsequent years and the automatic exchange of information concerning the entity. Failure to meet the criteria will give rise to a presumption of the opposite, i.e., no minimum substance level.

However, this presumption will be able to be challenged by submitting:

- a) documents justifying the economic basis for setting up the entity;

- b) information on the entity's staffing structure (experience and qualifications of employees, their roles in the structure, duration and form of employment);
- c) unambiguous evidence that decisions on material revenue-generating activity occur in the entity's country of tax residence.

Rebuttal of the presumption will avoid the obligation to further examine the entity and report for a period of one year, extendable to five years. Consequences of declaring an entity a shell if the presumption is not rebutted, the entity will be declared a shell. This will be likely to give rise to severe ramifications on tax grounds:

- a) the entity will be deemed to be a look-through entity;
- b) the authorities will refuse to issue a tax residence certificate to the entity or will issue a certificate stating that the entity cannot benefit from the withholding tax exemption;
- c) the entity will be deprived of tax benefits under the EU parent-subsidiary regime (withholding tax exemption for dividends, interest, royalties) and double tax treaties

8. AML obligations

As a result of the amendment of the Anti-Money Laundering and Countering the Financing of Terrorism (AML) Act of 1 March 2018, the Register of Activities for the Benefit of Companies or Trusts has been in place in the Polish AML system since 31 October 2021. Entities providing services that qualify as services for the benefit of companies or trusts have been required to obtain an entry in the Register.

Who is affected by the obligation to register?

The obligation to register with the Register is incumbent on entrepreneurs who provide services consisting in:

- creation of a legal person or an organisational unit without legal personality;
- acting as a member of the board of directors or enabling another person to exercise that function or a similar function in a legal person or unincorporated entity;
- the provision of a registered office, business or correspondence address and other related services to a legal person or unincorporated entity;
- acting or enabling another person to act as trustee of a trust created by a legal transaction;
- acting or enabling another person to act as a person exercising rights over shares for an entity other than a company listed on a regulated market subject to disclosure requirements under European Union law or subject to equivalent international standards.

In practice, special attention must be paid by entrepreneurs who provide (e.g., under a lease agreement) real estate to legal persons or unincorporated organisational entities as their registered office address or as the address at which these entities will conduct their activity or have their correspondence address. Such an activity qualifies as an activity requiring registration.

What is the deadline for obtaining an entry in the register?

Entrepreneurs who plan to commence the activities covered by the registration requirement on or after 31 October 2021 should obtain the registration of the Registry before actually carrying out such activities.

In contrast, entrepreneurs trading as companies or trusts before 31 October 2021 had until 30 April 2022 to make an entry.

How to make an entry

Entry into the Register is made on the basis of an application submitted electronically via the ePUAP platform to the Director of the Tax Administration Chamber in Katowice.

The application to the Register must include.

- name or business name;
- the number in the Register of Entrepreneurs in the National Court Register, if such a number has been assigned, and the tax identification number (TIN);
- indication of services provided to companies or trusts;
- a qualified electronic signature, a trusted signature or the personal signature of the applicant.

A statement of awareness of the criminal liability for making false statements will be included in the application.

Additional requirements imposed on providers of services to companies or trusts

The Act introduces the requirement that the partners, members of the board of directors, persons managing activities in the entity for the benefit of companies or trusts and tangible beneficiaries of the entity providing services to companies or trusts have not been duly convicted of an intentional offence against the activities of state

institutions and local self-government, against the administration of justice against the credibility of documents, against property, against economic turnover and interests in civil law transactions, against money and securities, a terrorist offence, an offence committed for financial or personal gain or an intentional fiscal offence.

In addition, the aforementioned persons must have knowledge or experience relating to activities for companies or trusts, which is deemed to be fulfilled in the case of:

- Completion of a training or course covering legal or practical issues relating to activities for companies or trusts;



- the performance, for a period of at least one year, of activities relating to companies or trusts, evidenced by appropriate documents.

... what are the penalties for non-entry?

An entrepreneur who carries out activities for the benefit of companies or trusts without obtaining an entry in the register of activities for the benefit of companies or trusts is subject to a fine of up to PLN 100,000.

9. White collar crime - Article 296 of the Penal Code in the light of planned amendments

Article 296 of the Penal Code provides for the offence of abuse of trust, also known as mismanagement of a manager. Criminal liability is incurred by a person who, being obliged to deal with the property affairs or business activities of a natural person, a legal entity or an organisational unit without legal personality, by abusing the powers granted to him or by failing to fulfil the obligation incumbent on them, causes significant property damage. In the event that even a mere 'imminent danger' of causing damage is brought about, there is a risk of imprisonment of up to three years for the perpetrator.

Within the framework of Article 296 of the Penal Code, the legislator provides for an application mode of prosecution of the offence. This means that if the wronged party is not the State Treasury, then the prosecution of the offence takes place at the request of the wronged party. Due to the fact that the damage does not refer to the loss on the part of the shareholders of an enterprise, a commercial law company, they are currently not considered wronged parties under this regulation.

The Ministry of Justice, in a draft amendment to the Penal Code, proposes extending the catalogue of wronged parties to include a partner, shareholder or member of a wronged company or member of a wronged cooperative. This change is motivated by the fact that proceedings in this case can be initiated by any interested entity in terms of its property interest within a given organisational structure, according to the intention of the Ministry, after the introduction of the changes, it will not be required, as it has been the case so far, to formally express the will to prosecute by a competent statutory body of the wronged party, but it will be sufficient for such a will to be expressed on the part of an entity included in the wronged party's organisational structure.

The planned changes have been met with a negative reception, with representatives of the doctrine signalling the potential consequences of their introduction. After all, every bold investment decision involves a certain risk of damage, and the mere incurring of risk is penalised under the indicated regulation. As a consequence of the extension of rights, shareholders (also minority shareholders) will be equipped with an instrument to influence company bodies. If they are not satisfied with the decisions taken, they may attempt to exert pressure on decision-making bodies, raising the spectre of time-consuming criminal proceedings, which may have a paralysing effect on the functioning of the company.

10. MLI Convention

As of January 2022, the provisions of the MLI (The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting) Convention entered into

force in relation to the agreements concluded between Poland, Chile, Pakistan, Estonia, Croatia, Hungary, Greece and Spain.

What does this mean in practice?

The main modification is the change of the method of avoiding double taxation from the exemption method with progression to the method of proportional credit (so-called tax credit). This method is less favourable for taxpayers. In practice, from 2022 it will cover income earned by Polish tax residents from sources in Jordan, Pakistan and Greece, and from 2023 from Estonia and Spain.

The exclusion method (which has been used until now) is that foreign income is not taxed in Poland. However, it is taken into account when calculating the so-called effective tax rate, which is used to calculate tax on Polish income. The effective tax rate is determined by adding together foreign and Polish income and determining what percentage of the income would be taxed if all income were taxed in Poland, in practical terms, where between 12% (lower rate) and 32% (higher rate) will be the tax rate.

This also means that if the taxpayer does not earn income from Polish sources, such income is not taxed in Poland.

The tax credit method involves calculating Polish tax on the total income and tax paid abroad, but only up to the amount of tax due on that income in Poland. This means that a taxpayer who receives income taxed at a lower tax rate (in amount) will have to pay additional tax in Poland, up to the amount that would be due on the whole income in Poland.

In practice, this also results in the taxpayer having to pay advance payments on such income in Poland, and may be exempt from such payments on the basis of a decision of the tax office if they demonstrate that their foreign income will be taxed at a higher rate than in Poland.



The entry into force of the MLI Convention also affects income from dividends and the sale of shares in real estate companies (companies of which at least 50% of the assets are real estate located in its country of domicile).

The agreement introduces a requirement to hold shares for at least 365 days in order to apply the profit exemption. Poland does not apply this condition to contracts that already have such a condition (but usually for a longer period).

The convention triggers taxation in the country of residence of the real estate company of the proceeds from the disposal of its shares by a foreign tax resident.

11. Problems of calculating the reserved portion - a practical problem related to the heir's liability for legacies

The settlement of succession, which is an integral part of inheritance, continues to raise many questions in practice. The reasons for this can be traced back to a number of factors: the increasing complexity of lending, the increasing affluence of society and the still relatively low public awareness of the rules for drawing up wills are undeniably important, but it should be noted that the rules in force in this area in the Polish legal system are not conducive to simplifying the process.

A legal issue related to the problem of proper calculation of a reserved share has become the subject of consideration by the Supreme Court. The Court of Appeal, in connection with doubts raised in the facts of the case, addressed the following question to the Supreme Court: *'When determining the liability of the heir under Article 998 § 1 of the Civil Code, should one take into account the surplus exceeding the value of the share of the estate which constitutes the basis for calculating the reserved share due to the beneficiary, i.e. the part of the estate calculated pursuant to Article 931 § 1 of the Civil Code, or the surplus exceeding the value of the legatee's reserved share, i.e. the part of the estate calculated on the basis of the fraction obtained pursuant to Article 991 § 1 of the Civil Code. (in both cases taking into account Article 992 of the Civil Code)?'*

The Supreme Court took a position on the issue in a resolution of 8 September 2021. It was unequivocally resolved that the basis for calculating the reserved share due to the beneficiary is the inheritance share referred to in Article 931 § 1 of the Civil Code being the fraction resulting from the rules of statutory inheritance (i.e., the fraction in which the heir would inherit if appointed under the law), taking into account the subjective modification resulting from Article 992 of the Civil Code (i.e., taking into account unworthy heirs and heirs who have rejected the inheritance, but not heirs who have renounced the inheritance or have been disinherited). The Supreme Court also pointed out that an heir entitled to a reserved share is liable for legacies and instructions only up to the amount of the excess exceeding the value of that inheritance share.

Thus, the view hitherto expressed by some representatives of the doctrine and presented in the resolution of the Supreme Court of 31 January 2001 was abandoned. ¹according to which the reduction of this value to 1/2 or 2/3, constituting a consequence of the application of Article 991 of the Civil Code, would apply here. ²

¹ Resolution of the Supreme Court - Civil Chamber of 31 January 2001, OSNC 2001 No. 7-8, item 99, p. 6

² E. Skowrońska-Bocian, in Commentary to the Civil Code, Rev. IV, 1997, p. 152.

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