"Estonian CIT" a real chance for lack of taxation - check if you can benefit from it

Guidelines for taxpayers on the flat-rate tax on corporate income - CIT taxation system including amendments as of 2024

Purple Prospectus| **October 2023 r.**

Dear Sirs and Madams,

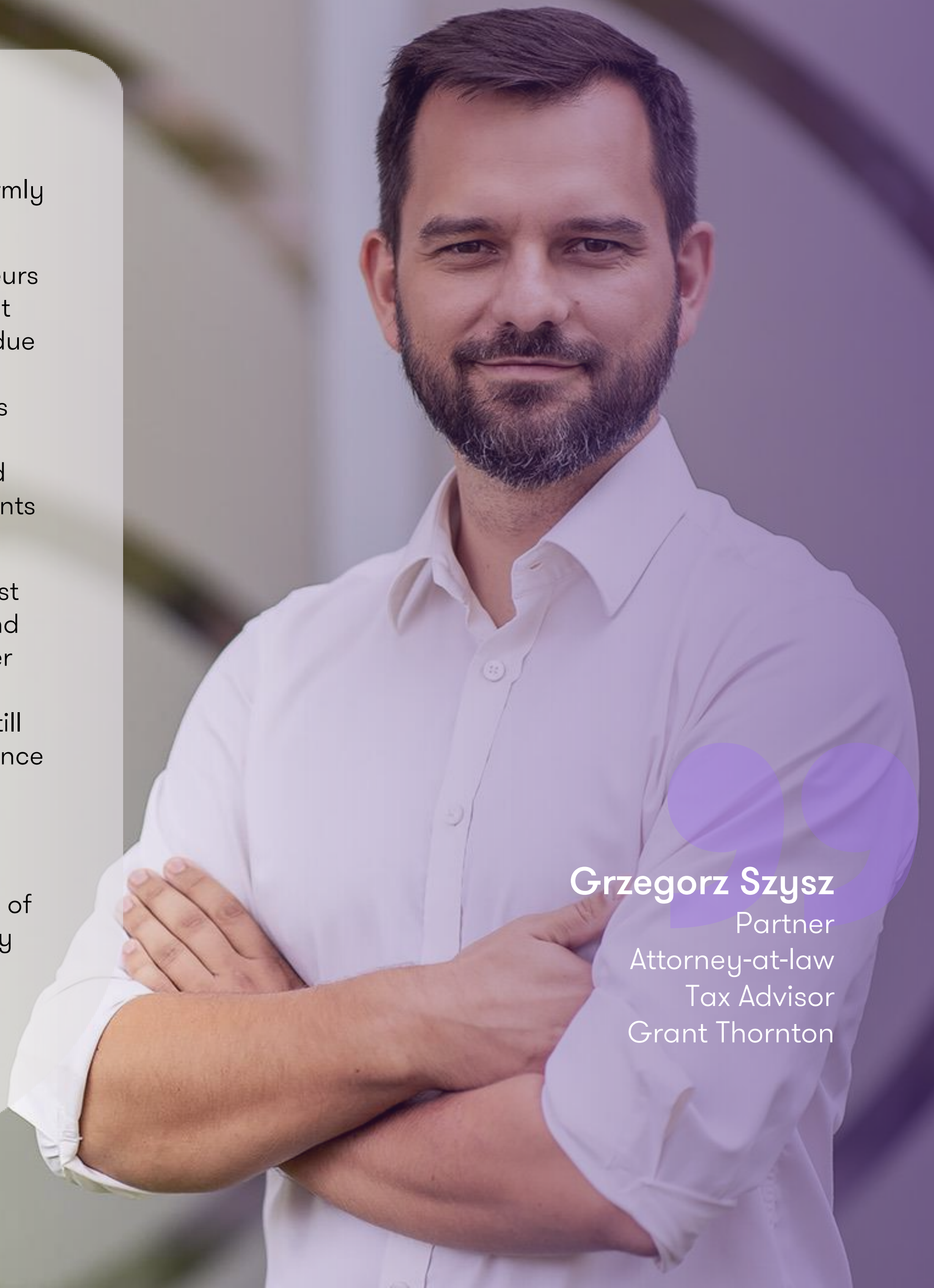
A taxation system modelled on the so-called Estonian system is now firmly established in the Polish reality of corporate taxation.

So far, nearly 13,000 taxpayers have opted for it and many entrepreneurs are preparing to implement this tax model. As a result, we are confident that this model will soon be used by tens of thousands of companies, due to its growing interest and popularity. We are already equipped with a considerable number of around a thousand individual interpretations issued by the National Revenue Information Office, as well as several dozen judgments of administrative courts, which have already clarified a number of interpretative doubts with which entrepreneurs, accountants and their advisors have been confronted so far.

As the practice of the use of the so-called Estonian flat rate shows, most doubts are resolved in favour of taxpayers, which encourages more and more of them to implement the new taxation model. Although no further changes to the provisions' content are known for the time being, which would come into effect from 2024, we cannot rule out that this could still change in the autumn. Press announcements from the Ministry of Finance so far suggest a drive to make it even more attractive.

The growing popularity of family foundations is bringing significant changes for many Polish entrepreneurs. Contrary to initial fears, The establishment of a family foundation does not eliminate the possibility of having a company benefiting from Estonian CIT, as long as it is directly the founder and not the foundation that controls such an entity.

We invite you to read the report. We hope that its conclusions will contribute to your profitable business decisions.



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Who can benefit from the flat-rate?

Companies (limited liability companies, joint-stock companies or simple joint-stock companies) and partnerships (limited partnerships or limited joint-stock partnerships):

- Whos shareholders are exclusively **natural persons;**
- Who holds no shares (and similar rights) in other entities;
- Who meet minimum employment requirementof at least **3 employees*** (an exception for start-ups);
- Whos operating revenue **exceeds passive revenue** i.e.:
    - claims,
    - interest,
    - interest part of the lease instalment,
    - sureties and guarantees,
    - copyrights/industrial property rights,
    - disposal and exercise of rights from financial instruments,
    - transactions with related parties when no or little economic added value is generated;
- **Who file a notice of choice** to the Tax Office by the end of the first month of the planned flat-rate taxation period in**(possibly to enter a flat-rate tax on company income during the year);**
- Who prepare **financial statements** in compliance with the Accounting Act and not IAS.

*or monthly expenses amounting to 3xaverage monthly remuneration are incurred for the benefit of 3 natural persons engaged under other contracts who are not shareholders/partners

Note

- the condition of a minimum employment based on a contract other than an employment **contract is fulfilled, as long as the taxpayer is formally a payer of social security contributions or PIT** - even if an exemption from the payment of tax or contributions applies to the employee
- Shareholders can be **founders and beneficiaries of a family foundation**

An attractive solutions that most taxpayers should consider. However **not for everyone.**

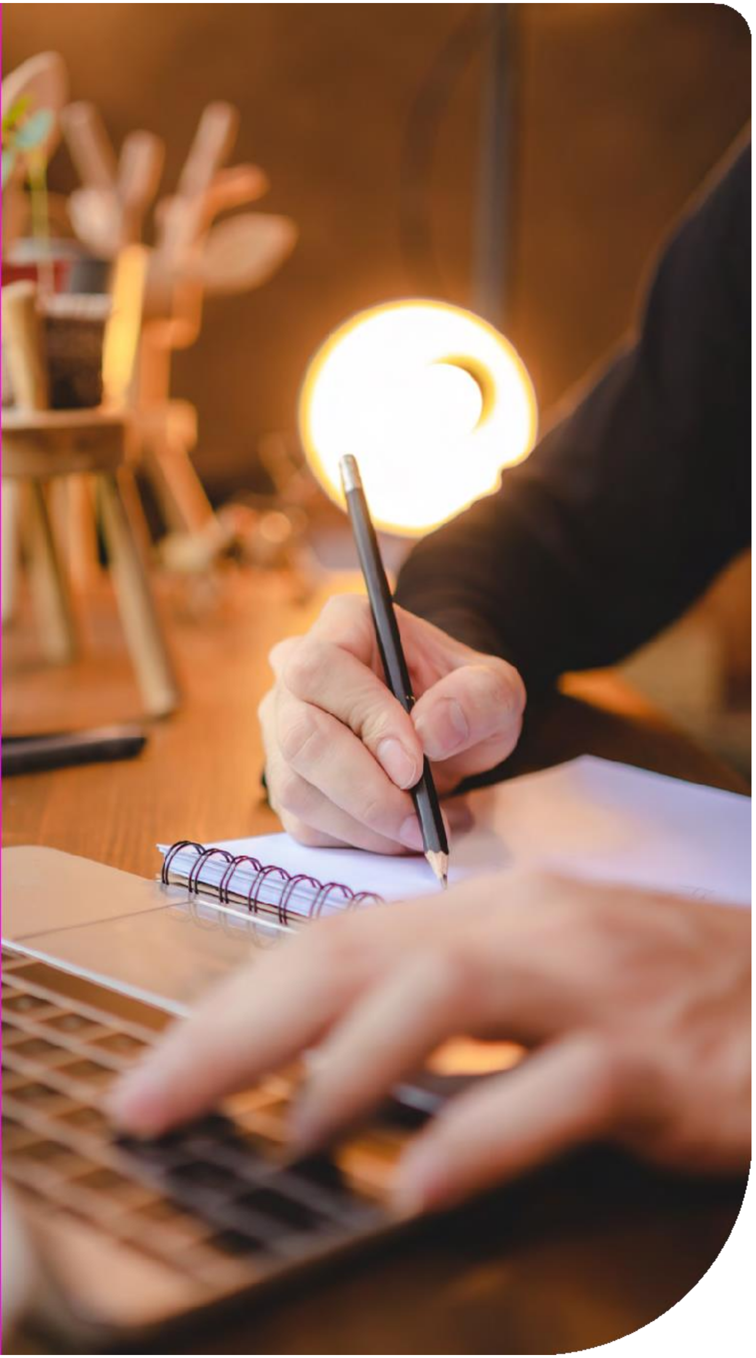
If:

- Your company/partnership is a member of **a capital group** (it holds shares in other entities or the shareholders/partners of the company/partnership are not natural persons), or...
- …You benefit from exemptions within a special economic zone **(SEZ)** or the Polish investment zone **(PIZ)**, or…
- ...You run a financial company/partnership or a lending institution, or...
- …You do not employ and are not planning to employ at least **3 employees**, or…
- …Your **passive revenues** exceed revenues from **the operating activity**
- …You derive most of your income **from copyrights/industrial property rights**

The Estonian tax IS NOT for you

Instead of this bulletin, visit jakaulga.pl. There, you can find out about tax credits that can help your business grow.

Everybody else is invited to continue reading and evaluate the possibility and legitimacy of changing their taxation model.



The essence of the so-called Estonian tax (flat-rate)

In practice, the so-called „Estonian tax” is an alternative corporate income tax system defined in the act as a **flat-rate tax on corporate income** (hereinafter referred to as the „flat-rate").

The essence of the flat-rate is that **tax on the conducted business activity is not paid until the profits are distributed to** shareholders/partners.

As a result, the calculation of income (tax profit/loss) fades into the background, while the actual transfers to shareholders/partners and their related entities become the key aspect.

If the company/partnership does not make broadly understood transfers to shareholders/partners or they fall within the admissible catalog, as detailed further herein, → **it is not obliged to pay CIT.**

If shareholders/partners decide to distribute the profit in part or in full, the possibility to apply the flat-rate is not excluded. → **The effective tax rate on the distributed profit will be lower than standard CIT and PIT settlements.**

The end of the flat-rate period will not be equivalent to the obligation to pay tax on the undistributed part of profits. As a result, the so-called Estonian CIT will no longer be only an expensive loan deferring the tax payment date.

The above rules **do not depend on, *inter alia*, capital investments. The scale of income earned also is not a limitation.**

Subject of taxation with the flat-rate

CIT is not paid on current income but on:

Pay-out of dividend (profit), i.e., in connection with the distribution of profits or advanced payment of these to the shareholders/partners, on the part of profits determined in compliance with the Accounting Act that are subject to distribution.

Forms of profit distribution other than dividend, including but not limited to:

- profit divided or allocated to coverage of losses if such losses originated in the period preceding flat-rate taxation
- so-called hidden profits, i.e. profits distributed to shareholders/partners or related entity by means of payment of interest on loans granted to the company/partnership by a shareholder/partner, donation, representation expenses, remuneration exceeding 5 times the average remuneration;
- on expenses not connected with the taxpayer's business activity i.e. **expenditure on mixed-used company cars or other assets.**

Reorganisation transactions (e.g., combinations, splits, transformations) in the flat-rate taxation period.

Entering the flat-rate tax system – due to completely different taxation terms, the difference between the book and tax value of assets must be determined first.

Note

- Flat-rate taxpayers will have a new deadline for tax payment, **set by the end of the third month** of the tax year following the year in which profit distribution of any kind was made
- flat-rate taxpayers pay a tax on hidden profits and non-business **expenses by the 20th of the month** following the month in which the expenses occur

The exact calculations are presented on the following pages.

Significant impact of the flat-rate on PIT

Even though the essence of the flat-rate tax is change of the terms of taxation with CIT, transition to the new taxation model means also a far-reaching reduction of PIT for the shareholders/partners.

Profit distribution means that the company/partnership is obliged to pay CIT at the rate of 10% or 20%, i.e., higher by 1 pp than the standard one.

The shareholder/partner (natural person) receiving the dividend is, however, entitled to an additional credit, i.e., reduction of the 19% PIT on the dividend by the respective part of CIT paid by the company/partnership (70% or 90% of CIT paid, depending on the circumstances).

In consequence, if the dividend is paid by:

- the so-called small taxpayer→ PIT on the dividend is reduced from **19% to 10%**,
- other companies/partnerships than the small taxpayer→ PIT on the dividend is reduced from **19% to 5%**.

CIT rates and deduction scale for PIT

Taxpayer type	Classic model of CIT taxation		Flat-rate tax on corporate income (so-called Estonian CIT)	
	CIT	PIT	CIT	PIT
Other than small	**19%** (on income)	**19%** (on dividend)	**20%** (on dividend*)	**5%** (70% CIT deduction**)
Small	**9%** (on income)	**19%** (on dividend)	**10%** (on dividend*)	**10%** (70% CIT deduction**)

* In addition to the dividend, the taxation base for CIT paid by the company/partnership in the form of a flat-rate may be other special categories, including those specified on p. 6.

** The PIT rate in the case of flat-rate regards taxation of dividends and not other forms of transfer of cash from the company/partnership.

Tax effectiveness

CIT:

Variant I: Taxpayer other than small	CIT
Taxation base (tax profit/loss)	1 000 000
Tax (19%)	190 000
Net profit	810 000
	PIT
Taxation base	810 000
Tax (19%)	153 900
Profit after PIT	**656 100**
Total tax charge	**34.39%**

Variant II: Small taxpayer	CIT
Taxation base	100 000
Tax (9%)	9 000
Net profit	91 000
	PIT
Taxation base	91 000
Tax (19%)	17 290
Profit after PIT	**73 710**
Total tax charge	**26.29%**

Flat-rate (Estonian CIT):

Variant I: Taxpayer other than small	CIT
Taxation base (balance sheet profit/loss)	1 000 000
Tax	200 000
Net profit	800 000
	PIT
Taxation base	1 000 000
Tax	50 000
Profit after PIT	**950 000**
Total tax charge	**25%**

Variant II: Small taxpayer	CIT
Taxation base	100 000
Tax	10 000
Net profit	90 000
	PIT
Taxation base	100 000
Tax	10 000
Profit after PIT	**90 000**
Total tax charge	**20%**

- For the sake of transparency of presentation, the simulation was prepared with application of simplifications, i.e. the shareholder/partner holds 100% of shares and the pay-out regards 100% of gross profit generated in the given year.

- The differences in the taxation base for different assumptions as to the scale of paid out profit are presented on the next page.

Tax effectiveness

Effective tax rate (collectively at the company/partnership and shareholder/partner level)

	No profit distribution		50% profit distribution		100% profit distribution	
	Flat-rate	Classic CIT and PIT	Flat-rate	Classic CIT and PIT	Flat-rate	Classic CIT and PIT
Taxpayers other than small	0%	19%	12,5%	27%	25%	34%
Small taxpayers	0%	9%	10%	18%	20%	26%

The flat-rate means real **lack of income tax** if the profits are not paid out, while the classic model always means 9% or 19% of tax, depending on whether the profits are paid out or not.

Even if a part or all profits are paid out in the form of a dividend, due to the additional right of the shareholders/partners to reduce the PIT on the dividend, **the effective tax rate is several percentage points lower than in the classic model.**

In the opinion of Grant Thornton, each taxpayer which meets the conditions for entering the presented taxation system or is close to meeting them should consider using the new model and make a thorough analysis and calculation with regard to all relevant circumstances. In particular, it is necessary to take into account the current use of tax allowances or the possibility of settling tax losses from previous years, as well as the tax on expenditures on the use of company cars for mixed purposes, which may lead to a justified conclusion of maintaining the current model.

Flat-rate vs increased health insurance contribution for entrepreneurs

Effective tax rate

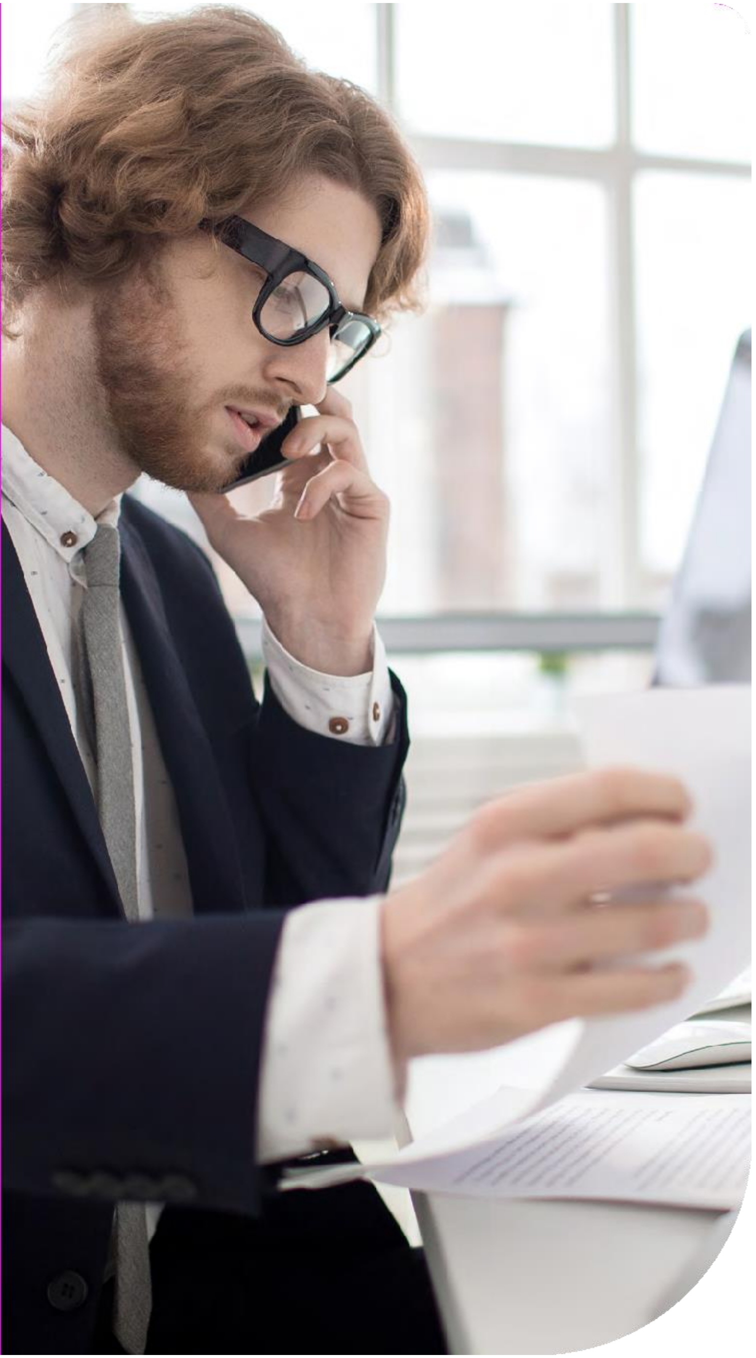
	No profit distribution		50% profit distribution		100% profit distribution	
	Flat-rate	PIT	Flat-rate	PIT	Flat-rate	PIT
Taxpayers other than small	0%	~ 24% -28%	12,5%	~ 24% -28%	25%	~ 24% -28%
Small taxpayers	0%		10%		20%	

Entrepreneurs conducting business in the form of sole proprietorships, civil partnerships, general partnerships are obliged to pay tributes at the level ranging from approximately 24% to approximately 28% of the obtained income, regardless of whether they reinvest or consume profits, i.e:

- 19% PIT on income (flat rate),
- 4.9% health contribution on income with limited right to deduct it from PIT,
- 4% solidarity surcharge on income above PLN 1 million per annum.

The effective tax rate for the above-mentioned group of entrepreneurs will in each case be significantly higher than for an entrepreneur conducting business activity, e.g. in the form of a limited liability company and drawing dividends from it.

In Grant Thornton's view, the overall regulation of the flat-rate and the amount of health insurance contributions, in addition to the need to limit the liability of private assets for liabilities related to the business, remain factors justifying consideration of changing the legal form of the business to a limited liability company.



What else can you gain?

By using a flat-rate:

- **You will maintain your small taxpayer status more easily,** as the status is valid until the end of the financial year regardless of the current gross sales revenue performance during the year.
- The potential loss of small taxpayer status **will not occur during the tax year,** but only at the beginning of the next one.
- As a flat-rate tax on company income, **you can submit quarterly VAT returns if your gross sales value did not exceed €4,000,000 in the previous year.**
- You do not have to prepare information on the tax strategy pursued, even if you meet the legal prerequisites
- **You can still benefit from forms of entrepreneurial support** such as grants, EU subsidies or de minimis aid.

You need support? Have any questions?

We are at your service

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