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The Polish Sejm, the lower chamber of the parliament, passed a bill on June 26 amending the 1992 Corporate Income Tax Law and the 1991 Personal Income Tax Law. The bill also introduces for the first time controlled foreign corporation regulations. If enacted, the new rules would become effective as of January 1, 2015.

The introduction of CFC regulations is the latest move by the Polish government to limit cross-border tax optimization and close existing loopholes. Previous efforts included amending existing double taxation treaties (DTTs) or signing new DTTs to implement changes such as the following:

- introducing a switchover clause that allows Poland to unilaterally change the method for avoidance of double taxation from exemption with progression to ordinary credit;
- introducing a ''real estate-rich company'' clause (as provided for in article 13.4 of the OECD model convention);
- expanding the categories of income that are subject to the ordinary credit method rather than the exemption method, to include business profits, capital gains, and directors' fees; and
- introducing specific antiavoidance clauses and widening the scope of the exchange of tax information clauses.

Poland also expanded its network of tax information exchange agreements to 14 jurisdictions (Andorra, Belize, Bermuda, the British Virgin Islands, Gibraltar, Grenada, Guernsey, Jersey, the Cayman Islands, Liberia, San Marino, the Bahamas, Dominica, and the Isle of Man).

Other prior legislation introduced a corporate income tax on joint stock partnerships. These partnerships, which were previously treated as fully tax-transparent entities, are now liable to a 19 percent income tax, effective as of January 1, 2014. This legislation targeted a widespread tax-optimization scheme based on the combination of tax-transparent joint stock partnerships and tax-exempt closed-ended investment funds that resulted in an effective nontaxation of income earned on Polish investments.

The new CFC regulations will be further supported by the planned general antiavoidance rules, which may be introduced in 2015, based on so-called assumptions announced by the Ministry of Finance in early 2013.

The CFC Regulations

The CFC regulations are structured as two new articles — each with basically the same language and 18 separate subsections — to be added to the 1992 Corporate Income Tax Law and the 1991 Personal Income Tax Law, as new article 24a and new article 30f, respectively. The new provisions impose a 19 percent flat tax on a CFC's income.

The CFC regulations define the term ''foreign corporation'' very widely as a legal person that is a corporation in organization, an organizational body without legal personality, or a partnership without legal personality — all of them without seat or place of management within the territory of Poland — in which the Polish taxpayer (corporate or individual) has a share in capital, voting rights, or a right to participate in profits.

Further, a CFC has also been widely defined as:

- a foreign corporation with seat or place of management in a jurisdiction on the Ministry of Finance's April 2013 blacklist, which includes 37 countries and territories;
- a foreign corporation with seat or place of management in a jurisdiction that is not on the April 2013 blacklist, but with which Poland or the European Union did not conclude a tax treaty, constituting a basis for receiving tax information from tax authorities of such a country; or
- most importantly, a foreign corporation that meets all of the following criteria:

  a) a Polish resident taxpayer owns, directly or indirectly, for an uninterrupted period of at least 30 days, at least 25 percent of the capital, voting rights, or shares involving participation in profits;

  b) at least 50 percent of the revenues of such a corporation in one fiscal year comes from passive income — that is, dividends or other participations in profits of legal persons, capital gains, receivables, interest, or loans or guarantees of any kind, as well as from royalties, intellectual property rights (including revenues from alienation of such rights), or alienation of or other proceeds from financial instruments; and

  c) at least one of the income categories referred to in item b), received by the foreign corporation, is subject, in the country of the seat or place of management of such a foreign corporation, to a tax that is at least 25 percent less than the 19 percent income tax rate applicable in Poland (that is, less than 14.25 percent), is income tax exempt, or falls outside of the scope of income taxation — except for the dividends that are tax exempt under the EU parent-subsidiary directive.

The basis for application of the 19 percent Polish CFC income tax will be the CFC's income, calculated pro rata to:

- the period in which the Polish taxpayer held at least the above-mentioned 25 percent stake in the corporation; and
- the taxpayer's share in the profits of that corporation, after the deduction of dividends received from that corporation or amounts received from the alienation of shares in that corporation.

The amounts that qualify for the above deduction, but could not have been deducted in any fiscal year, may be deducted in any of the next five consecutive years.

The CFC regulations provide for a set of deductions from the above-mentioned 25 percent stake in the foreign corporation related to the stakes in that corporation held by the other subsidiary (Polish or foreign) of the taxpayer, if certain conditions are met by that subsidiary.

The calculated 19 percent Polish CFC income tax amount due may be reduced by the amount of the foreign income tax paid by the CFC — calculated pro rata to the Polish taxpayer's share in the income of such foreign corporation. To properly calculate the taxable income, tax base, and the amount of tax due related to the CFC, Polish taxpayers must maintain registers of CFCs that are available to the tax or audit authorities within seven days of a request.

The CFC income tax shall not apply if:

- the particular CFC has annual revenues of less than €250,000; or
- the CFC operates ''a real business activity'' in a country other than a member state of the EU or European Economic Area, in which it is subject to an unlimited tax liability, and its income does not exceed 10 percent of its gross revenues from such ''a real business activity'' in that country — under the condition that there is a legal basis resulting from a DTT or other tax treaty concluded by Poland or the EU with that country, allowing for the exchange of tax information from tax authorities of that country.

The CFC income tax and the obligation to maintain the register of CFCs shall not apply if the particular CFC operates a real business activity in a member state of the EU or EEA.

Under the new bill, a real business activity occurs if, in particular:

- the CFC's registration is related to the existence of an enterprise that actually performs activities constituting business activity, including the maintenance of an office, qualified personnel, and appropriate equipment used in the business activity;
- the CFC does not form a structure that lacks economic substance;
- there is a reasonable relation between the scope of activities of the CFC and an office, personnel, and equipment actually maintained by such a corporation;
- the agreements concluded by the CFC are in accordance with the economic reality, have a business justification, and do not obviously contradict the general business interest of such a corporation; or
- the CFC fulfills its basic business functions by itself, using its own resources, including the management personnel present on-site.

The new CFC provisions shall also apply to the Polish taxpayer operating a permanent establishment in a foreign country, unless the PE's income has been included in the general tax base.

Entry Into Force

In the course of the legislative process, the Senate (the upper chamber of the Polish parliament) reviewed the draft bill and on July 24, 2014, passed an appropriate resolution introducing a number of minor, mainly editorial, changes. Therefore, it is expected that the Sejm will accept and pass the proposed changes and the bill will be signed by President Bronislaw Komorowski and published in the official gazette before November 30, 2014, thus allowing its provisions to enter into force on January 1, 2015.

The date of November 30, 2014, is crucial in this context because the Polish Constitutional Tribunal held a few years ago that laws imposing negative tax consequences on taxpayers (for example, higher or additional taxes) must be announced at least one month before they become effective.

The question of the exact date on which the new CFC regulations would actually become effective is far more complicated. Although the new regulations would formally enter into force on January 1, 2015, the effective application of its provisions to particular foreign corporations owned by Polish resident taxpayers may begin on different dates. The transitional provisions of the new bill provide that those taxpayers shall apply the new rules, beginning from the first fiscal year of the CFC that began *not earlier* than the first day of the fourth month following the month in which the new regulations will be officially announced. Thus, assuming that the CFC regulations would be published no later than November 30, 2014, the new CFC provisions will effectively apply to CFCs whose new fiscal year starts on March 1, 2015, or later.

Conclusion

The new CFC regulations would clearly affect most of the existing tax-optimization schemes in 2015, as most of the CFCs currently owned, directly or indirectly, by Polish resident taxpayers, would fall under the CFC regime. The most likely ways to avoid the application of the CFC regulations would be to not fulfill at least one of the conditions for the existence of a CFC — that is, keeping the foreign corporation's direct or indirect threshold below 25 percent, keeping the passive income-sourced share in a total revenue stream received by the foreign corporation below 50 percent, or locating the foreign corporation in a jurisdiction that imposes an income tax rate between 14.25 and 19 percent.

Alternatively, one could consider bringing more ''substance'' to the foreign corporation, thus justifying the real business activity status of that corporation. ◆