

Family foundations provide tax benefits

Essence and purpose

The purpose of introducing the institution of family foundation to the Polish legal system is to make it possible to preserve the family nature of a founder's assets and business and thus protect the founder's family members. A family foundation will be responsible for managing the assets of the family business donated by the founder and for financially securing the group of people indicated by the founder. It will have legal personality. The minimum value of founder's contribution to a family foundation is PLN 100,000.

A family foundation will have a Management Board, as well as a partially elective, just as the Assembly of Beneficiaries, Supervisory Board. But it is the status of its beneficiary (beneficiaries) i.e. the entity for and in the interest of which the family foundation operates, that is of key importance from the perspective of the foundation's income taxation. The beneficiary is therefore entitled to specific advantages (benefits) from the foundation. These may be benefits that are specific or that will be specified in the future, as well as an interest in the liquidation estate after the family foundation is terminated.

A family foundation beneficiary whose status is non-transferable, may be designated by name or determined as described in the foundation's statute, e.g. as a specific group of people. However, only an individual or public benefit organization can become a beneficiary of a foundation. This excludes all types of commercial entities from the group of potential beneficiaries. The founder him/herself can also be a beneficiary of a family foundation.

The end of May (22 May 2023) is to be the effective date of the Family Foundation Act, which has already been (and may still be) amended even before it goes into effect.



Permitted activities

Most importantly when it comes to planning the continued operation of a family business by a family foundation, it will be permitted to do so in only the following areas: (i) sale of assets (if not acquired solely for the purpose of resale), (ii) lease, rental or other form of providing assets (if not simultaneously used in the business activities of the founder, beneficiaries or related entities), (iii) joining and participation in commercial companies, investment funds, cooperatives and similar entities, (iv) acquisition and sale of securities, derivatives and rights of a similar nature, (v) lending to certain entities, or (vi) trade in foreign legal tender. This means that a family foundation will have a very limited scope of permitted activities. This is important because a breach of these restrictions may result in taxation with CIT of the foundation's income therefrom, which is an exception to the rule that only the transfer of certain benefits to the beneficiaries results in taxation, as the current operations of a foundation are exempt from CIT.

Exemption of current profits

As mentioned above, family foundations are subject to corporate income tax (CIT) regulations. They have been, however, covered by a solution based on the Estonian CIT mechanism, which means that as long as a foundation pays no benefits or transfers no assets to its beneficiaries in connection with its dissolution, it will not be subject to taxation. Only the payment of benefits by a family foundation will result in taxation, i.e. with PIT (or CIT) on the part of the beneficiary and CIT on the part of the foundation itself.

Payment of benefits - including benefits in the form of hidden profits (see below) - and transfer of assets to the foundation's beneficiaries in connection with its dissolution gives rise to an obligation to pay a 15% flat-rate CIT.

Whereas for the foundation's beneficiaries (PIT taxable persons) the benefits or assets they receive are classified as income from another source and also subject to taxation at the rate of 15% (10% for beneficiaries from tax group I and II). A PIT exemption has, however, been provided for beneficiaries who are members of the founder's immediate family, the so-called "zero" tax group. These include spouses, descendants (children, grandchildren, great-grandchildren), ascendants (parents, grandparents), stepchildren, siblings, stepparents.

It should also be added that the contribution of assets to a family foundation is tax-neutral for both the founder and the foundation. When it comes to inheritance tax, an exclusion has been provided for the acquisition of goods or property rights that are the subject of a benefit or constitute assets received in connection with the dissolution of a family foundation.

Thus a family foundation will become a vehicle that enables a tax-efficient (at least 15%) taxation of the income it earns and transfers to its beneficiaries, especially those closest to the founder. Such profits can in particular consist of capital gains (sale of shares, dividends). In this respect it is, however, necessary for such income to be generated by activities that the foundation is permitted to perform under the law. This is because tax regulations on family foundations carry certain risks that should be taken into account when considering the use of this new institution.

Limited tax benefits

If a foundation performs activities outside the permitted scope, such activities will be taxed at the CIT rate of 25%. In such cases the foundation will, however, be allowed to claim tax-deductible costs.

Attention should also be drawn to the matter of the so-called "thin capitalization" limit. As noted above, a family foundation may grant loans to: (i) companies and partnerships in which the foundation holds shares or participates as a partner, (ii) beneficiaries. Interest on such loans would constitute the borrowing company's tax-deductible cost, and would not be taxable for the foundation. Therefore - although the regulations on so-called thin capitalization will apply to loans from a family foundation - the PLN 3 million limit of the excess debt financing costs (safe harbor) will not apply to the costs associated with obtaining funds, either directly or indirectly, from a family foundation. It should be remembered that the interest on such loans granted by a family foundation to certain entities should be set on an arm's length basis.

Moreover, in planning to use a family foundation as a form of financing it is important to remember the regulations on hidden profits, which are subject to taxation at the rate of 15%. For the purposes of this institution, hidden profits have been clearly defined in the act as, for example, an outstanding installment on a loan made to a beneficiary or interest on a loan granted to a foundation by its related party. These restrictions should be analyzed with respect to the specific current or future factual (business) circumstances of each case.



Summary

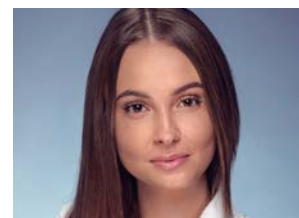
Despite certain restrictions on the scope of activities that family foundations will be able to perform, as well as limitations on the favorable taxation of their profits, the new institution may be an effective instrument that will, on one hand, protect family assets, and on the other allow for their management and successive growth free from current income tax charges.

In this form, family foundations will be an attractive alternative to closed-end investment funds, by exempting from taxation the sale of shares of operating companies and other capital gains. Other tax preferences, such as the ability to claim as tax-deductible the market value of withdrawn assets - determined as at their contribution, may make it possible to raise the tax value of such assets.

Appropriate structuring of a family foundation, also through the use of holding structures, may therefore make it possible to not only correlate business activities (within the permitted scope) with protecting the interests of future generations as intended by the founder, but also to grow the business in a preferential tax environment, or to transfer profits to certain categories of people in a tax-efficient manner.



RAFAL KRYSA
Senior Manager,
DDP BDO Polska
tel.: +48 22 543 16 00
Rafal.Krysa@bdo.pl



DANUTA KLUSKA
Consultant,
DDP BDO Polska
tel.: +48 22 543 16 00
Danuta.Kluska@bdo.pl

The information presented herein does not constitute comprehensive information or opinion. Consult your 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 2022:

■ 1st place The Best Tax Advisor in the category of medium-sized companies

The 2022 rankings prepared by the Rzeczpospolita and Parkiet dailies:

■ 4th Most Active Firm on the Stock Exchange

■ 5th Best Audit Firm

■ 6th Best Auditor of Listed Companies

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