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REPORT

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
Subject:	Code of Conduct Group (Business Taxation) – Report to the Council = Endorsement

Poland's 15% corporate income tax rate for small taxpayers (PL006)

I/ AGREED DESCRIPTION

The following description was agreed by the Code of Conduct Group on 31 May 2018:

By Act of 5 September 2016 Poland amended the Corporate Income Tax Act and Personal Income Tax Act and introduced a reduced tax rate of 15% for small companies. The law entered into force as of 1st January 2017.

Policy rational

The reduced taxation for small taxpayers and start-up taxpayers aims at accelerating growth and development and creating favourable conditions for increasing entrepreneurship, especially for young people, for whom obtaining outside financing for business activity is often a significant barrier and who have a less competitive position than large companies. The tax burden, measured by the nominal rate, is the same for such a taxpayer as for the largest taxpayers, regardless of the type of activity. This may affect the competitiveness of small taxpayers (taxpayers starting their business activity) compared to other taxpayers, who usually have bigger possibilities of raising funds for development and investments than small entities or entities starting their business activity.

The regime

The regime provides for a reduced tax rate of 15%. The general CIT rate is 19%.

The reduced rate applies to:

a) small taxpayers, defined as taxpayers with sales revenues (including VAT) not exceeding the equivalent in PLN of EUR 1 200 000 in the previous tax year, and

b) taxpayers who start a business activity in the tax year that they started that activity.

In the case of taxpayers who are just starting their business activity, the reduced CIT rate will apply only in the first year of the taxpayer's existence (i.e. in the year it started its business) regardless of the size of gross sales revenues. It is assumed that taxpayers starting their business generally do not exceed the threshold indicated in the regulation (1 200 000 EUR). The continued application of the reduced CIT rate in subsequent tax years will only be acceptable if such a taxpayer meets the criteria for qualifying him as a small taxpayer.

The provisions are also applicable to PE's of foreign companies, as long as the taxpayer meets the conditions for the application of the provision. A PE is not treated as a separate entity, so in the case of the application of the 15% tax rate the tax authorities should look at the company as a whole. As a consequence a small PE of a large non-resident company would not benefit lower tax rate.

The application of the reduced rate is not limited to any specific type of business or activities. It applies to the same income as the general rate.

In order to prevent tax optimisation, it provides for limiting the application of the 15% rate for taxpayers starting their activity, which were created as result of transformation of one company (CIT taxpayer) into another company (also a CIT taxpayer). Such taxpayers will be able to apply a reduced tax rate only from the third fiscal year, provided that the requirement to remain a small taxpayer this year is maintained.

This limitation is introduced to prevent taxpayer's restructuring operations - by changing the formula of activity or artificial adjustment of its size – in order to benefit from the reduced rate.

There are no special administrative procedures for the application of the reduced tax rate. Taxpayers are obliged to make advance payments and submit annual tax returns in application of general principles.

Statistics

The number of taxpayers subject to CIT in Poland in 2016 was 483,000.

The average income of Polish corporate income taxpayers for 2016 was PLN 11 million (approximately 2,5 million EUR) (information based on tax returns).

In the 2014 impact assessment preceding the adoption of the regime the number of taxpayers who achieved income in the amount not exceeding the equivalent in PLN of EUR 1 200 000 was estimated at 393 000 (for 2016 the figure was 417 000). Furthermore, during the five years preceding the introduction of this regulation, an increase in the total number of taxpayers was observed on average by 7% (i.e. by 23 000 taxpayers per year), as well as taxpayers reporting a tax due on average by 8% (i.e. by 10,000 taxpayers per year).

II / FINAL ASSESSMENT

The following assessment was agreed by the Code of Conduct Group (business taxation) on 24 July 2018:

	1a	1b	2a	2b	3	4	5	OA
PL – 15% CIT rate for small taxpayers	X	X	X	X	X	X	X	X

In accordance with the agreement of the Code of Conduct Group at the meeting of 31 May 2018 based on the agreed description presented at that meeting (WK 6111/2018, hereafter referred to as "agreed description"), the following draft assessment has been prepared with regard to paragraphs 1 to 5 of letter B of the Code of Conduct ("the Code"). The measure has been assessed against all Code criteria taking into account relevant agreed guidance.

Explanation

Significantly lower level of taxation:

"Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code"

The Polish measure was adopted on 5 September 2016. The law entered into force as of 1st January 2017.

The measure provides for a reduced tax rate of 15% for small companies and companies which have started their activity in the tax year for which the measure is applied. The generally applicable corporate tax rate is of 19 %.

The preferential rate is 4 percentage points lower than the generally applicable corporate tax rate. This corresponds to a 21% lower tax rate under the measure than under the general provisions. The reduced rate is therefore significantly lower than the rate generally applying.

Based on past practice of the Code Group measures that benefit only to small companies will be considered not to pass the gateway criterion of the Code as they will not affect "in a significant way the location of business activity in the Community" in the wording of letter A of the Code. As a definition of what constitutes small companies reference has in the past been made to the Commission's Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (2003/361/EC). The recommendation refers to a threshold of an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million. The maximum amount defined for the application of the Polish measure at issue is significantly lower as it applies to taxpayers with sales revenues (including VAT) not exceeding the equivalent in PLN of EUR 1 200 000. This is well below the threshold as defined in the 2003 Recommendation.

However, the Polish measure also applies to taxpayers who start a business activity in the relevant tax year without any definition of a threshold or limitation relating to the size of the enterprise and its activity. The measure could therefore apply to taxpayers that would not be considered as small or medium sized enterprises. This aspect of the measure would pass the gateway criterion of the Code.

The measure is therefore potentially harmful within the meaning of paragraph B of the Code to the extent that it applies to taxpayers who have recently started its activities without any limitation to the amount of its sales revenues, turnover or other factor.

Criterion 1:

"whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents"

Criterion 1 contains two elements. The first element is whether the measure is exclusively available to non-residents or transactions with non-residents (criterion 1a). The second element is whether it is only or mainly used by non-residents or for transactions with non-residents (criterion 1b).

1a) Criterion 1a concerns the *de jure* application of the measure.

The measure is available to small taxpayers, defined as taxpayers with sales revenues (including VAT) not exceeding the equivalent in PLN of EUR 1 200 000 in the previous tax year, and to taxpayers who start a business activity in the tax year that they started that activity. The provisions are also applicable to PE's of foreign companies, as long as the taxpayer meets the conditions for the application of the provision. The measure does not provide for the exclusion of residents or transactions with residents.

1b) Criterion 1b is used to complement the assessment under criterion 1a which only looks at the literal interpretation of the measure. It takes account of the *de facto* effect of the measure. Where the majority of taxpayers (or counterparties to transactions) benefitting from the measure are in fact non-residents the measure will fall foul of criterion 1b.

In light of the recent introduction of the measure, it is unlikely that statistical or impact data is either available at this stage, or representative enough to reflect the comprehensive effects of the measure.

However, from the information made available by the Polish delegation it follows that the number of taxpayers subject to CIT in Poland in 2016 was 483,000. The average income of Polish corporate income taxpayers for 2016 was PLN 11 million (approximately 2,5 million EUR). In the 2016 impact assessment preceding the adoption of the measure the number of taxpayers who achieved income in the amount not exceeding the equivalent in PLN of EUR 1 200 000 was estimated at 417 000.

These numbers show a wide application of the measure with no risk of ring-fencing.

Criterion 2:

“whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base”

As regards criterion 2 the division between criteria 2a and 2b is done in the same way as in the case of criterion 1 (i.e. *de jure* interpretation and *de facto* analysis). In general, a measure is caught by criterion 2 if the advantages are ring-fenced from the domestic market so that they do not affect the national tax base. In most cases, the evaluation against criterion 2 follows closely that of criterion 1.

2a) What has been written under criterion 1a applies by analogy to criterion 2a.

There are no rules preventing domestic taxpayers from benefiting from the measure nor to exclude domestic transactions from the benefit of the measure.

2b) On the basis of the explanations provided above and the marking under criterion 1b, the evaluation of criterion 2b follows the same reasoning.

Criterion 3: "whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages"
The application of the reduced tax rate of 15% is not limited to any specific type of business or activities. It applies to the same income as defined for the application of the general tax rate of 19%. There is a specific anti-abuse provision for the measure. In order to prevent tax optimisation the application of the 15% rate is limited for taxpayers starting their activity, which were created as result of transformation of one company (CIT taxpayer) into another company (also a CIT taxpayer). Such taxpayers will be able to apply a reduced tax rate only from the third fiscal year provided that the requirement relating to the definition of a small taxpayer is continuing to be fulfilled. There is another provision preventing the application of the regime in case there is a transfer of property to the new company exceeding a value of 10 000 EUR. The rule applies to organised assets (such as an existing business or its part) and to standalone assets such as IP rights or anything intangible or tangible nature. To this should be added the recent Polish general anti-abuse rule which targets artificial arrangements that are set up for tax optimisation purposes and includes a detailed list of artificial arrangements. This general provision appears to be sufficient to catch any potential abuse that might not be caught by the specific measure. These provisions appear to be adequate for preventing abuse of the regime through artificial arrangements.

Criterion 4: "whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD"
The Code of Conduct Group adopted the new Guidance on the interpretation of the fourth criterion of the Code of Conduct for business taxation at the 22 November 2017 meeting. This is before the Polish measure was notified to the Code Group. Therefore, we propose to take the guidance into account in this assessment. The arm's length principle is enshrined in Polish income tax law and contains the principles to be respected within the framework of a transfer pricing analysis in line with the revised OECD Transfer Pricing Guidelines (Action 8-10 of the OECD BEPS report). Those provisions fully apply in the context of the measure. The Polish measure also appears to be in line with the other elements of the 2017 guidance on

the interpretation of criterion 4.

Criterion 5: "whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way"
All preconditions necessary for the granting of a tax benefit should be clearly laid down in publicly available laws, decrees, regulations *etc*. before a measure can be considered transparent. There are no special administrative procedures for the application of the reduced tax rate. Taxpayers are obliged to make advance payments and submit annual tax returns in application of general principles laid down in the tax legislation.

Overall assessment:

The Polish measure introducing a reduced corporate tax rate for small and new enterprises respectively appears to be in line with all Code criteria. In light of the assessment made, the Polish measure should therefore be considered **overall not harmful** from a Code of Conduct point of view.