HARMONISATION OF POLISH DIRECT TAX LEGISLATION PRIOR TO EUROPEAN UNION ACCESSION

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The historical context

Postwar Poland turned out to be a highly challenging tax environment. The Polish tax system, prior to 1939 regarded as relatively sophisticated on a European scale, after WWII degenerated into a Soviet satellite. The degeneration was epitomised by the Polish Constitution of 1952, which contained no coherent references to taxation, whereas specific regulations would derive from lower order sources, such as cabinet or ministerial ordinances. Such a situation made it possible for the communist regime to politicise taxation and employ it in a "class struggle" against the non-public sector. The shifts away from parliamentary enactments and taxpayer equality overshadowed the postwar tax system in communist Poland, and had a profound impact on the social perspective of taxation after the pro-democratic and pro-market reforms initiated in 1989, notably concerning a lingering distrust in taxation impartiality and professionalism of tax authorities.

In my view, the historic landmark in taxation reform did not take place in 1989 but as early as 1980 (when an Act on Tax Liabilities was passed, thereby empowering the legislature to amend the tax law *via* parliamentary act). This time also marked the establishment of crucial civic and legal institutions, such as the Supreme Administrative Court, Constitutional Tribunal and the Ombudsman, whose impact on legal education and tax law transparency was immeasurable.

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The post-communist transition to a free-market economy has been complicated *inter alia* by tax system imperfections. The initial income tax codifications of 1991 were marred by loopholes and interpretation ambiguities. Both the Act on the PIT and Act on the CIT have been repeatedly amended, consequently Poland has worked out a model in line with European peers.

The socio-political dimension of direct taxes

Politics plays a vital part in tax system considerations, as Parliament is the driving force behind all legal changes in this domain. The current thrust of tax system reform is a function of the evolving socio-economic environment in Poland, where a pro-European political platform is accepted by the majority of the political scene. A political compromise regarding taxes has to date been possible across ideological rifts, although winning a parliamentary majority for the government's economic programme has – on numerous occasions – proved precarious. Polish politicians share the view that reform comes as an inescapable by-product of European Union convergence, while opposition parties (despite their progress in opinion polls) do not wield enough power to block tax changes. Furthermore, the opposition does not represent a rational alternative to the ongoing tax reform, therefore a considerable deviation from its course is unlikely. Taxes remain a socially sensitive issue, the latest changes being acclaimed by entrepreneurs (benefiting from CIT cuts). Private individuals employed on a contractual basis are less optimistic, as (unlike businesses) most of the relevant tax incentives (including housing breaks) are being phased out. In all likelihood, the scope for considerable PIT evasion is limited, as private taxpayers, unlike companies, are generally devoid of major tax optimisation possibilities.

Introduction

Legal regulations concerning direct taxes in the European Union are, to date, harmonised to a relatively limited extent. However, Poland, in its drive to join the European structures, on the one hand recognises the need for a complex reform of the taxation system, whose key assumption would be reforming the public finances; while on the other hand seeks to seize the opportunity to create an environment on a par with other European Union tax jurisdictions. The observed thrust of the reform also involves changes to direct taxes. Within the Polish tax system, direct taxes mainly comprise: Personal Income Tax, Corporate Income Tax, and Real Estate Tax. Less important from the perspective of fiscal revenue generation are: Inheritance and Donation Tax, Means of Transport Tax, and Agricultural and Forest Tax.

Beneath I endeavor to present the most significant changes already effected in the domain of direct taxation.

Personal Income Tax

The amendment to the Personal Income Tax (PIT) Act adopted by Polish Parliament provides, in its assumptions, for a simplification of the tax system based on the scrapping of tax allowances and deductions, limiting the catalogue of tax exemptions, freezing the tax brackets and the deductible expenses from the contractual employment income, and broadening lump taxation for capital gains.

Beginning with 1st January 2004 the following tax allowances will cease to exist:

1. Contributions to organisations, of which taxpayer membership is not obligatory;

2. Cost of flat redecoration and modernisation;

3. Cost of transporting children to school;

4. Cost of taxpayer continued professional development and supplementary education;

5. Cost of high school tuition;

6. Cost of education aids and equipment, computer programs, and professional publications connected with employment;

7. Student allowance;

8. Wages of penitentiary inmates employed beyond penitentiary workplaces.

The scope of specific deductions is also limited. For example, the elimination of exemptions concerning supplementary remuneration, i.e.:

1. Amounts in compensation for using a private car for company needs;

2. Value of non-alcoholic drinks and meals provided for the workforce at work;

3. Value of employee tokens, coupons, vouchers for meal and non-alcoholic drink purchases;

4. Value of benefits payable from the Social Fund or Labor Union Fund.

Also, the scope of expropriation compensation has also been reduced; it will not apply to owners who have purchased real estate in the last two years before the commencement of an expropriation procedure, or have disposed of the property for a price lower by at least 50% of the expropriation compensation amount or the price of property sale for the purpose of expropriation, or in connection with a pre-emptive real estate purchase.

The reduction of tax exemptions is much wider, yet it is noteworthy, however, that they mainly affect employer and social benefits; while for example the exemption for gambling income still exists, which contradicts the very idea of socially responsible fiscal reform.
With reference to capital gains taxation changes, it is worth noting the arrival, starting from 2004, of a uniform, flat 19% rate on income from share gains. Additionally, the amendment unified the 19% rate for the taxation of other capital sources: loan interest, dividends, stock and bond discounts, and Capital Funds participation income.

The most important change to the PIT was the introduction of a linear taxation option, at a rate of 19%, for business activity income. Choosing this form of taxation requires a written declaration to that effect addressed to the Revenue Office before the 20th January of a fiscal year, or before commencing such activity (however not later than on the day of receiving the first income) – dependent on whether the taxpayer is commencing or continuing business activity. Flat taxation obviates the need for tax allowances and deductions; if the taxpayer opts for a tax allowance he/she will be automatically switched to the existing progressive tax rates of 19%, 30% and 40%. The Legislator's intention with regard to this amendment was to equalise from the tax rate standpoint the situation of individuals conducting business activity and corporate entities. The tax rate for corporations has been cut from 27% to 19% starting with 2004, which in the long term should lead to job generation and increased business activity amid small enterprises.

Corporate Income Tax

As far as the Corporate Income Tax is concerned, the acquisition changes to comply with European Union Law satisfy the provisions of Directive No 90/434/EEC. Article 10 point 5 item 2 of the Corporate Income Tax Act has introduced the rule that, in the event of corporate merger or division, its scope is also extended to taxpayers (corporates) who acquire the assets of companies headquartered in or managed by a board from a member country of the European

Union. This change responds to the concept of corporate merger and division neutrality from the taxation perspective. Another amendment sets off the taxation of dividends payable from abroad by a company having a seat in a European Union country other than Poland. It stipulates that the income tax of a Polish company is reduced by the income tax from dividends payable abroad. An additional pre-condition of such a reduction is the ownership in a Polish company of at least 25% of shares (i.e. voting rights) in a foreign company. The ownership should be direct and continuous for two consecutive years.

Another provision introduces the tax exemption for dividends paid by the Polish company to a company having a seat in one of the European Union countries. This exemption does not apply to income gained from share redemption, disposal of shares for the purpose of their redemption, or corporate liquidation. Such an exemption is applicable on condition that all incomes of the foreign company in question are taxed domestically and the foreign company holds in the Polish company not less than 25% of shares (i.e. voting rights).

Furthermore, the provisions concerning transfer pricing have been liberalised by limiting the scope of instances where Polish entities can be deemed connected parties. A transfer of income between two Polish parties does not affect the amount of taxation whenever both parties remain within the Polish tax jurisdiction.

The amendment effective from the beginning of 2004 also modifies the taxation of capital groups. So far, the main hindrances to the formation of capital groups have been very strict limitations concerning their status, the last amendment has altered the liability for tax dues and lowered the necessary profitability margin from 6% to 3%.

Real Estate Tax

Poland adheres to an archaic form of a proprietary tax, called Real Estate Tax. According to the existing law, and different from other European Union countries, the area of a real estate is taken as a basis for tax assessment. In most European Union economies, it is the value of a real estate that drives the tax liability. To date, Poland has not reformed this system before its EU entry. The Ministry of Finance has – for some time – worked on a reform of this tax. The intention is to introduce "katastralny" (real estate value) tax. This will require the involvement of property Realtors – special experts who will determine the marketable value of each property. The present system does not comply with the concept of common property taxation. As a result of basing the taxation on the area alone, and not taking into account the location or other economic aspects, a property in an attractive centrally located neighbourhood of a major city is liable to the same taxation as a property situated in the suburbs. In Poland, the real property tax comes into the budgets of territorial self-governments, the tax rates being established by particular communities, as long as they do not exceed the Real Property Tax Act framework.

As earlier observed, the very important direct tax – Real Property Tax has not yet been adapted in line with European Union legislation. However, one can assume that in the future this tax will constitute one of the most important sources of budget income. The planned reforms will broaden property taxation with a simultaneous lowering of indirect tax rates.

Summary

In summary, in the changes introduced to the direct taxes system, especially taxation of income, one can distinguish a trend toward taxation system optimisation, by lowering tax rates coupled with a phase-out of a complicated system of allowances and deductions. Ideally, all these measures ought to amount to a sweeping reform of public finances, inescapable for a full Polish accession to and compatibility with the European Union. It is noteworthy, however, that the aforementioned changes generally fall in line with European Union recommendations concerning direct taxes, while failing to rectify all the imperfections relating to individual tax regulations – which will most likely be subject to further, more radical reform. The specifics are not yet publicly known, yet they are likely to take on board the critical assumptions of government sponsored Pre-accession Economic Programme, PEP. According to forecasts contained therein, the Polish economy is set to benefit from rapid economic growth as well as intense investment activity, therefore the implemented tax reform (notably a lower CIT rate) will provide a powerful stimulus for entrepreneurship. The PEP also assumes future legal changes to the income taxes, aimed at new coordinative arrangements concerning capital gains taxation.