

TAX NEWSLETTER

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SUMMARY

Planned Changes In Corporate Income Tax – Most Probably To Be Introduced Starting From 1st January 2013

- Partnerships limited by shares as a CIT taxpayer
- Introducing the rules of establishing initial value of fixed assets in the European company, European cooperative and permanent establishment
- Widening the scope of thin capitalisation restrictions
- Unification of the derivatives' definition and respective tax point for PIT and CIT purposes
- Unification of the regulations regarding tax remitters with respect to CIT and PIT
- Amending the regulations regarding establishing of the amount of tax deductible costs in the case of disposal of shares acquired via exchange of shares

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INTRODUCTION

The current edition of Tax Newsletter is dedicated to presenting the planned changes in the corporate income tax legislation.

The most radical changes relate to tax treatment of partnerships limited by shares. Based on the proposed amendments they should be treated as CIT taxpayers. Similarly revolutionary changes are expected in the thin capitalization rules (the indirect relationship should also be covered by the restrictions). In addition, the statutory transfer pricing documentation requirements will be extended.

You will find more information in this issue of Tax Newsletter.

Yours sincerely,

Krystyna Szydłowska

Planned Changes in Corporate Income Tax – most probably to be introduced starting from 1st January 2013

As planned by the Ministry of Finance, major changes are to be introduced from 1 January 2013, with respect to the Act on Corporate Income Tax (hereinafter: "CIT Act"). The most significant assumptions concerning this amendment are:

Partnerships limited by shares as a CIT taxpayer

The Main assumption of the Legislator was to regulate the rules of taxation of partnerships limited by shares (Pol. S.K.A.). This was recently subject to wide discussion also in the ruling of Supreme Administrative Court.

Currently, the income of S.K.A., like in any other partnerships, is not taxed at the partnership's level but on the partners' level. Having this in mind – whenever a partnership limited by shares will not distribute profits, its gains remains untaxed.

The treatment of a partnership limited by shares as a taxpayer on the basis of the CIT Act will effect in introducing two levels of taxation of income generated by the partnership - in analogous manner as it is in the case of limited liability companies and joint-stock companies. According to the planned changes, partners of a partnership limited by shares, i.e. general partners and shareholders will be taxed on the actually earned income from participation in the partnership profits. None of them will be taxed on a current basis on the activity carried out by the partnership – relevant tax will be collected at the level of a partnership limited by shares itself.

The Ministry of Finance underlines that the proposed solution implying that income tax will be applicable both to income of these partnerships and income from participation in profits has been successfully put in place in many European countries (e.g. Germany or France).

Introducing the rules of establishing initial value of fixed assets in the European company, European cooperative and permanent establishment

The CIT Act until now has not regulated specifically the issue of determining the initial value of fixed and intangible assets due to the change of principal place of business of the European Company and subsequent effects of disposing of assets acquired and depreciated in the countries where the European Company has had its former place of business.

According to the legislator, the right to change the place of business without having to liquidate it in the country where it was located to date entails a risk that the initial value of fixed assets will be determined without any link with actual costs of acquisition incurred by taxpayers through reference to market value of assets moved to Poland. Therefore, it can give rise to a manifold decrease of the taxation basis by costs of acquisition of the same fixed assets.

The planned changes imply introducing a regulation defining the method of recognizing the initial value being the depreciation basis of these assets and tax deductible costs if they are disposed of for remuneration. The right to reduce the taxation basis only to the costs of acquisition of the depreciated asset that have not been deducted until this moment will be limited. It should be emphasised that the initial value of these assets determined by using this method cannot be higher than their market value.

The proposed changes should also apply to European Cooperative Societies and foreign establishments of enterprises bringing assets subject to depreciation to the foreign establishments located in Poland.

Widening the scope of thin capitalisation restrictions

According to the currently applicable CIT Act provisions *thin capitalization* concerns only loans (credits) granted by an entity holding at least 25% shares in the taxpayer's capital or by an entity in which the shareholder of the taxpayer holds at least 25% shares. Then, the interest on such loan is excluded from tax deductible costs in such a proportion in which the amount of taxpayer's debt to a given group of related entities exceeds the threefold amount of its share capital.

The intention of the legislator in this respect is to specify and complement the scope of related entities by including in the regulation also entities related indirectly, i.e. entities holding an indirect stake of at

least 25% shares in the taxpayer's capital and in the capital of the entity granting the loan to the taxpayer (stake defined in accordance with the rules of determining indirect share laid down by transfer pricing regulations).

- The proposed regulations refer to both corporations as well as to partnerships limited by shares and foreign partnerships.

Amendment of the regulations regarding transfer pricing rules

Amendments to the CIT Act planned by the legislator include also changes in transfer pricing. In line with the CIT Act tax authorities are entitled to estimate taxpayer's income and determine it in a higher amount than the one declared by the taxpayer if, due to existing relationships between the entities, the conditions imposed differ from the conditions that would have been agreed upon by independent entities. Moreover, taxpayers are obliged to document transactions concluded by these taxpayers with their related entities.

According to the Minister of Finance, following issues should be specified:

- Classification of organisational units without legal personality (including companies not being legal persons and their shareholders) as covered by "relationship" which are under transfer pricing regulations;
- Applying the documentation obligation to the company's deed (statute) where the rights of particular shareholders to participation in profits/losses of a company are stated and which may potentially influence the amount of income declared by the taxpayer being a partnership partner;
- Application of income estimation rules and documentation obligation to the part of income of taxpayers with limited tax obligation in Poland and taxpayers with unlimited tax obligation that is attributable to the foreign establishment of these taxpayers and in the case of taxpayers with unlimited tax obligation – the part of income generated in Poland attributable to this taxpayer;
- Introducing a possibility of making income adjustments by tax authorities in the case of re-estimation of income (if non-market conditions are agreed upon by domestic entities).

Please be informed that on the basis of new regulations, general rules resulting from the article 9a of Polish CIT Act apply accordingly e.g. to the contracts on joint venture or similar.

Unification of the derivatives' definition and respective tax point for PIT and CIT purposes

The aim of this amendment was to make up for the lack of a specific rule regarding the moment of recognition of income from derivative instruments. Until now the approach concerning the direct connection between the moment when the income from derivatives arises and the moment of executing rights resulting from these instruments has raised many doubts.

Therefore, the Ministry of Finance plans to indicate directly in the CIT Act that the income from execution of rights resulting from derivative instruments is generated upon execution of these rights.

Unification of the regulations regarding tax remitters with respect to CIT and PIT

In order to adjust CIT to the regulations introduced last year to the Act on Personal Income Tax regarding the procedure of collection of withholding tax on dividends and other income from participation in profits of legal persons, the Ministry of Finance decided to complement the CIT Act by inserting a clause which will entitle entities holding securities' accounts to collect tax on the above income.

Amending the regulations regarding establishing of the amount of tax deductible costs in the case of disposal of shares acquired via exchange of shares

Until now determining the scope of tax deductible costs due to redemption of shares received further to exchange raised many difficulties in practice.

Therefore, the legislator decided to make this more specific by stating precisely that the disposal of assets used in business activity constitutes an income from this activity.

It should be underlined that this change concerns components that were not classified as fixed assets as they are expected to be used for less than a year as well as components that were not entered in the register of fixed tangible and intangible assets by the taxpayer (despite such obligation).

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