On 24 August 2018, Poland’s Ministry of Finance (MoF) released a draft bill introducing significant changes to the tax law beginning 2019. The proposal affects a very broad range of the tax aspects of business activity, ranging from anti-abuse provisions, a major shift of the withholding tax (WHT) collection system, introduction of an intellectual property (IP) regime and exit taxation, to new rules for the taxation of bad debt trading and securities lending transactions, to name a few.

This Alert summarizes the key proposed changes.

**Major withholding tax reform**

- The proposed bill changes the withholding tax collection mechanism. Tax exemption or a lower rate at source system will be replaced with a pay-and-refund model, unless specific measures are undertaken by a tax remitter or a taxpayer.
- New rules relate to both intra-group and third-party payments.
- More details may be found in EY Global Tax Alert, [Poland’s 2019 tax reform proposal includes strict withholding tax regime likely to impact international groups](https://www.ey.com), dated 29 August 2018.
- The new rules are expected to expose all board members of Polish companies making cross-border payments, as well as board members of foreign taxpayers claiming refunds, to an increased level of risk related to criminal charges.
More stringent beneficial owner requirements

- The definition of beneficial owner will be changed and, in effect, it will be required to prove that the recipient conducts real business activity in the country of its seat taking into account certain criteria (premises, sufficient local staff, broad business rationale and local board members, etc.).
- Other conditions that would be tested include:
  - The recipient receives a payment for its own benefit, can decide how the received payment should be utilized, bears economic risk associated with the loss of (a portion) this receivable, and
  - The recipient is not a broker, representative, trustee or any other entity that is legally or actually obliged to transfer the payment (or its part) to another entity.

New penalties and sanctions

- The draft bill also provides for an additional tax liability applicable to a number of situations, including when a statement issued for the purpose of applying at source the WHT exemption or a lower WHT rate resulting from a tax treaty:
  - Was not truthful
  - The tax remitter has not carried out the required verification
  - The verification carried out by the tax remitter has not been adequate in relation to the nature and scale of the business activities
- The additional tax liability would be equal to 10% of the tax base and, in the case of payments above PLN15m, the rate would be doubled (on the surplus over PLN15m).
- In some other cases, 40% or its multiple can apply.

Apart from WHT collection, additional tax liability can apply in the case of transfer pricing reassessment or where the anti-abuse regulations are triggered.

Mandatory Disclosure Regime (MDR)

- The draft bill also implements an MDR in Poland, based on which transactions meeting certain hallmarks will have to be reported to the tax authorities.
- Apart from implementing the European Union (EU) Directive (2018/822) requirements, Poland will also require reporting of certain domestic transactions with 31 March 2019 as a first reporting date, which is earlier than required under the Directive.

Narrower scope of tax rulings

- Tax provisions aimed at counteracting tax avoidance, including clauses referring to the assessment of the business motive or artificiality of a transaction, cannot be the subject of an application for an individual tax ruling. Rulings already issued in this regard will become invalid.
- The tax authorities can reject issuing a ruling if they have a justified presumption that the facts presented in the application are designed to avoid taxation, as defined in the law.
- The Head of the National Fiscal Administration can repeal a ruling already issued if it meets the above-mentioned presumption.
- The above rules will also apply to situations in which measures designed to limit treaty benefits could be applicable.

Innovation box

- Profits from qualifying IP rights may be taxed at a preferential 5% tax rate. The incentive is based on the OECD BEPS Action 5 guidelines regarding the modified nexus approach.
- More details may be found in the EY Global Tax Alert, Poland publishes legislation on Innovation Box, dated 30 August 2018.

Notional interest deduction

- Taxpayers will be allowed to deduct deemed interest on certain parts of equity, amounting to the reference interest rate of the Polish National Bank as of the last banking day of the preceding tax year, increased by 1 basis points; however, no more than PLN250k of interest (US$70k) in a tax year.
- There will be certain limitations for the distribution of the qualifying equity on which a notional interest deduction is taken.
- This regulation is planned to come into force from 2020, with retroactive effect for qualifying equity payments/transfers performed in 2019 (assuming a tax year corresponding to the calendar year).

Exit tax

- This change constitutes implementation of the EU Anti-Tax Avoidance Directive in Poland in the area of exit taxation. A new tax, a so-called tax on unrealized profits (hidden reserves) that are embedded in a taxpayer’s property and that are potentially transferred together with such property
outside of Poland within transfers of the property within the same taxpayer (e.g., transfer by a Polish resident to its permanent establishment located abroad or transfer by a nonresident operating via a Polish permanent establishment to its home country or to another country in which it operates) or upon change of the taxpayer’s residence.

- Exit tax on unrealized profits shall be calculated as the difference between the fair market value of the property transferred (established based on separate rules) and its tax book value (that would have applied had the given property been disposed of) as of the date of the transfer.
- Any losses triggered upon the transfers subject to tax on unrealized profits shall be excluded from tax deductible costs.
- Upon transfers into Poland, taxpayers may be allowed to credit the foreign equivalent tax (i.e., the tax due in a foreign country and which is equivalent to the tax on unrealized profits) up to certain limits.
- It is planned that the tax payment together with the respective tax return filing will be due by the 7th day of the month following the month when the income was realized.
- Certain exceptions shall apply for the non-definite transfers (i.e., where the property is returned within 12 months).
- Upon a taxpayer’s request, a tax payment may be deferred and paid in advance during a period of five years, subject to additional requirements.
- The new rules shall apply from the tax year starting from 1 January 2019.

Eurobonds exemption
- Interest on bonds issued by Polish entities to foreign investors after 1 January 2019 may benefit from tax exemption.
- The exemption will apply to bonds with a maturity of one year or longer, which are traded on regulated stock markets and on multilateral trading facilities, under the condition that the entities related to the issuer will hold no more than 10% of the bonds issued.
- Additionally, certain changes will be introduced with respect to bonds issued before 1 January 2019 as regards to the method of tax collection (bond issuers might choose to be taxpayers and not tax remitters).

Bad debt trading
- The proposed changes introduce special rules relating to income recognition on purchased debts and debt portfolios.

- Under the current regime, no specific provisions existed and the developed practice was unfavorable for taxpayers. They had to recognize taxable income even if the debt was repaid only partially and the repayment did not cover the acquisition cost (the cost could only be recognized in proportion to the amount of repayment to the nominal value of the debt amount).
- This might lead to a situation where full utilization of the cost basis relating to a purchase of debt portfolio/debt is, often, not possible.
- The new provisions should enable taxpayers to recognize the full amount of the cost, up to the amount of taxable revenue derived.

Securities lending
- Securities lending transactions will be subject to more precise rules, according to which taxable income will be realized by lenders upon the return of loaned securities.
- The taxable base will be the difference between the value of the securities as of the loan date and the return date (the result will include any change in the value of securities, including foreign exchange differences).

Costs of cars in business activity
- Increase in the limit of the amount of depreciation write-offs and car insurance payments that qualify as tax deductible costs - from €30k or €20k (depending on the type of car) to PLN150k (approx. US$40k) annually.
- Introduction of the above limit (PLN150k) will also apply to lease payments (rent payments and other similar payments).
- Special rules for qualifying expenses related to cars used both for business and private purposes (50% of the expense could qualify as tax deductible costs in the case of lack of specific evidence).

Amendments to the GAAR
- Several changes to the General Anti-avoidance Rule (GAAR) have been proposed, including a change of the definition of tax avoidance and a list of circumstances which can imply that the structure was artificial.
- A new procedure aimed at withdrawing the implications of tax avoidance has been proposed. It relates to a situation where a taxpayer admits to implementing an artificial structure and proposes how this situation can be amended, and allows the tax authorities to assess the new approach.
Reduced 9% CIT rate

- The draft provides for a reduced 9% corporate income tax (CIT) rate on income other than income from capital gains.
- Broadly, the reduced rate may apply on the conditions that:
  - An entity is a small taxpayer (its revenues in a given year do not exceed the equivalent of €1.2m)
  - The ratio of income to revenues in a previous tax year did not exceed 33%
- The reduced rate will not be available for entities created as a result of restructuring.

Cryptocurrencies

- The proposed changes to the Polish CIT and personal income tax (PIT) Acts introduce rules relating to so-called virtual currencies. This area has not been regulated for tax purposes in Poland so far. The new provisions introduce:
  - The definition of virtual currencies covered by the new rules (broadly, include cryptocurrencies and centralized virtual currencies)
  - Classification of the source of income (capital gain income, not combined with other sources of income)
  - The definition of taxable revenue relating to virtual currencies
  - Specific rules of recognition of deductible costs and taxable income, as well as losses relating to the virtual currencies

Changes to the Polish CFC regime

- Extending the definition of foreign entities which could be affected by the controlled foreign company (CFC) provisions to include:
  a. Trusts, foundations and other fiduciary arrangements
  b. Capital groups or particular companies forming capital groups which conduct CFC qualified business activity
  c. Organizationally or legally separated parts of foreign companies or other entities both having or not having legal personality
  d. A permanent establishment of a foreign entity could be also treated as a separate foreign entity for CFC purposes
- Broadening the CFC list of qualified links between a taxpayer and foreign entity to include:
  a. Expected and future rights to profits
  b. Exercising actual control – which is described as control resulting, inter alia, from legal arrangements, proxies and actual relations which allow for dominant control over a foreign legal entity
- Introduction of certain anti-abuse provisions that disregard artificial relationships which distort the relations or status of a foreign entity for CFC purposes.

Other proposed changes

- Abolition of the 50% sanction CIT rate that is applied when a tax office assesses additional income based on transfer pricing grounds and a taxpayer does not hold valid transfer pricing documentation. Instead, the additional tax liability mentioned in point 3 (new penalties and sanctions) is introduced.
- Clarification of the cost basis when a loan receivable is contributed to a subsidiary in an exchange of shares (debt-to-equity conversion).
- Extension of the tax exemption for closed-ended investment funds (securitization funds) so that interest on certain loans granted by entities subject to supervision of the competent authority, which were acquired by the fund, can benefit from the CIT exemption.
- Decrease of the transfer tax rate (tax on civil law transactions) on loans from 2% to 0.5%.

Since the announced measures are likely to have a significant impact on international groups operating in Poland, further developments in this area should be monitored and initial assessment made to prepare for the change.

Future Global Tax Alerts will report on developments in this area as well as other significant changes proposed in the 2019 tax reform.

Endnotes

1. Organisation for Economic Co-operation and Development.
2. Base Erosion and Profit Shifting.
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