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| Common tax consequences of business financing in Poland

Introduction

In accordance with information provided by the National Bank of Poland, the amount of direct foreign investments in Poland in 2009, compared with the situation in 2008, increased by 32.221 mln EUR, i.e. of 11,9% (figures of 2010 are not published yet). More than 90% of the investments are from European Economic Area (mainly: Belgium, Germany, Netherlands, Luxembourg, Spain, France).

The most popular legal form of carrying out business activity by non residents in Poland is via a limited liability company ("LLC"). One of the advantages of setting up a LLC is the low amount of minimum required share capital (PLN 50 000 which is approx. EUR 15 000. Please note: effective 8 January 2009 PLN 5000).

There is however, a fundamental question at the planning stage on how to finance the business so that it grows. Minimum equity will not be enough to acquire assets needed to conduct normal business activity and therefore, the question may appear whether the Company should have its equity increased by its current or new shareholder (equity financing) or get direct financing through loans (debt financing).

Of course, as anywhere else, there are pros and cons to each option and that is why many entities developing their business in Poland decide to have a mix of both. Nevertheless, before making a final decision, it is worth considering the initial tax consequences of equity and debt financing as tax burdens may be an important factor to be considered.

To get a full and clear picture before making any such decisions, consultation with a local law, tax or audit company is advisable.

Debt financing-tax issues

Loans are principally subject to the **Civil Law Activities Tax** ("CLAT") at 2% of the loan amount. A reduced rate of 0,5% applies to loans granted by shareholders. CLAT is paid within 14 days from the first of the following events: conclusion of the agreement or transfer of funds.

Interest paid to foreign entities will be principally subject to withholding tax of 20%. Under certain conditions, the tax rate can be decreased (even to 0%) per the EU Directives implemented to the Polish regulations or double tax treaties. In order to benefit from preferential rates, the payer of interest must document the tax residency of its recipient with a foreign certificate of residency. Under the EU Directive implemented to the Polish tax law, Poland can impose a withholding tax on interest at a gradually decreasing rate until 2013.

Interest paid is generally tax deductible. However, Polish tax law restricts the financing granted by related entities by setting a limit calculated on the basis of a debt to equity ratio. For companies with the shareholder loan amounts exceeding three times their share capital, part of the interest paid to the shareholder will not constitute a tax deductible item (thin capitalization restriction).

Interest on a loan from a related party must be also analyzed from the transfer pricing viewpoint. According to Polish tax law; loan interest rates should be comparable to market rates. If the conditions of a loan agreement between related companies differ from those agreed by independent entities, the tax authorities may make an adjustment leading to the exclusion of some costs of interest from the corporate tax calculation.

Equity financing-tax issues

Companies concluding transactions with related entities are obliged to prepare specific transfer pricing documentation of such transactions. Transfer pricing documentation is required if cumulated loan amounts exceed an equivalent of EUR 30 000. If no such documentation is presented, the positive difference between the income determined by the tax authorities (as a result of the above mentioned adjustment) and that declared by the taxpayer, is subject to tax at a rate of 50%.

The most common forms of granting funds are share capital increases and so-called "additional payments". Both actions are subject to transaction tax - Civil Law Activities Tax ("CLAT") payable within 14 days from the relevant shareholders resolution. Tax is calculated at 0,5% of the funds transferred to the entity.

Contrary to the case of loans, no interest can be paid or accrued on increased capital and additional payments. Therefore, besides the CLAT issue, equity financing in most cases does not trigger more immediate tax consequences for the company.

Investors may however, expect to receive profit from their shares in the form of dividends. Under the Polish tax regulations, revenue from the distribution of profit (such as dividends) of a corporate entity with its seat in Poland, is taxed at a rate of 19%. Tax on dividends is withheld and remitted by the dividend payer.

Since the accession of Poland into the EU in 2004, and following EU Directives, an exemption from withholding tax on dividends earned by EU companies was introduced.



To benefit from this exemption, the recipient of the dividend must meet a number of conditions (e.g. it must be subject to unlimited tax liability in an EU member state and must hold at least 10% shares of the company paying the dividend for a period not shorter than 2 years).