

# Application of Estonian CIT requires preparation

## I. Provisions introducing the Polish version of so-called Estonian CIT have been published

An act that allows companies (limited liability and joint-stock) the application of the Polish version of the so-called Estonian CIT was published on 30 November 2020, i.e. the latest possible publication date. This solution is provided for in the Act of 28 November amending the Corporate Income Tax Act and certain other acts (2020 Journal of Laws, item 2122). The act contains two alternative solutions, i.e. a flat-rate tax on company income (so-called Estonian CIT) and a special investment fund that makes it possible to account for fixed asset depreciation faster. The new regulations will go into effect on 1 January 2021.

## II. Numerous conditions must be met to be able to use the Polish version of Estonian CIT

The new regulations specify several conditions that must be met by a taxable person who wants to use the new flat-rate tax (Estonian CIT). They are described in Article 28j of the amended CIT Act. Most of all, total revenue (including output VAT) from business operations generated in the tax year preceding the year in which the company will begin applying flat-rate taxation cannot exceed PLN 100 million. In addition, less than half of such revenue may come from: debts, interest and gains on all types of loans, interest on lease installments, guarantees and warranties, copyrights or industrial property rights, including from the sale of such rights, from the sale and exercise of rights to financial instruments and from transactions with related parties. It is also necessary to meet conditions relating to average employment (we described them in one of our tax alerts in August 2020) and to company shareholders. Furthermore, the company cannot prepare its financial statements in accordance with IAS. Slightly different conditions apply to small taxable persons and to taxable persons that are just starting operations.

## III. Not all companies will use the flat-rate tax as of January 2021

Generally, the ability to choose taxation with the new flat-rate tax as of 1 January 2020 only applies to companies whose tax year is concurrent with the calendar year. Corporate income tax taxable person whose tax year is other than the calendar year and began prior to 1 January 2021 and will end after 31 December 2020 will until the end of their tax year apply the "old" CIT regulations, i.e. without the ability to pay a flat rate. In such situations, flat-rate taxation may be chosen starting from the tax year beginning after 31 December 2020. If therefore, for example, a company's tax year begins on 1 April 2020 and ends on 31 March 2021, the company will not be able to start applying the Estonian CIT until 1 April 2021.

As early as 1 January 2021 limited liability and joint-stock companies will be able to apply the flat-rate tax on company income (so-called Estonian CIT), as long as their tax year is concurrent with the calendar year. They will, however, have to meet conditions relating to employment, revenue and shareholders, as well as notify of having selected this type of taxation and recalculate their revenue and costs.



## IV. Companies will have a month to declare choosing the new flat-rate tax

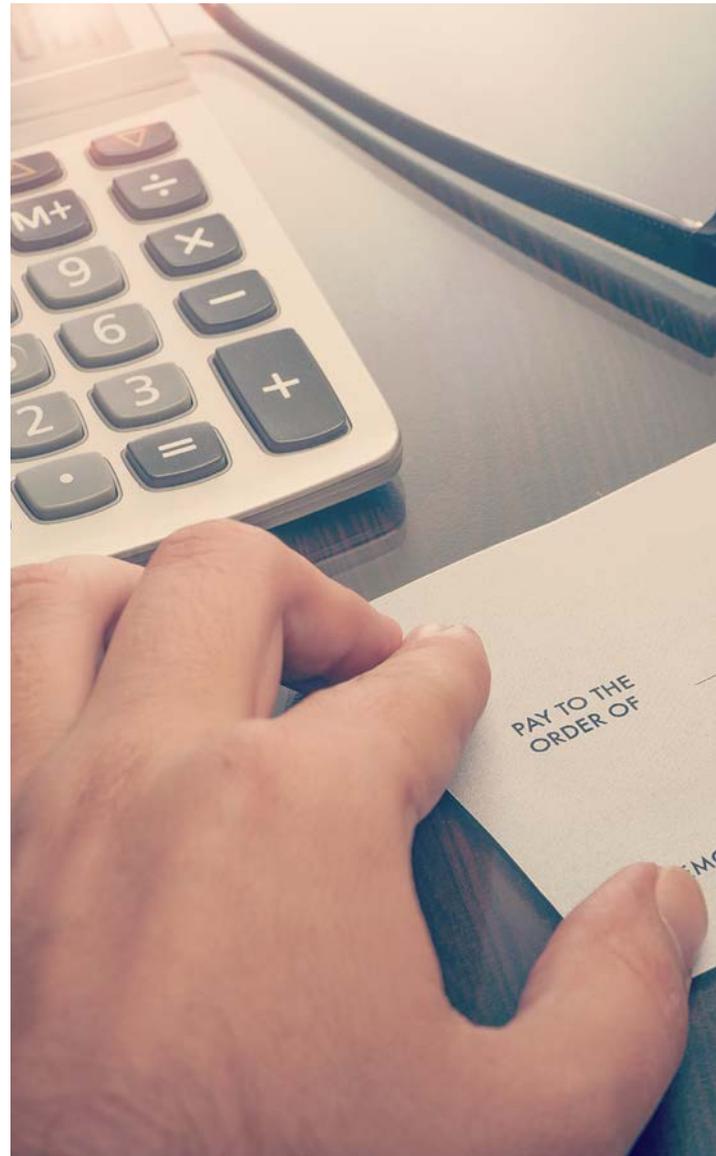
To use the new form of taxation it will also be necessary to notify the head of the relevant tax office of having chosen flat-rate taxation, using a designated template, by the end of the first month of the tax year in which flat-rate taxation is to be applied. So if a company wants to apply the flat-rate tax as of 1 January 2021, it must notify the tax office by 31 January 2021. However, this deadline will only apply to companies whose tax year is concurrent with the calendar year. If a company has a tax year different from the calendar year, it will have a different deadline for submitting the declaration. If, therefore, its tax year ends on, for example, 31 March 2021 and it intends to apply flat-rate taxation as of 1 April 2021, then it will have until the end of April 2021 to notify the tax office.

## V. Accounting departments will have a lot to do to prepare companies for Estonian CIT

The use of Estonian CIT will become available as of 2021. However, to make it possible, company accounting departments will have to restate the tax result to a result close to the net financial result, i.e. the result determined in accordance with accounting regulations. Appropriate restatements will have to be made on both the revenue and cost side. They are to pertain to cost and revenue items for the tax years preceding the first year of flat-rate taxation. They will be considered in the return for the year directly preceding the first year of flat-rate taxation. And so for companies that decide to be taxed with Estonian CIT as of 1 January 2021, the differences must be included in the return for the year 2020, which companies (whose tax year is concurrent with the calendar year) should file by the end of March 2021.

## VI. Taxable revenue must be restated to approximate accounting revenue

As part of restating its tax result to an accounting result for the purpose of flat-rate taxation, the company must add two items to its revenue from business activities (as defined in Article 12 par. 1 of the CIT Act). Firstly, revenue which in accordance with accounting regulations is included in the taxable person's net financial result for the tax years preceding the first year of flat-rate taxation and not included in revenue from business activities as defined in CIT regulations and has not been previously included in such revenue. Secondly, the costs incurred in the same period and included in tax-deductible costs, if under accounting regulations they have not thus far been included in the company's net financial result.



## VII. Tax-deductible costs will increase certain accounting revenue and costs

A restatement similar to that of revenue will have to be performed on the cost side. Also in this case, two items will have to be added to costs. The first is revenue from business activities generated in the tax years preceding the first year of flat-rate taxation, which until now had not been included in the net financial result. It is revenue that increases the tax base, but is not recognized as revenue in accordance with accounting regulations. The second are expenses incurred in the same period and in accordance with accounting regulations included in the company's net financial result, which had not previously been included in tax-deductible costs.

## VIII. Some accounting revenue and costs will not have to be added

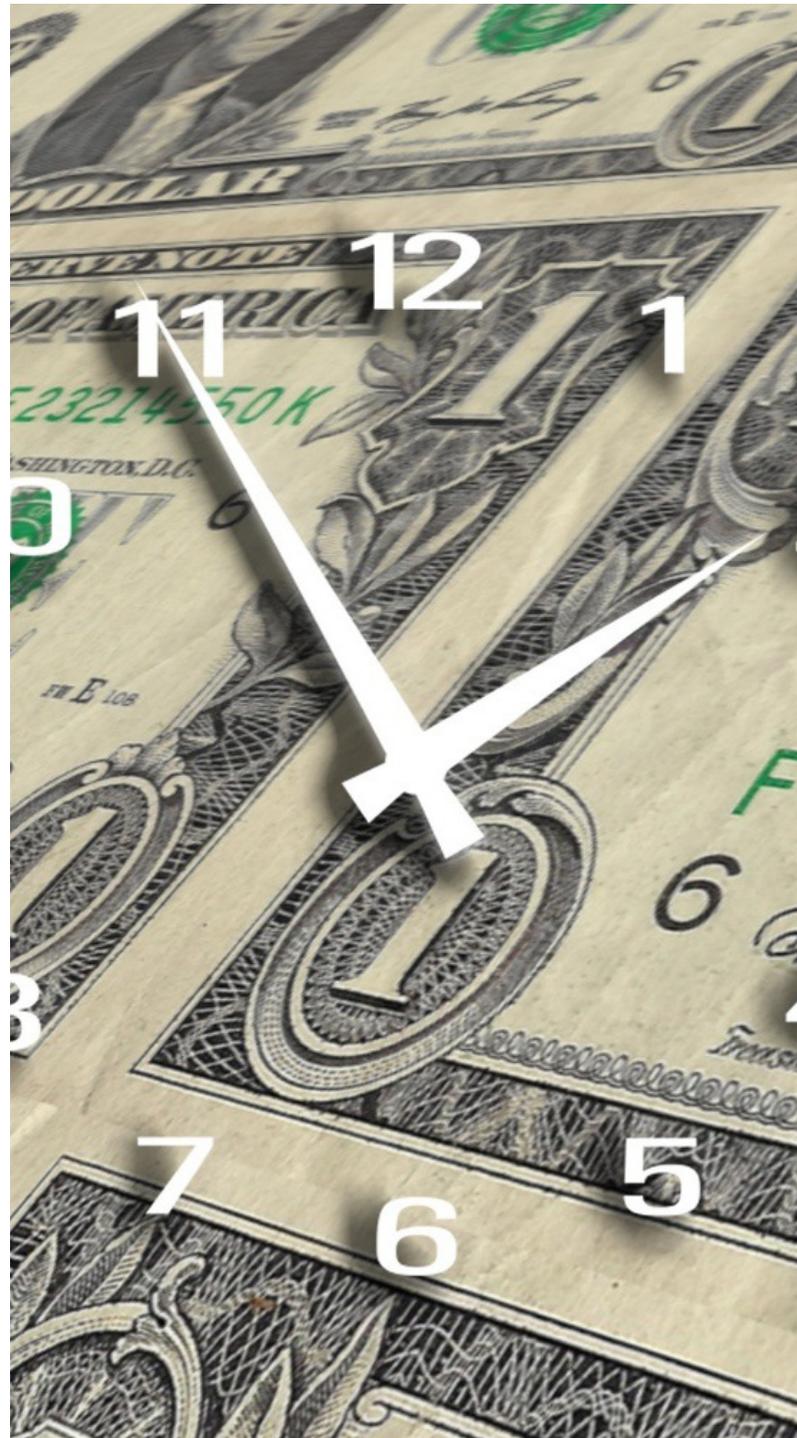
The restatement of revenue and costs does not, however, in any case pertain to revenue that in accordance with Article 12 par. 4 of the CIT is not included in taxable revenue from business activities, or to costs that in accordance with the provisions of the CIT Act are included in tax-deductible costs (a list of such costs may be found in Article 16 of the CIT Act). This, however, only applies to expenses and costs that are clearly listed in the catalogue of revenue from business activities and tax-deductible costs in the cited provisions of the CIT Act. This means that the preparation of such a restatement will require a lot of attention and in-depth analysis of both revenue and costs, and very good knowledge of the provisions of the CIT Act and the Accounting Act.

## IX. Excess tax from additions will be paid over the next three years

The addition of the required items to revenue from business activities and the adjustment of costs may result in an increase in output tax for the year in which the additions are made (e.g. in the return for 2020) compared to what the tax would be if the taxable person did not choose flat-rate taxation. In view of this, the regulations allow for settling the "excess" tax over time. But only if the tax will increase by at least 50%, i.e. will be 50% higher than if revenue were determined as before (e.g. when instead of 5 million the tax will amount to 7,5 million, i.e. exactly 50% more). It will then be possible to pay the "excess" in portions over a period of no more than 3 years counting from the end of the tax year preceding the first year of flat-rate taxation (the regulations do not specify what portions). The method chosen to settle the "excess" will have to be reported by the taxable person in the year-end tax return.

## X. Transformed companies will need to determine transformation income

Special provisions apply to recalculation of revenue and costs when a company is transformed. In such cases it is necessary to determine the transformation income. Determination of transformation income will apply in the case of a taxable person formed as a result of company transformation, whose first tax year after the transformation is also the first year of flat-rate taxation. Income from such a transformation is the excess of the market value of the company's assets as at the transformation date over their tax value determined as at that date.



## XI. Company will determine the market value and tax value of its assets

The new regulations specify the method that is to be used to determine the market value, as well as the tax value in the event of a transformation of a company that will apply flat-rate taxation in the first year after the transformation. Market value is to be determined in accordance with Article 14 par. 2 of the CIT Act - for securities and other assets the transfer of which does not lead to a change in economically significant functions, assets or risks, or in accordance with Article 11c - in other cases. The tax value of an asset is to be calculated as a value not previously included in any form in tax-deductible costs as defined in Article 15 of the CIT Act or in Article 22 of the PIT Act, i.e. a value that would have been adopted by the taxable person as such a cost had the taxable person disposed of the asset for consideration.



**RAFAL KOWALSKI**  
Head of Tax Department  
tel.: +48 22 543 16 00  
Rafal.Kowalski@bdo.pl

## XII. Undistributed profits, distributed profits and uncovered losses have to be determined

Irrespective of the need to perform appropriate recalculations of revenue and costs, the company will also have to separate as part of its equity as at the last day of the tax year preceding the first year of flat-rate taxation (i.e. as at 31 December 2020, if it chooses to start applying it as of 1 January 2020) the amount of undistributed profits and the amount of distributed profits charged to equity, generated in the years preceding the first year of flat-rate taxation, as well as the amount of uncovered losses incurred in the years preceding the first year of flat-rate taxation. The taxable person and his legal successors are required to disclose the separation of profits and losses in financial statements prepared in accordance with accounting regulations in the period from the year in which the separation was performed to the year in which the profits were paid out or the losses were covered (where the loss may only be covered after the end of application of flat-rate taxation).



The information presented herein does not constitute comprehensive tax information or a tax opinion. Consult your tax adviser before making any decisions.

BDO is an international network of independent audit and advisory firms. Service provision within the BDO network is coordinated from the Brussels global office. BDO's beginnings go back to 1963. We have been present in Poland since 1991.

We have 5 offices in: Warsaw, Kraków, Poznań, Wrocław and Katowice. BDO has for years been recognized in prestigious rankings of the activities performed by its Audit and Tax Advisory Departments, including most recently:

The last distinctions for the company are related to the Rankings:

Companies and Tax Advisors of Dziennik Gazeta Prawna for 2019:

- 1<sup>st</sup> place The Best Tax Advisor in the category of medium-sized companies
- 3<sup>rd</sup> place for tax projects implementation

The 2019 rankings prepared by the Rzeczpospolita and Parkiet dailies:

- Best Audit Firm (5<sup>th</sup> place);
- Firm Most Active on the Stock Exchange (5<sup>th</sup> place)

BDO spółka z ograniczoną odpowiedzialnością sp.k., ul. Postępu 12, 02-676 Warszawa;  
tel.: +48 22 543 1600, fax: +48 22 543 1601, e-mail: office@bdo.pl