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TAX ALERT

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TAX EXEMPTIONS IN THE ACT ON SUPPORT FOR NEW INVESTMENTS

A government draft of an Act which purpose is to introduce new mechanisms to support entrepreneurs in making new investments (hereinafter referred to as the “**Draft Act**”) has been submitted to the Lower Chamber of the Polish Parliament. The proposed support measures will mainly consist of income tax exemptions for both CIT and PIT taxpayers. The proposed provisions are to supersede the existing regulations concerning the benefits available to investors which operate in special economic zones.

The main assumptions underlying the Draft Act are as follows:

- entrepreneurs which start new investment projects or make certain reinvestments will be eligible for the exemption;
- tax preferences will no longer only apply to designated areas: the exemption will be available throughout the entire territory of Poland;
- in principle, the exemptions will range from 20% to 50% of the project costs.

Tax Exemption

The most important change in comparison to the preferences available to date to those entrepreneurs which operate in special economic zones is that the tax exemption will not be conditional upon investing in a designated area; instead it will apply to the entire country irrespective of the place of business.

The planned exemption will be available to entrepreneurs which plan to make new investments in Poland by establishing new production plants and by making reinvestments consisting in increasing the production capacity of existing enterprises, diversifying the production of an enterprise, or introducing fundamental changes to the production process. However, replacement investments will not be eligible for support.

It should also be emphasised that only those entrepreneurs which are found to comply with the medium-term development strategy referred to in the Act on the Principles of Conducting Development Policy will be able to take advantage of the opportunities stipulated in the Draft Act. Government representatives have stressed that innovative projects will be preferred. Those industries that will not be able to apply for the support stipulated in the Draft Act have been explicitly listed in the proposed provisions. These industries include those which business activities relate to structures and construction services, hotel and catering services, financial and insurance services, and professional, scientific services, etc.

Support in the form of exemptions from income taxes will be granted on the basis of a decision issued by the bodies which will manage the area in question (these areas will be determined by way of a regulation) in accordance to the delegation granted by the Minister of Economy. The duration of the decision’s validity (10, 12, or 15 years) will be stated depending on the amount of

state aid, the field of business activity, and the conditions to be met by the entrepreneur in order to receive the support as stipulated in the Act. The provisions of the Code of Administrative Procedure will apply to the procedure in accordance to which decision has been issued. Importantly, an entrepreneur will be able to obtain more than one decision concerning support in the case of multiple new investments (or reinvestments). On the other hand, no decision will be issued to an entrepreneur which has been convicted of an offence against the natural environment, or to an entrepreneur which partner or member of the Management Board has been convicted of such an offence.

The decision will be issued after the entrepreneur has met a number of qualitative and quantitative criteria which will vary depending on the development level of the area in question. The purpose of these criteria will be to assess whether the investment serves the economic and social development of the country and of the region. The entrepreneur will, among other things, need to incur a certain amount of eligible costs which will be determined depending on the unemployment rate in the region in which the investment is to be made (according to the draft regulation, the higher the unemployment rate in the district in question, the lower the amount of eligible investment costs required; this amount will range from PLN 10 million to PLN 100 million). It should be stressed that the amount of eligible costs to which micro-, small- and medium-sized enterprises, as well as entrepreneurs which invest in modern business services and R&D are required to commit will be significantly reduced (by 80, 95, or 98% of the required investment cost). Aid will also be conditional upon meeting the requirement concerning the minimum share of the entrepreneur's own funds, which is set at 25% of the eligible investment costs. The qualitative criteria that will have to be met include creating new jobs, and operating in industries which are in line with Poland's development policy, etc. More detailed criteria will be set out in the regulation accompanying the Act.

The tax exemption stipulated under the Draft Act will constitute state aid. The amount of aid will range from 20% to 50% (the exception being the area of the capital city of Warsaw where it will be 10%). **The regulations discussed here indicate that the tax exemption could amount to 20% to 50% of the total value of an investment project which means that the income taxes paid by entrepreneurs would be reduced by the same amount.** The actual amount of tax exemption (state aid) granted will directly depend on the unemployment rate in the district in question, the location of the investment within the province in question, the size of the enterprise, and the scale of the investment (among other things, the aid amount will be greater for small- and medium-sized enterprises, and separate rules will apply to so-called large investment projects, i.e. those with an eligible cost amount in excess of EUR 50 million).

The expenses which would be eligible for support in the case of new investments will include the investment costs incurred during the period of validity of the decision, including, without limitation, the costs incurred for the acquisition, construction or upgrade of any fixed assets, and the costs incurred for renting or leasing property, as well as for intangible assets related to the transfer of technology through the acquisition of patent rights, or licences, etc.

The tax exemption will apply from the month in which the entrepreneur incurs the investment expenses in the period after the date of the decision. In order to take advantage of the exemption, the entrepreneur will have to retain the ownership of the assets related to the investment expenses for five years and will also have to ensure that the investment project continues to operate in the region where the aid was granted for the same period counted from the completion of the entire investment project (this will be reduced to three years for micro-, small-, and medium-sized enterprises). The tax exemption will only apply to the business activity carried out at the location as indicated in the decision.

According to the Draft Act, the bodies which manage the areas in question will be obliged to provide information services free of charge to those entrepreneurs which apply for support, assist them in contacts with public authorities, as well as recommending optimal locations for new investment projects.

The possibility of suspending tax preferences in the event of an unfavourable a central budget situation is covered in the Draft Act, but this will not apply to those entrepreneurs which have initiated the procedure in order to obtain a decision concerning the support, or to those which have registered their investment projects in the Register of Support for New Investments as planned new investments. The decision, in this respect, will be made by the Council of Ministers.

Anti-Abuse Clause

The Draft Act also introduces amendments to the Corporate Income Tax Act and to the Personal Income Tax Act in the form of the so-called "small anti-abuse clause". Under the draft provisions, an entrepreneur will lose its right to use the tax exemption provided by the new regulation from the date on which its income from business activity stipulated in the decision has been earned in connection with the conclusion of a contract or engaging in another transaction primarily in order to obtain an income tax exemption, or that the transactions in question are not *bona fide*, or the taxpayer which takes advantage of the exemption engages in a legal transaction which main objective, or one of its main objectives, is tax avoidance or tax evasion.

According to the explanatory memorandum enclosed with the Draft Act, the purpose of this clause is to eliminate fictitious arrangements which have no basis in economic reality and are used solely to obtain a tax benefit. These actions should also be construed to include transactions which sole purpose is to modify the amount of taxable income in a manner which could directly result in increasing the state aid ceiling.

Experts stress that the introduction of the anti-abuse clause related to the tax exemption might result in the new provisions being rarely used in practice, since the very idea behind the Act is to offer a tax preference, and therefore it will be an important factor affecting the commencement of new investment projects; on this basis, any application from an entrepreneur for a decision on support could be construed as having been submitted in order to avoid taxation.

Entry into force of the New Provisions

The Draft Act is currently in Parliament and its first reading is planned for the 20 March session. Therefore, the Act is expected to come into force at the end of May, or at the beginning of June.

The final wording of its provisions will only be known after the legislative work has been completed. However, already at this stage it can be concluded that the changes proposed in the Draft Act and in the regulation will probably contribute to simplifying the current system of promoting new investment projects under which the special economic zones operate. When the new provisions enter into force, entrepreneurs which plan new investments will no longer be limited to designated geographical areas, instead they will be able to implement these projects anywhere in Poland. This solution will certainly simplify access to tax preferences. However, experts emphasise that certain changes could result in reducing support in various regions compared to the previous level owing to the criteria set out in the Draft Act. In addition, the anti-tax avoidance clause introduced by the new provisions should certainly be assessed unfavourably, since it might make the new regulations too risky for entrepreneurs. It is to be hoped that these obvious shortcomings of the Draft Act will be removed during the parliamentary work.