Corporate income tax subjects

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Prof. dr. hab. Hanna Litwińczuk

Dr. Karolina Tetłak, LL.M.

Warsaw University, Poland

1. General presentation of CIT in Poland

1.1. A quick overview of the system of CIT in Poland

The Corporate Income Tax was first introduced in Poland on 1 January 1989. In the early 1990s a major legislative effort was made to create a modern system of taxation. The first law on the taxation of corporations was then substituted with the Corporate Income Tax Act of 1992 which is in force until today.

The Polish system of income taxation provides for a tax distinction between corporations and partnerships. For tax purposes, the concept of tax opacity has been adopted for corporations. Under this approach, corporations constitute separate entities, distinct from their shareholders, whereas partnerships are transparent and do not have a status of separate taxpayers. Since partnerships are disregarded for the purpose of income tax, the tax is charged on the level of the partners.

As regards the number of corporations, in 2010 there were approximately 343 165 CIT taxpayers, out of which 9133 were corporations divided by shares. The total number of businesses in Poland in 2010 was approximately 1,67 million. The relatively low number of corporations and the proportion of corporations in the total number of businesses indicates that the setting up of a corporation is not an ordinary way of performing a business activity. Instead, corporations are normally used by big companies only. The prevalent number of businesses in Poland is run by the self-employed, i.e. individuals who register as entrepreneurs to take advantage of a more beneficial system of taxation of businesses in comparison to the charges imposed on employees.

In 2010, corporations declared income of 208 billion PLN. The CIT revenue was 21,77 billion PLN, compared to 35,59 billion PLN of PIT revenue and to 222,55 billion PLN of tax resources of the State in general. The Gross Domestic Product in 2010 was 1415,514 billion PLN. The CIT/GDP ratio was approximately 1,54%.

As far as other taxes which resemble CIT but are distinct from CIT are concerned, there is a tonnage tax in the Polish tax system. The tonnage tax is an alternative to CIT, applicable to certain shipping companies that may elect to have their profits chargeable to tonnage tax, subject to certain conditions. The method of calculating taxable profits of a shipping company involves a reference to the net tonnage of the ship operated. The amount of the tonnage tax does not depend on the current profit or loss of the company, but the income is calculated as a flat rate, depending on the tonnage. The daily flat rate income is determined based on the net tonnage of the ship from every 100 NT, according to the rates in euro. The tax rate is 19%. The tonnage tax profit replaces both the tax-adjusted commercial profit/loss on a shipping trade and the chargeable gains/losses made on tonnage tax assets. Other profits of a tonnage tax company are taxable in the normal way. The selection of this type of tax, as an alternative to CIT, is not a commonplace in Poland due to a small number of shipping companies performing transport services. The amount of tax revenue collected in 2010 was 3 billion PLN. Apart from the tonnage tax, there are no further taxes considered as "additional taxes" to CIT. Corporations are not subject to social security contributions on their income, but they must pay such contributions for their employees.

1.2. Presentation of the historical evolution of CIT in Poland (to the extent relevant)

The CIT Act has been changed significantly since it was introduced. The accession to the European Union and the need to implement EU directives considerably influenced Polish tax law.

The personal scope of CIT (i.e. the list of entities which are subject to CIT) has been modified since CIT exists in Poland. The first change, in 1996, was the introduction of tax groups, i.e. groups of associated companies. When a group is formed, the companies forming it lose their separate taxpayer status. Instead, the group calculates its total income and pays the tax. The group can only be composed of share companies and limited liability companies resident in Poland for tax purposes. There is a number of additional requirements regarding the capital, participation and the level of income. Despite considerable liberalization over time, the conditions for the creation of a tax group are very restrictive and therefore there are less than 20 such group taxpayers in Poland.

Another modification of the personal scope of CIT, in 2002, involved the addition of companies “under organization”. This change was introduced because under Polish law a company can carry on a business activity after filing an application for incorporation but it gains a full legal personality when it is included in the registry. Until registration, it operates as a company but is not fully incorporated. Covering such companies under the CIT Act allows to catch their income before they become corporations.

In 2005 the lawmaker included foreign partnerships without legal personality, treated like legal persons in their countries of residence and taxable there on their worldwide income. This change was prompted by the need to implement the Parent-Subsidiary Directive.

2. Legislative technique

2.1. Sources

Pursuant to Article 217 of the Polish Constitution, the exclusive legal instrument for tax matters, including defining CIT and other tax subjects, is the act of the Parliament. It means that taxable entities are defined through a section of the tax law (CIT Act). It is not acceptable for a provision in another piece of legislation, such as a decree, or for case-law, to define tax subjects. Similarly, personal exemptions are only introduced by statutory legislation.

2.2. Legal drafting

The Polish tax system does not contain an accurate list of entities which fall under CIT. Instead, it provides for a general criterion of legal personality. However, it also includes entities without legal personality other than partnerships. Additionally, foreign partnerships are subject to CIT if they are treated like legal persons under their domestic law and are taxable on their worldwide income in the country of residence. In fact, the definition of the personal scope of CIT combines both of the above legal drafting techniques because there are certain entities (such as capital groups or foreign non-transparent partnerships) specifically listed and a feature-based determination of the CIT taxpayers.

3. Domestic entities

3.1. First approach

The personal scope of CIT in Poland consists of an exhaustive list of taxable entities. The accurate list of all domestic entities which are subject to CIT in Poland includes:

- legal persons,

- capital companies under organization,

- organizational entities without legal personality, except companies (partnerships) without legal personality,

- companies (partnerships) without legal personality resident in other countries and taxable there on their worldwide income,

- capital groups.

To ensure consistency with the annexes to the Parent-Subsidiary Directive and the Interest-Royalty Directive, the CIT Act includes an annex reproducing the annexes to the Directives. The implemented mechanism applies to companies subject to tax on their worldwide income in any Member State of the European Union, other than Poland.

The range of domestic entities which are not subject to CIT in Poland includes partnerships (companies without legal personality) and enterprises, undertakings or businesses, such as branches of foreign corporations, airports, excise warehouses, magazines, carried on by individuals, corporations or other entities subject to PIT or CIT.

The reason why some entities are subject to CIT while others are not is that the Polish tax law refers largely to legal personality. All natural persons are subject to PIT and all other entities are subject to CIT, including entities without legal personality, with the exception of partnerships. However, given that legal personality is not an exclusive reason for being subject to CIT, there is no widely accepted reason for distinguishing between taxable subjects and non-taxable subjects. The distinction is not coherently based on legal personality. Unlike "organizational entities" without legal personality, partnerships are transparent, and the domestic academic literature does not offer a clear explanation for the contrast between opacity of corporations and other entities without legal personality and transparence of partnerships.[1] It is accepted that the lack of legal personality in the case of partnerships is a sufficient explanation for their different treatment in comparison to companies.

3.2. More details

3.2.1. Link between company law and tax law

Since the main criterion for being a CIT taxpayer is legal personality, the range of taxpayers is determined by civil law. The Civil Code stipulates that legal personality is granted to entities by acts of the Parliament. As a result, the definition of a person subject to CIT depends upon various legal acts, such as company law, that provide incorporation of certain categories of entities. Thus, entities that have a specific legal form, which has been granted legal personality, are subject to CIT.

The company law allows the existence of one-person companies. They have a legal personality and, therefore, are subject to CIT.

Do entities without legal personality have to pay CIT? If so, what are the conditions for these entities to fall under the scope of CIT?

As a rule, it is necessary to enjoy legal personality to be subject to CIT. However, certain entities without legal personality have to pay CIT. This rule applies to all organizational entities without legal personality other than partnerships and to foreign

[1] M. Jamroży, Opodatkowanie spółki osobowej, Warszawa 2005.

companies without legal personality that are treated as taxable legal persons in their countries of residence.

Corporations (for company law purposes) may be outside the scope of CIT only if they are covered by a special exemption, such as that applicable to REITs. There is also a tax exemption provided for companies operating in special economic zones.

3.2.2. Charitable organizations and associations

Under Polish law, a non-profit activity may be undertaken by CIT taxpayers, yet the provisions of the CIT Act do not require any special legal form for the qualification as a non-profit organization. In practice, a charity may exist in the legal form of a company, an association or a foundation. All these types of entities have legal personality and their tax status is regulated by the CIT Act, which means that charitable organizations are subject to CIT because of their legal form.

Generally, income of non-profit organizations is tax exempt. Two basic tax exemptions apply to charities, if several conditions are fulfilled. The first exemption refers to the purpose of the activity, and the second to the status of a so-called public benefit organization.

Under the provisions of the CIT Act, all taxpayers whose objectives involve scientific, technical, educational (including those involving the education of students), cultural, sportive, environmental activities or acting in support of community initiatives for the construction of roads and telecommunication network in the country, the supply of rural water, charity, health care and social assistance, vocational and social rehabilitation of the disabled, and religious worship are exempt from corporate income tax to the extent the income earned is spent on these objectives (Article 17 para. 1 sub. 4 CIT Act). This objective exemption covers all kinds of income (such as business profits, investment income, rental income, and donations) with the exception of the items listed in Article 17 para. 1a CIT Act (e.g. income derived from the production of wine, spirits, beer, electronic equipment, fuels, tobacco, precious metals and income derived from the trade in these goods as well as income from leasing activities). These items are taxed at the regular corporate income tax rate of 19 % (Article 19 para. 1 CIT Act).

The prerequisite for benefiting from this tax exemption is that this special kind of activity should be indicated in the statute (articles of association) of the organization. The requirement of listing the charitable goals in the statute of the CIT taxpayer means that only a few forms of legal entities may benefit from the special tax rules. Foundations, associations and companies have to list certain possible goals in their statutes in order to be recognized as non-profit organizations. The catalogue of the goals is closed. It means that only the goals stipulated in the CIT Act allow to benefit from the tax exemption. The taxpayer has to include at least one of the listed goals in its statute. Only income appropriated for the purpose stipulated in the analyzed provision will be tax exempt. Unlike companies, partnerships cannot be recognized as non-profit organizations and qualify for the exemption because they are not subject to CIT.

Another tax exemption is of a subjective character and relates to a certain group of taxpayers. These taxpayers are: state-owned enterprises, cooperatives and companies, incorporated municipal companies, for which the function of the founding body is performed by local government units or their subsidiary entities established pursuant to separate regulations and budgetary establishments and other unincorporated organizational units which pay corporate incomes tax - if the object of their activities is to satisfy public needs indirectly linked with environmental protection with respect to water supply and sewage systems, municipal sewage, waste dumps and municipal waste management and its collective transport.

Furthermore, public benefit organizations established under the Act on Public Benefit Organizations and Volunteering are exempt from corporate income tax if the income earned is spent on their statutory objectives, with the exception of business activities (subjective exemption; Art. 17 para. 1 sub. 6c CITA). All legal forms mentioned: associations, foundations, companies (limited liability company and joint stock company) (acting non-profit), as well as church organizations, may apply for the status of a public benefit organization. Public benefit organizations do not form another type of legal entity. It is a special legal status that any of mentioned entities may have. The relevant public benefit activities include social assistance; charitable activities; the support and promotion of the national tradition and the development of the Polish national consciousness; activities for ethnic minorities and regional languages; the protection and promotion of health; activities for the disabled; the promotion of equal rights for women and men; education; culture, art, and the protection of cultural and national heritage; European integration and the development of cooperation between societies; assistance to Poles living abroad; and the promotion of the Polish Republic abroad (Art. 4 para. 1 of the Act on Public Benefit Organizations and Volunteering). Business activities must not exceed a certain threshold (Art. 20 para. 1 sub. 2 of the Act on Public Benefit Organizations and Volunteering) and they are not covered by the corporate income tax exemption of Art. 17 para. 1 sub. 6c CIT Act. Certain investment income, however, is covered by the exemption pursuant to Art. 17 para. 1e.

The discussed tax benefits are not reserved for Polish non-profit organizations. Special regulations are also provided for international organizations. The Polish corporate income tax act does not contain any territorial restrictions regarding the pursuit of allowed activities. Therefore charitable activities may also be pursued outside Poland. The conditions applicable to foreign charities under which a tax exemption may be granted are the same as for Polish entities. First, a taxpayer may be granted a tax exemption based on the purpose of the activity. Second, the exemption for public benefit organizations explicitly refers to foreign entities. They are granted a tax exemption if, in their residence state, they have a status similar to that of a public benefit organization in Poland.

The VAT Act does not expressly regulate the non-profit activity. Under Art. 15 of the VAT Act, the term “taxpayer” means any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity. Thus the status of the VAT taxpayer is strictly linked to performing an economic activity. If a non-profit organization does not run a business, it is not subject to VAT. However, if a non-profit organization happens to additionally perform any economic activities, it qualifies as a taxpayer under the VAT Act. Still, a tax exemption may apply.

In the VAT Act there are several tax exemptions that concern certain activities in the public interest, the supply of services, and the supply of goods closely linked thereto, by non-profit organizations to their members in their common interest, with aims of a political, trade-union, religious, patriotic, philosophical, philanthropic or civic nature. Another exemption applies to the supply of certain services closely linked to sport or physical education by non-profit-making organizations to persons taking part in sport or physical education (Art. 43 para. 1 of the VAT Act). The scope of exempted services is limited and excludes services linked to marketing, advertising, promotion, entrance to sports events, sport accommodation linked to sports activities, lease of sport equipment or sports venues. In order to benefit from the exemption a non-profit organization cannot perform such services in a systematical way of making profit and its statute must indicate that the purpose is the organization's activity is development and promotion of sport. Any profits should be assigned to the continuation or improvement of the services supplied.

The described exemptions are strictly linked to the purpose of the activity. The VAT Act also provides for another exemption which depends on the annual value of sales. If the annual value of sales does not exceed 30.000 EUR, a taxpayer may choose to be tax exempt. Non-profit organizations that conduct an auxiliary business activity on a small scale may benefit from this exemption.

3.3.3. Miscellaneous on CIT subjects

Under Polish law, specific legal structures such as trusts, silent partnerships, etc. are not regulated and they do not have any special status with regard to CIT. Trusts are not recognized as taxpayers. The parties to a trust are treated according to the general principles of civil law under which a fiduciary contract may be concluded but the tax law does not recognize a beneficial owner. The concept of ownership is formalistic and focuses on legal deeds.

Silent partnerships are not recognized under the CIT Act and they do not have a separate tax status. However, such contracts may exist under the general rule of the freedom of contract. If a silent partner receives income from a silent partnership, it is taxed according to this partner's status. Income derived by a silent partner who is a corporation is subject to CIT.

State-owned entities enjoy special tax exemptions under the CIT Act such as that applicable to the State Treasure, the National Bank of Poland, budgetary entities, state funds and agencies etc.

Companies belonging to a group no longer enjoy full tax personality in Poland, if they register as a group taxpayer. In such a case, the individual companies (group members) may no longer file a separate tax return. The entire group files a joint tax return and calculates a tax on the income of all members. The fact that the tax personality is restricted for group members under the CIT Act does not influence full tax personality of individual companies for the purposes of other taxes.

3.3.4. Partial implementation of CIT

Currently, partnerships are not subject to CIT. This rule applies to civil partnerships as well as limited partnerships and partnerships limited by shares. Under Polish tax law all partnerships are transparent and the tax is levied on the level of the partners (PIT for individual partners and CIT for corporations). This principle was adopted because partnerships do not have a legal personality separate from their partners and it was considered adequate to reflect this concept in taxation. It fully applies to all income earned by partners. Poland did not introduce a rule under which partnerships may be partially liable to CIT (i.e. part of their profits are taxed under CIT). There are also no check-the-box regulations which means that partnerships or other entities which normally do not fall within the scope of CIT may not opt to be treated as CIT subjects. On the other hand Polish law does not allow CIT subjects to be treated as transparent entities.

A major change in the personal scope of CIT is planned for 2014. The government proposed to include partnerships limited by shares into the personal scope of CIT. The purpose of this change is to improve the taxation rules applicable to partnerships and make the choice of the legal form for business activity tax neutral. As mentioned below, nowadays limited partnerships are an important tax planning tool. Making them opaque for tax purposes will, in the opinion of the government, increase tax revenue and equalize the situation of taxpayers.

3.3.5. Tax planning

The choice between setting up a corporation rather than a partnership (or the opposite) is to a large extent tax-driven in Poland. It is especially beneficial to set up a partnership limited by shares because in such a case shareholders are not taxable as entrepreneurs and do not have to pay tax advances during the tax year when the partnership earns income. Instead, they only pay tax when the income is paid out to them (when they receive any payments).[2] This allows a tax deferral and full control over the moment the tax is paid. Moreover, dividends in-kind received by shareholders are not taxable income to the partnership which results in a tax planning possibility whereby assets are disposed of tax free by the partnership. The government takes the view that such an approach creates unfair privileges for certain taxpayers. Therefore, a change of law has been proposed to make partnerships limited by shares subject to CIT and treat them like corporations. The reason for this is not that much motivated by the need to guarantee the neutrality of taxation as by the need to prevent tax avoidance and increase tax revenue in the face of the crisis of public finances. The academic literature focuses on the neutrality of taxation in the context of the change of legal form rather than the choice of legal structure.

3.3.6 Others

Submission to CIT means that a taxpayer has to keep records and books for tax purposes. If income cannot be calculated on the basis of the books, it is estimated pursuant to the CIT Act and subject to tax at a 50% rate (rather than the regular 19%). The procedural consequences connected with being subject to CIT include the obligation to file tax returns.

4. Cross-border situations

Where a foreign entity carries out business in Poland, it is subject to CIT under the same conditions that apply to residents. As a rule, an entity is subject to CIT if it has legal personality or is a company under organization. Additionally, foreign partnerships may be subject to CIT if they are treated as legal persons in their home country and are taxable there on their worldwide income. The criterion applicable is therefore whether the residence country of the entity treats it like a legal person (CIT taxpayer) despite of the lack of legal personality. A “resemblance test” does not apply and it does not matter whether an entity has features comparable to those of a domestic CIT subject as long as it does not have a legal personality. The type of income-generating activity carried out by the entity is irrelevant. Foreign entities may

[2] Decision of the Supreme Administrative Court from16 January 2012, No. II FSP 1/11.

not opt to be treated as either transparent or opaque, since there are no check-the-box regulations.

Following Article 2 a (iii) of the Parent-Subsidiary Directive regarding the “subject to CIT” condition, the CIT Act refers in Articles 20 (2) and 22 (4) (2) to “a company subject in a EU member state other than Poland to an income tax on all of its income, regardless where it is earned”. The CIT Act expressly requires a company to take one of the legal forms listed in an annex 5 to the Act, based on the annex to the Directive. The catalogue of legal forms that companies benefiting from the Directives resident in the particular states can get is exhaustive. There is also a condition of being subject to corporate income tax in an EU member state. The provisions also express the condition that a company must be a resident for tax purposes in a member state, without referring to its seat. The rules generally reflect the sense of the Directive. However, Polish law does not include two important requirements contained in the Directive. First, it is not mentioned that a company cannot be considered, on the basis of a double tax treaty with a third country, as having tax residence outside of the EU. The reason for such a regulation is the assumption that on the basis of the Polish double tax treaties there may not be any cases of double residence and – as a result – a company subject to tax on all of its income in an EU country automatically may not be a tax resident in another country.[3] Second, Polish provisions do not provide that a company must be subject to CIT without being exempt from tax. Contrary to the wording of the Directive, it allows for preferential treatment to entities that – as a rule – are subject to CIT but are exempt from it on the basis of special rules, including double tax treaties or tax decisions. The same reasoning and regulations are valid in the context of other tax Directives implemented to Polish law.

[3] K. Gortat-Kopacka, A. Sobczak, Wpływ dyrektyw unijnych na kształtowanie CIT w Polsce (3), Przegląd Podatkowy nr 3/2005.