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## REPORT

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

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### Poland's Investment Zone regime (PL013)

|                              |
|------------------------------|
| <b>I/ AGREED DESCRIPTION</b> |
|------------------------------|

The following description was agreed by the Code of Conduct Group on 20 May 2019:

## 1. Relevant legal framework

The Act of 10 May 2018<sup>1</sup> on support for new investments on the whole Polish territory (hereafter „Act of 10 May 2018”) complemented by the Regulation of 28 August 2018<sup>2</sup> on public aid to be granted to certain enterprises for new investments (hereafter “Regulation of 28 August 2018”) represent the legal framework.

The tax exemption is available for resident companies or non-resident companies carrying out new investments. The measure is in force since 30 June 2018.

## 2. Purpose of the measure

The aim of the measure is to grant support for **new investments** in:

- **Tangible fixed assets or intangible assets**, related to the:
  - Establishment of a new enterprise;
  - Improvement of production capacity of an existing enterprise;
  - Diversification of production of an existing enterprise; or
  - General change in the production process of an existing enterprise.

## 3. Design of the measure

### 3.1 *Beneficiaries*

Any taxpayer subject to CIT or PIT may benefit from the tax exemption.

### 3.2 *Territorial scope*

Area of investment: new investments on the entire Polish territory.

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<sup>1</sup> <https://www.gov.pl/attachment/4b640048-18ca-493a-96fd-c0f5c06e04f9>

<sup>2</sup> <https://www.gov.pl/attachment/569cf811-7bce-4681-a36e-04e20eb555e6>

### 3.3 Eligible activities

Companies performing production activity, reinvestment or even establishing a new company can benefit from the tax exemption. The following types of activities are eligible to benefit from the tax exemption<sup>3</sup>:

- enterprises in the sector of traditional production industries<sup>4</sup>; and
- enterprises from the business services sector<sup>5</sup> providing:
  - financial auditing,
  - accounting and bookkeeping (excluding tax declarations),
  - services of head offices<sup>6</sup> and management consulting,
  - IT services - repair and maintenance services of computers and communication equipment;
  - research and experimental development services in the areas of natural and technical sciences,
  - architectural and engineering services, technical testing and analysis services,
  - call centers.

### 3.4 Tax advantage

The advantage is a tax exemption for the income obtained by the taxpayers for a period of 10, 12 or 15 years [tax holiday]. The duration of the tax holidays depends on the intensity of the State aid in the relevant region, i.e. the higher the allowed State aid in a given region is the longer is the duration of the tax exemption.

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<sup>3</sup> On the ground of regulation of the Council of Ministers of 28 August 2018 on public aid to be granted to certain enterprises for new investments

<sup>4</sup> **with the exception** of enterprises producing, i.a.: explosives, alcohol, tobacco products, steel, or companies operating in the energy generation and distribution sector; wholesale and retail trade, facilities and construction works, services related to accommodation and catering services, and running game centres. Companies from the metallurgy, iron and steel sectors, the coal sector, and the transport sector are not eligible for support under the EU regulations; also financial and insurance services and real estate services.

<sup>5</sup> Financial and insurance services, services connected with immovable property are explicitly excluded.

<sup>6</sup> services of head office and holding companies, except financial holding company

The exemption shall only be applicable to income generated from business activities carried out as part of an investment covered by the support decision<sup>7</sup>.

It means that only income obtained in connection with the implementation of such an investment is subject to exemption<sup>8</sup>. Thus, the tax exemption should not be used in relation to income obtained from other economic activity.

### 3.5 Amount of the tax exemption

The exemption cannot exceed a maximum amount. The maximum amount is related to the value of state aid available to an individual investor for a particular investment project. This value depends on the investment location, unemployment rate in the investment location, the size of the enterprise and the amount of investment expenditure (expenditure for purchase of tangible assets or two years' labour costs).

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7 Therefore, if the entrepreneur simultaneously conducts activities which are not covered, then the supported activities shall be organizationally separated, and the level of exemption shall be determined on the basis of data (revenues and costs) of the separated activity.

8 Art. 17 par. 1 point 34a of the CIT Act. The objective of providing support, which is analogous to the act on special economic zones, art. 3 of the Act on supporting new investments refers to support (exemptions), which is granted for the implementation of a new investment.

The maximum amount of state aid in the form of CIT or PIT tax exemption is determined based on the regional aid map for 2014-2020 (representing the percentage of costs eligible for regional aid, i.e. 25% or 35%, and sometimes 50%). The support for medium and small/ micro enterprises is increased by 10 and 20 percentage points respectively (i.e. 25% becomes 35% or 45% respectively).<sup>9</sup>

Example:

An entrepreneur obtained the permit, under which qualified costs in the amount of PLN 50.000.000 were incurred, the intensity of the aid was set at 35%, which means that the maximum value of public aid that the entity may benefit is PLN 17.500.000.

As a result of the investment, the taxpayer obtained PLN 10.000.000 from operating activities in the first year. This income would normally be taxed with 19% CIT. In this case, the aid used (tax exemption) will amount to PLN 1.900.000 in the first year.

As the maximum value of benefit is limited to PLN 17.500.000, the entrepreneur has the possibility to benefit from the tax exemption for a further period of 9 years [if the same amount of exempt income is obtained every year] until the maximum value is exhausted:  $\text{PLN } 1.900.000 \times 9 = \text{PLN } 17.100.000$ .

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<sup>9</sup> According to the State aid regulations, the eligible costs of the new investment are:

- land acquisition cost, cost related to purchase, development or modernization of fixed assets (e.g. machines), cost related to the acquisition of intangible assets (patent, computer programs, licenses, certificates, know-how and unpatented technical knowledge etc.)<sup>[7]</sup>, or
- 2-year labour costs of newly hired employees<sup>[8]</sup>.

For large companies, the costs of the new investments covering costs related to the acquisition of intangible assets (*patent, computer programs, licenses, certificates, know-how etc.*) shall be classified to eligible costs to be covered by support up to 50% of the eligible expenditure to be covered by aid.

Investments in intangibles are limited, as they must meet the limitations of the state aid regulations. These conditions do not match the conditions agreed by Member States through the modified nexus approach.

### 3.6 *Form taken*

The tax exemption is granted upon request, in the form of a **decision of the Minister** for economy. The same minister checks or delegates the compliance checks with the conditions contained in the decision on the support<sup>10</sup>. The decision sets the timeframe, the economic activity and the conditions to be met.

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<sup>10</sup> The competent minister in charge of economy shall control the implementation of conditions contained in the decision on support on the terms set out in Article 40 and Chapter 5 of the Act of 6 March 2018 - Entrepreneurs Law.

However, if the economic entity:

- 1) has ceased an economic activity specified in the decision on support on the area indicated therein or
- 2) grossly failed to fulfil the conditions specified in the decision on support or
- 3) has not removed deficiencies in the implementation of the conditions, referred to in Point 2, identified during the control, referred to in Article 22, within the time limit for their removal set out in the notice of the competent minister in charge of economy

- the competent minister in charge of economy shall repeal the decision on support.

According to art. 17 of the Act on supporting new investments the competent minister in charge of economy shall repeal the decision on support also on the request of economic entity. The competent minister in charge of economy shall declare the expiry of the decision on support on the request of the economic entity which has not benefited from the public aid or the economic entity which has benefited from the public aid and fulfilled all conditions stipulated in the decision on the support and conditions of granting public aid referred to in the provisions issued on the basis of Article 14(3).

### 3.7 Requirements to be fulfilled

The Minister grants the decision based on **quantitative** criterion and **qualitative criteria**<sup>11</sup>.

- **Quantitative criterion**

The quantitative criterion relates the minimum investment costs to the level of unemployment in the district where the investment shall be realised<sup>12</sup>. In addition, the eligible costs of the new investment the enterprise is obliged to incur are reduced for certain entrepreneurs<sup>13</sup> [R&D activities and in the sector of business services].

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<sup>11</sup> As per art. 2 of the Act of 10 May 2018

<sup>12</sup> the higher the unemployment rate in a given district, the lower the required investment expenditure.

<sup>13</sup> in particular the eligible costs of the new investment the enterprise is obliged to incur are reduced by:

- 95% when the investment relates to certain services [e.g head offices and management consulting services, financial auditing, accounting and bookkeeping, data processing, hosting, computer infrastructure, services in relation with computer programming and consultancy in IT and related services, hereafter referred to as “modern business services”], and R&D activity;
- 98% for micro enterprises;
- 95% for small enterprises, and - 80% for medium-sized.

| <b>Unemployment rate in the district/ average unemployment in Poland</b> | <b>Minimum level of investment [in millions]</b><br><i>(eligible costs that the enterprise is obliged to incur)</i><br><i>[1 EURO = 4.3 PLN [EUR approx.:]]</i> |                            |  |
|--|---|----------------------------|--|
|  | <b>Large<sup>14</sup> enterprise</b>  | <b>Medium enterprise</b>   | <b>Small enterprise , or<br/>R&amp;D projects, or<br/>Modern business services</b> |
| <b>&lt; or equal 60% of national average</b>                             | PLN 100<br>[EUR 23.000.000]   | PLN 20<br>[EUR 5.000.000]  | PLN 5<br>[EUR 1.200.000]   |
| <b>Between 60% and 100%</b>  | PLN 80<br>[EUR 18.500.000]  | PLN 16<br>[EUR 4.000.0000] | PLN 4<br>[EUR 1.000.000]   |

<sup>14</sup> Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain types of aid compatible with the internal market pursuant to Art. 107 and Art. 108 of the Treaty: evaluation criteria to define the size of enterprises: number of employees, turnover and/or balance sheet total.

| Category of enterprise | Average annual employment | Yearly turnover or/ | Total annual balance |
|------------------------|---------------------------|---------------------|----------------------|
| Medium                 | <250                      | ≤50 EUR m           | ≤43 EUR m            |
| Small                  | <50                       | ≤10 EUR m           | ≤10 EUR m            |
| Micro                  | <10                       | ≤ 2 EUR m           | ≤ 2 EUR m            |

All other companies not falling into the micro, small or medium category are considered to be large companies.



|  |                            |                           |                           |
|--|----------------------------|---------------------------|---------------------------|
| <b>Between 100% and 130 %</b>  | PLN 60<br>[EUR 13.800.000] | PLN 12<br>[EUR 3.000.000] | PLN 3<br>[EUR 700.000]    |
| <b>Between 130% and 160%</b>   | PLN 40<br>[EUR 9.200.000]  | PLN 8<br>[EUR 2.000.000]  | PLN 2<br>[EUR 500.000]    |
| <b>Between 160% and 200%</b>   | PLN 20<br>[EUR 4.600.000]  | PLN 4<br>[EUR 1.000.000]  | PLN 1<br>[EUR 250.000]    |
| <b>Between 200% and 250 %</b>  | PLN 15<br>[EUR 3.500.000]  | PLN 3                     | PLN 0.75<br>[EUR 180.000] |
| Above 250% average unemployment rate in the country in selected cities | PLN 10<br>[EUR 2.300.000]  | PLN 2<br>[EUR 500.000]    | PLN 0.5<br>[EUR 120.000]  |

- **Qualitative criteria**

There are two qualitative criteria: 1) the sustainable economic development and 2) the sustainable social development. The company asking for the tax benefit basically needs to fulfil 6 points out of 10 which can be awarded in both criteria, and not less than 1 point for each of the criteria<sup>15</sup>. The methods for fulfilling them differ for investments in services and in industrial production. (See annex 2 for more details).

<sup>15</sup> The requirements are reduced as the intensity of the state aid available in Poland increases: 50% for areas with 35% percent intensity of the state aid (thus, scoring required of 5 points out of 10; and 40% for areas where the intensity of state aid is 50% thus, scoring required of 4 points out of 10.

For investment in the service sector the 10 points are:

### **Economic sustainability**

- Investing in services supporting industries which may provide Poland with a competitive advantage;
- Export oriented sales<sup>16</sup>;
- Pursuing R&D activity<sup>17</sup>;
- Export oriented services<sup>18</sup>;
- Status as a micro, small or medium-size-enterprise.

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<sup>16</sup> Declaration to be made by the taxpayer that it will achieve an appropriate volumes of sales (products, goods and materials) outside Poland within the period the investment will be maintained. For the year 2017 the average intensity of sales outside Poland was at 23,1%.

<sup>17</sup> Either 1% of the operational costs are related to R&D costs or purchase of R&D services during the period the investment is maintained; or 2% of the work time of all employees is devoted to development activities...

<sup>18</sup> Declaration to be made by the taxpayer that it will establish and maintain a center of business services with the scope of activities exceeding beyond Poland during the period the investment will be maintained, and the value of the annual revenue from the sale of services of the center will not be lower than PLN 100.000.

## Social sustainability

- Creating well-paid<sup>19</sup> jobs and offering stable employment;
- Pursuing an economic activity with low environmental impact;
- Locating the investment in regions with high unemployment rates or in one of the 122 medium cities listed in the Regulation;
- Supporting the acquisition of knowledge and vocational qualifications and cooperation with industrial schools;
- Undertaking actions to care for employees.

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<sup>19</sup> This criterion has more to do with the quality of jobs created than with an obligation to create them. It rather refers to the levels of remuneration of newly created jobs under a new investment, for which the average gross remuneration exceeds the average remuneration in the national economy in accordance with the current communication of the President of the Central Statistical Office of Poland, and offering employment for not less than 80% of employees based on an employment contract.

An investor has to make a declaration in the application for the issuance of the decision on support that the annual average gross remuneration for each employee employed under the new investments, excluding members of the management board of capital companies or shareholders of partnerships, will exceed the average remuneration in the national economy in accordance with the current communication of the President of the Central Statistical Office of Poland and not less than 80% of those employed under the new investment after the date the decision on support is issued will be employed based on an employment contract during the period the investment will be maintained.

The Regulation refers to a net increase of jobs created in relation to the new investment. This shall mean a net increase in the number of employees in the specific establishment in the meaning of Regulation No 651/2014 in relation to the new investment against the average employment during a period of 12 months preceding the date the decision on support is received. The number of jobs means employees employed on a full-time basis during a period of one year, along with the employees employed on a part-time basis, converted into full-time jobs, including the employees employed based on an employment contract for a limited time to perform occasional or seasonal work.

The tax exemption shall have effect from the month in which the enterprise has started incurring labour costs until the maximum allowable regional aid has been exhausted.

In the case of a new company, an increase of jobs created should be counted from zero, because in the previous 12 months no employees were employed in that company. Thus, technically it is possible that for a newly created company that only "one" job is created, which afterwards must be maintained for 3 years (SMEs) or for 5 years (a large company).

As per 9.2 of the Regulation of 28/08/2018, three **other conditions** must be met in order to be able to use the exemption from income tax:

- maintaining ownership of component assets for specified period of time,
- maintaining new investment in the same region for specified period of time,
- maintaining the level of employment of a certain number of employees<sup>20</sup> for a specified period of time.

The specified period is 5 years for large enterprises and 3 years for micro, small and medium-sized enterprises.

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<sup>20</sup> newly created jobs in the relation to the new investment

## **II / FINAL ASSESSMENT**

The following draft assessment was agreed by the Code of Conduct Group on 10 July 2019:

|   | <b>1a</b> | <b>1b</b> | <b>2a</b> | <b>2b</b> | <b>3</b> | <b>4</b> | <b>5</b> | <b>OA</b> |
|---|-----------|-----------|-----------|-----------|----------|----------|----------|-----------|
| <b>PL – TAX EXEMPTION - SUPPORT FOR<br/>NEW INVESTMENT (“SNI” REGIME)</b> | V         | ?         | V         | ?         | V        | X        | X        | V         |

V = harmful

X = not harmful

The PL013 measure was notified under the 2019 Standstill notification exercise. The following assessment has been prepared with regard to paragraphs 1 to 5 of the Code, based on the "agreed description" endorsed by the COCG in the meeting of 20 May 2019 (see above). The measure was assessed against all Code criteria.

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 Act of 10 May 2018<sup>21</sup> on support for new investments on the whole Polish territory (hereafter „Act of 10 May 2018”) complemented by the Regulation of 28 August 2018<sup>22</sup> on public aid to be granted to certain enterprises for new investments (hereafter “Regulation of 28 August 2018”) represent the legal framework. The measure on support for new investment (SNI) which is a tax exemption is currently in force. The new laws expand the area offering tax incentives up to almost 100% of Poland’s territory.

Any taxpayer subject to CIT or PIT may benefit from the tax exemption, under the condition that a new investment is made. The new investment can be undertaken anywhere in Poland and the exemption shall only be applicable to income generated from business activities carried out as part of an investment covered by the support decision<sup>23</sup>.

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<sup>21</sup> See ADD1 to the agreed description.

<sup>22</sup> See ADD 2 to the agreed description.

<sup>23</sup> Thus, if the entrepreneur simultaneously conducts activities which are not covered, then the supported activities shall be organizationally separated, and the level of exemption shall be determined on the basis of data (revenues and costs) of the separated activity.

The advantage is a tax exemption for a period of 10, 12 or 15 years [tax holiday]. The **duration of the tax holiday** depends on the intensity of the State aid in the relevant region, i.e. the higher the allowed State aid in a given region is the longer is the duration of the tax exemption. If the investment is to be located in one of the existing 14 Polish SEZ, the tax exemption is granted for 15 years. The Polish territory is therefore split in special zones and regions according to the intensity of the State Aid in each region.

The tax exemption cannot exceed **a maximum amount** which depends mainly on two factors: location of the investment and the size of the company (see also calculation example under point 3.5 of the agreed description)<sup>24</sup>.

This tax exemption (SNI regime) constitutes a significantly lower level of effective taxation than the general corporate income tax rate which is 19%.

**It is therefore potentially harmful within the meaning of paragraph A of the Code.**

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<sup>24</sup> Thus, the level of tax exemption may amount to: i) 10% - 50% for large enterprises; ii) 20% - 60% for medium enterprises, iii) 30% - 70% for micro and small enterprises, depending on the region where the investment is located. The level of aid intensity is increased by 20 percentage points for small enterprises and 10 percentage points for medium enterprises.

### 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.

Both Polish resident companies and Polish permanent establishments (PEs) of non-resident companies subject to Polish corporate income tax which carry out new investments in Poland and derive income from such investment can benefit from the tax exemption.

#### *General remarks regarding all sectors of activity*

Taxpayers may benefit from the tax holiday if several conditions [see agreed description point 3.7] are met: i) a *quantitative criterion (minimum investment)* which depends on the level of unemployment in the region where the investment is made<sup>25</sup> and ii) *two qualitative criteria (economic sustainability and social sustainability)* which differ according to the sector of activity: service sector or industry sector.

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<sup>25</sup> The higher the unemployment rate in a given district, the lower the required investment expenditure. It further differs on the size of the company or of the activity performed.



In addition to the minimum investment requirement, any taxpayer wishing to benefit from the tax exemption must meet at least six other points (out of a possible of ten) from the two qualitative criteria (and at least one point per criterion). This threshold is lowered to five or even to only four points if the new investment is made in regions where the maximum intensity regional aid amounts to 35% or 50%<sup>26</sup> [which covers more than half of the Polish territory].

There seem to be no explicit provisions restricting the benefits exclusively to transactions undertaken by non-residents or transactions engaged with non-residents. However, among the qualitative criteria to be met either by the industry sector or by the service sector there are points that require that the taxpayer engages to undertake export oriented sales or export oriented services. Therefore, it could be argued that the measure has elements of ring-fencing. However, as the taxpayer must meet six out of ten available points, it could be argued that these ring-fencing elements are not sufficient because other points, which do not restrict transactions, are in the majority.

It therefore cannot be concluded that the measure is ring-fenced in its entirety.

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<sup>26</sup> [http://europa.eu/rapid/press-release\\_IP-14-180\\_en.htm](http://europa.eu/rapid/press-release_IP-14-180_en.htm);  
[https://www.paih.gov.pl/files/?id\\_plik=33704](https://www.paih.gov.pl/files/?id_plik=33704)

*Specific remarks regarding the Services sector, in particular the modern Business services centers*

Upon a closer analysis of the way in which the specific conditions for the services sector can actually be met, the measure appears at least partly *de jure* ring-fenced. First, under the *Criterion for sustainable economic development* there are two points [out of the five points that can be chosen] that encourage:

- i) either non-residents to establish business services centres in Poland (see point on Export oriented services<sup>27</sup>), or
- ii) mainly transactions with non-residents (see both point on Export oriented sales<sup>28</sup> and point on Export oriented services).

If the taxpayer engages to meet any of those two points in order to reach the six points threshold, the company must declare that it will achieve a certain volume of transactions with non-residents and/or that the annual revenue from the sale of services outside Poland will be above a specific threshold.

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<sup>27</sup> Declaration to be made by **the taxpayer that it will establish and maintain** a center of business services with the scope of activities exceeding beyond Poland during the period the investment will be maintained, and the **value of the annual revenue from the sale of services of the center will not be lower than** PLN 100.000.

<sup>28</sup> Declaration to be made by **the taxpayer that it will achieve** an appropriate volumes of sales (products, goods and materials) outside Poland within the period the investment will be maintained. For the year 2017 is concerned the average intensity of sales outside Poland was at 23,1%.

Thus, a multinational group establishing its business services center in Poland or a resident company establishing such a center to perform specific (shared) services for non-residents will necessarily engage to meet the point(s) on *Export oriented services or Export oriented sales*. In practice, such companies become actually obliged to engage mainly in transactions with non-residents, for several reasons.

*First*, the only practical and feasible way to ensure that such requirements are met throughout the period the investment is maintained is to engage mainly if not exclusively in transactions with non-residents.

*Second*, an activity falling under the scope of the business service sector (see details under criterion 3 below) will always satisfy the point on *export-oriented services*. While it can reasonably be presumed that such a taxpayer may fulfil any of the other first three points<sup>29</sup> of the *Criterion on Social sustainability*, it is very unlikely it will choose or even be able to fulfil the last two<sup>30</sup>. Therefore, the only way to reach the minimum threshold of six points is to fulfil two other points out of the five points under the *Criterion on Economic sustainability*. And, among the remaining points among which it can choose to fulfil those two points, there are *the export oriented sales*, *the pursue of R&D activity*, and *the size of the company*.

A company performing business service activities, be it in the context of intra-group services or a resident company performing such services for non-residents, will always be obliged to meet at least one of the two points with ring-fencing effects.

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<sup>29</sup> - Creating well-paid jobs and offering stable employment  
- Pursuing an economic activity with low environmental impact;  
- Locating the investment in regions with high unemployment rates<sup>29</sup> or in one of the 122 medium cities listed in the Regulation.

<sup>30</sup> - Supporting the acquisition of knowledge and vocational qualifications and cooperation with industrial schools;  
- Undertaking actions to care for employees.

To sum up, entities active in the Business service sector cannot avoid choosing one of the points resulting in ring-fencing. This results in the regime being partly ring-fenced in so far as such activities are concerned.

### *Conclusions*

1. For the above reasons the Polish tax exemption measure should be considered partly ring-fenced, insofar as the Business service sector is concerned.
2. The Code of Conduct Group should agree on how to deal with such measures that may contain partial ring-fencing features by including additional criteria/ points to be met.

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 the current case as the regime has been introduced recently there are no statistics to support an analysis of a possible *de facto* 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 analogously to criterion 2a, insofar as the Business service sector is concerned.

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”

*a. Preliminary remarks on the scope of Criterion 3*

Criterion 3 of the CoC *per se* does not prohibit granting tax advantages to any specific economic activities, but it requires that sufficient substance is in place. *The Guidance on the interpretation of the third criterion* gives further indications on the main elements that the analysis under criterion 3 should cover. To ensure that the activities benefiting from the preferential regime have adequate substance the measure should provide for i) adequate number of employees with necessary qualifications (adequate employment); ii) adequate amount of operating expenditure with regard to the core income generating activities (adequate expenditure), and last but not least iii) adequate monitoring.

b. Main features of the Polish SNI regime

The **activities allowed** and thus benefiting from the tax exemption<sup>31</sup> are both from:

- the traditional production sector<sup>32</sup>, and
- the business services sector<sup>33</sup> [be it intra-group services or not]:
  - financial auditing, accounting and bookkeeping<sup>34</sup>, services of head offices<sup>35</sup> and holding companies, management consulting,
  - IT services - repair and maintenance services of computers and communication equipment;
  - R&D experimental services in the areas of natural and technical sciences,
  - architectural and engineering services, technical testing and analysis services,
  - call centers.

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<sup>31</sup> On the ground of regulation of the Council of Ministers of 28 August 2018 on public aid to be granted to certain enterprises for new investments

<sup>32</sup> **with the exception** of enterprises producing, i.a.: explosives, alcohol, tobacco products, steel, or companies operating in the energy generation and distribution sector; wholesale and retail trade, facilities and construction works, services related to accommodation and catering services, and running game centres. Companies from the metallurgy, iron and steel sectors, the coal sector, and the transport sector are not eligible for support under the EU regulations; also financial and insurance services and real estate services.

<sup>33</sup> Financial and insurance services, services connected with immovable property are explicitly excluded.

<sup>34</sup> Excluding tax declarations

<sup>35</sup> Services of head office and holding companies, except financial holding company.

The beneficiaries must fulfil **several criteria**:

- i) *a quantitative criterion (**minimum investment expenditure**)* which depends on the level of unemployment in the region where the investment is made and differs on the size of the company or of the activity performed<sup>36</sup>; it can include capital investment (purchase of tangible assets<sup>37</sup> or purchase from unrelated parties of intangible assets<sup>38</sup>) or two years' employment costs of new jobs created in relation to the investment; and
- ii) *two qualitative criteria (**economic sustainability** and **social sustainability**)* which differ according to the sector of activity: service sector (a rather mobile sector of activity) or industry sector (less mobile sector of activity).

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<sup>36</sup> The higher the unemployment rate in the region, the lower the investment needs to be. The minimum investment amounts range from approximately EUR 2.300.000 to EUR 23.000.000 for large companies; from EUR 500.000 to EUR 5.000.000 for medium, and from EUR 120.000 to EUR 1.200.000 for small, R&D activities and modern business services.

<sup>37</sup> E.g. land, buildings and objects, machineries and devices;

<sup>38</sup> E.g. the purchase price of intangible assets relating to the technology transfer through the acquisition of patent, licensing rights, know-how and unpatented technical knowledge.



**Employment requirement** is not mandatory; the measure imposes neither the creation of new jobs, nor a minimum number of such new jobs.

Insofar as the quantitative criterion is concerned: the taxpayer may choose to include among the eligible investment costs the two years' expenditure for new jobs created in relation to the investment, but it is not obliged to do so. The taxpayer may choose to only include the capital investment, if no new jobs are created. Therefore, the employment requirement is not mandatory. Even if new jobs are created, and the taxpayer chooses to include the two years' labour costs, the Regulation merely refers to a net increase of jobs created in relation to the new investment. Regarding a new company, a "net increase" of jobs created should be counted from zero, because in the previous 12 months no employees were employed in that company. Theoretically, there could be only "one" single job created.

Insofar as the qualitative criterion on Social sustainability is concerned: the taxpayer has the possibility, but not the obligation, to choose among the five points of the Social sustainability criterion, and again there is no requirement for a minimum number of jobs to be created:

- for service sector - a declaration is made to *Create well-paid jobs and offer stable employment* [annual average remunerations above the average remuneration in the national economy and at least 80% of the new employees are employed based on an employment contact maintained for the period of the investment];
- for industry sector – a declaration is made to *Create specialist jobs to pursue the economic activity covered by the new investment and offer stable employment* [at least 80% of the new employees are employed based on an employment contact maintained for the period of the investment and at least 80% of the new employees have a university, secondary or vocational school degree).

c. Assessment against criterion 3 of the Code

First, as the Polish SNI regime is available to both production activities, and to the more mobile services activities, it is appropriate that an analysis is undertaken for each of the sectors.

**1. Industry/production sector**

In addition to the *quantitative criterion (minimum investment)*, the *two qualitative criteria* to be met and the ten points among which the taxpayer may choose are:

**Criterion of Economic sustainability**

- Investing in services supporting industries which may provide Poland with a competitive advantage;
- Export oriented sales<sup>39</sup>;
- Members of the National Key Cluster selected in the competition organized by the minister for the economy;
- Pursuing R&D activity<sup>40</sup>;
- Status as a micro, small or medium-size-enterprise.

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<sup>39</sup> Declaration to be made by **the taxpayer that it will achieve an appropriate volumes of sales** (products, goods and materials) outside Poland within the period the investment will be maintained. For the year 2017 is concerned the average intensity of sales outside Poland was at 23,1%.

<sup>40</sup> Either i) **1% of the operational costs** are related to R&D costs **or** purchase of R&D services during the period the investment is maintained; or ii) **2% of the work time of all employees** is devoted to development activities during the period the investment is maintained.

### **Criterion of Social sustainability**

- Creating specialist jobs to pursue the economic activity covered by the new investment and offering stable employment;
- Pursuing an economic activity with low environmental impact;
- Locating the investment in regions with high unemployment rates<sup>41</sup> or in one of the 122 medium cities listed in the Regulation;
- Supporting the acquisition of knowledge and vocational qualifications and cooperation with industrial schools;
- Undertaking actions to care for employees.

The Polish SNI regime therefore requires **a minimum investment** (capital investment or two years' costs of employment created in relation to the investment) and gives **the option to create specialist jobs**.

The minimum capital investment amounts from approximately EUR 2.300.000 to EUR 23.000.000 for large companies; or from EUR 500.000 to EUR 5.000.000 for medium companies.

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<sup>41</sup> i.e. not less than 160% of the national average unemployment rate.

The employment requirement is however not clearly defined.

It can be presumed that adequate new assets and/or premises exist following an investment in capital (assets).

However, it cannot be presumed that adequate new employment is required only because the taxpayers performs an industry/ production activity (see also see comment above point b) since the SNI measure does not require that adequate new employment is created, but only leaves the possibility to the taxpayer to choose to do so in order to meet one extra point and reach the necessary threshold.

In addition, among the eligible costs of intangible assets is the price for purchase of intangible assets from unrelated parties (see footnote 18). As the income of the taxpayer derived from that investment is tax exempt and the investment is the purchase price of such IP assets, such income will be exempt without any adequate substance or nexus requirement, and for a very wide category of IP assets. While it is true that the SNI regime/ tax exemption is not designed as a specific IP box measure, it nonetheless may have similar effects (e.g. a production company purchasing such IP assets following an investment will benefit from the tax exemption on the income from the sale of the goods [thus, embedded royalties], or may charge royalties to its own branches or subsidiaries or later on sell such IP assets and potentially deriving capital gains].

## 2. Service sector

In addition to the *quantitative criterion (minimum investment)*, the *two qualitative criteria* to be met and the ten points among which the taxpayer may choose are:

### **Criterion of Economic sustainability**

- Investing in services supporting industries which may provide Poland with a competitive advantage;
- Export oriented sales<sup>42</sup> [the taxpayer has to declare it will achieve an appropriate volumes of sales (products, goods and materials) outside Poland, i.e. above the Polish average intensity of export sales];
- Pursuing R&D activity<sup>43</sup>;
- Export oriented services<sup>44</sup> (the taxpayer has to declare it will establish and maintain a center of modern business services with the scope of activities exceeding Polish territory, and the value of annual revenues from the sale of services should exceed PLN 100.000 (approximately EUR 25.000));
- Status as a micro, small or medium-size-enterprise.

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<sup>42</sup> Declaration to be made by **the taxpayer that it will achieve an appropriate volumes of sales** (products, goods and materials) outside Poland within the period the investment will be maintained. For the year 2017 is concerned the average intensity of sales outside Poland was at 23,1%.

<sup>43</sup> Either i) **1% of the operational costs** are related to R&D costs **or** purchase of R&D services during the period the investment is maintained; or ii) **2% of the work time of all employees** is devoted to development activities during the period the investment is maintained.

<sup>44</sup> Declaration to be made by **the taxpayer that it will establish and maintain** a center of business services with the scope of activities exceeding beyond Poland during the period the investment will be maintained, and the **value of the annual revenue from the sale of services of the center will not be lower than** PLN 100.000.

### **Criterion of Social sustainability**

- Creating well-paid<sup>45</sup> jobs and offering stable employment;
- Pursuing an economic activity with low environmental impact;
- Locating the investment in regions with high unemployment rates<sup>46</sup> or in one of the 122 medium cities listed in the Regulation;
- Supporting the acquisition of knowledge and vocational qualifications and cooperation with industrial schools;
- Undertaking actions to care for employees.

The Polish SNI regime therefore requires **a minimum investment** (capital investment or two years' costs of employment created in relation to the investment) and gives **the option to create well-paid jobs**.

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<sup>45</sup> This criterion has much to do with the quality of jobs created than with an obligation to create them. It rather refers to the levels of remuneration of newly created jobs under a new investment (excluding members of the management board of capital companies or shareholders of partnerships) for which the average gross remuneration exceeds the average remuneration in the national economy in accordance with the current communication of the President of the Central Statistical Office of Poland, and offering employment for not less than 80% of employees based on an employment contract.

<sup>46</sup> i.e. not less than 160% of the national average unemployment rate

The SNI regime targets and encourages the performance of **modern business services**. *First*, services of head office and holding companies<sup>47</sup>, management consulting or other mobile types of income generating activities such as income from IP related activities, IT services, call centers are enumerated explicitly among the eligible activities. *Second*, the minimum investment required is significantly reduced for such entrepreneurs<sup>48</sup>, i.e. by 95% (see also table in the agreed description). It thus ranges from approximately EUR 120.000 to EUR 1.200.000, depending on the level of unemployment of the district where the enterprise makes the investment. This encourages and makes it easier for taxpayers performing (intra-group) business services or R&D activities, to meet the quantitative criterion, regardless of the size of the company. All these circumstances constitute a strong incentive for taxpayers performing business services and/or performing R&D related activities, which would wish to establish a new company to perform (intra-group) business services and/or R&D related activities, and undertaking transactions mainly with non-resident counterparts, or simply for residents companies performing such business services to undertake transactions mainly with non-residents.

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<sup>47</sup> See also remarks made under point c1 concerning eligible costs of intangible assets and subsequent tax exemption of the IP income derived.

<sup>48</sup> in particular the eligible costs of the new investment the enterprise is obliged to incur are reduced by:

- 95% when the investment relates to **certain services** [e.g head offices and management consulting services, financial auditing, accounting and bookkeeping, data processing, hosting, computer infrastructure, services in relation with computer programming and consultancy in IT and related services, hereafter referred to as “modern business services”], and **R&D activity**;
- 98% for **micro** enterprises;
- 95% for **small** enterprises, and - 80% for **medium**-sized.

These points are very easy to meet for a taxpayer establishing a new company to perform (intra-group) services and or R&D related activities, with a view to performing such services for other group members. Such activities would easily score at least three points under each of the two Criteria, without actually requiring a lot of substance.

The SNI regime thus lacks an adequate employment requirement and moreover gives the possibility to benefit from the tax exemption to IP related income without an adequate substance or nexus requirement, and from a very wide category of IP assets.

#### **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”

##### General transfer pricing rules:

This may be relevant in respect of the business service sector and intra-group performed services. As the income (the price of the service performed) may be exempt from tax in Poland, it is relevant for the pricing of the transaction that the arm's length principle and internationally accepted principles for the determination of profit within the group are followed.

The same is relevant if any IP income (royalties, capital gains) derived is part of the income exempt from tax in Poland.



The Polish transfer pricing rules do not directly refer to the OECD rules outlined in the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and are provided for in article 11 (a) – (t) of the UPDOP. In general, associated parties or taxpayers entering into transactions with entities resident in low-tax jurisdictions are required to set transaction prices on similar terms that would be agreed between unrelated parties. If prices of transactions between associated parties or with entities resident in low-tax jurisdictions do not conform to the arm's length principle, the tax authorities may make an adjustment using the comparable uncontrolled price method, the resale price method, the cost-plus method, the profit split method or the transactional net margin method (article 11d of the UPDOP).

**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.

The tax exemption is granted upon request from the taxpayer concerned, in the form of a **decision of the Minister** for economy, based on quantitative and qualitative criteria<sup>49</sup>; a so-called “support decision”

The same minister checks or delegates the compliance checks with the conditions contained in the decision on the support<sup>50</sup>. The decision sets the timeframe, the economic activity and the conditions to be met.

The procedural steps for the issuance of the support decision and the compliance checks are established in the two relevant legal acts in a transparent and detailed manner.

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<sup>49</sup> As per art. 2 of the Act of 10 May 2018

<sup>50</sup> The competent minister in charge of economy shall control the implementation of conditions contained in the decision on support **on the terms set out in Article 40 and Chapter 5 of the Act of 6 March 2018 - Entrepreneurs Law.**

However, if the economic entity:

- 4) has ceased an economic activity specified in the decision on support on the area indicated therein or
- 5) grossly failed to fulfil the conditions specified in the decision on support or
- 6) has not removed deficiencies in the implementation of the conditions, referred to in Point 2, identified during the control, referred to in Article 22, within the time limit for their removal set out in the notice of the competent minister in charge of economy

- the competent minister in charge of economy shall repeal the decision on support.

According to art. 17 of the Act on supporting new investments the competent minister in charge of economy shall repeal the decision on support also on the request of economic entity. The competent minister in charge of economy shall declare the expiry of the decision on support on the request of the economic entity which has not benefited from the public aid or the economic entity which has benefited from the public aid and fulfilled all conditions stipulated in the decision on the support and conditions of granting public aid referred to in the provisions issued on the basis of Article 14(3).

### Overall assessment (OA):

In light of the assessment made under all Code criteria and for all the considerations put forward above the Polish SNI regime is assessed as **harmful** from a Code of Conduct point of view.

Business services activities, such as head offices, holding companies, management consulting and/ R&D related activities and income are eligible for the tax exemption restricted mainly to transactions with non-resident counterparts and without being accompanied by adequate substance requirements.

This measure is therefore **harmful** in respect of the preferential treatment of income of entities in the service sector.

On a more general note, the Code of Conduct Group should decide how to deal with measures that contain ring-fencing features by including a number of alternative criteria/ points to be met.

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