FINANCING OF A POLISH LIMITED LIABILITY COMPANY

This paper concerns legal and tax aspects connected with the financing of a Polish limited liability company. In particular we focus on the operations on the share capital, loans granted by shareholders and the rules of transfer pricing.

METHODS OF INTER-COMPANY FINANCING

Polish law generally requires transactions to be well documented, especially for tax purposes. Tax inspections can be very meticulous, particularly with regard to inter-corporate transactions. The arms-length principle is treated very seriously in Poland and from the point of view of the Polish tax law a "shareholder financing" is in no way different than a financing provided by a third party. Therefore, any payment received by a Polish SPV from the shareholder must be documented as one of the transactions recognized by corporate law, i.e.:

1) capital increase
2) loan
3) so-called additional contributions – a special kind of shareholder financing governed by the Polish corporate law (see below)
4) payment for goods, services, licenses, etc. provided by the SPV

Unless a payment from the shareholder to the subsidiary can be documented to justify one of the above transactions, the tax authorities may require the company to pay an income tax. Depending on the findings of the inspection, the income tax may be calculated on the total received amount or on the equivalent of the interest the SPV would have otherwise been liable to pay in respect of a standard bank loan.

CAPITAL INCREASE

Increase of the share capital requires a prior resolution of the shareholders. Unless it has been foreseen in the Articles of Association, it also requires an amendment of the Articles, which needs to be documented by a notary public. Upon an increase of the share capital the company must file tax returns and pay a stamp duty amounting to 0.5% of the increase. The returns need to be filed (and the stamp duty paid) within 14 days of the resolution, otherwise

the company's Board members can be liable to fines, whereas the SPV would need to pay penalty interest in respect of tax arrears.

LOAN

Loans are a convenient instrument of inter-corporate financing, however, there are certain complications associated with accounting for such loans. First of all, loans must bear interest, otherwise, the company receiving the loan should recognize an income in respect of an extra benefit (free financing). In case of inter-corporate transactions, transfer pricing rules apply, which rely on the arms-length principle. Under the transfer pricing legislation, the tax authorities may require that each transaction between related companies, such as inter-corporate loans, be accompanied by a so-called transfer pricing documentation, which should provide justification that a given transaction is concluded on the same terms as between independent companies (for more details on these rules, please see below). In case of loans, the main factor to be dealt with by the transfer pricing documentation is the interest, which needs to be coherent with the market reality.

Another aspect connected with loans are the thin capitalization rules. According to the Polish CIT provisions, interest paid in respect of the loan the amount of which exceeds 3 times the share capital would not be deductible. It means that companies whose share capital is relatively low can treat only a small portion of the interest as tax deductible. For example, if a company has a capital of PLN 5,000 (ca. USD 1,600 – which is a minimum share capital allowed by the Polish law), it can recognize interest accrued on that part of the loan which does not exceed PLN 15,000.

The good news is that loans granted by the shareholders are exempt from the stamp duty, which otherwise amounts to 2% of the loan.

ADDITIONAL CONTRIBUTIONS

The Articles of Association may provide for the shareholders' obligation – which arises under a resolution of the Shareholders' Meeting - to bring in so-called additional contributions, up to an amount defined by the Articles. Such additional contributions do not become part of the share capital and can be returned to the shareholders upon a relevant decision of the Shareholders' Meeting, provided that certain requirements regarding the Company's financial situation are fulfilled.

Just like in the case of increase of the share capital, such contributions are subject to stamp duty of 0.5%.

TRANSFER PRICING

Although not a classic way of financing a company, high sales margins, license fees or high-yielding loans are popular instruments, often referred to collectively as transfer pricing tools, used to siphon off funds from subsidiaries. Tax authorities are well aware of these practices and are particularly sensitive to any transactions of sales, whether concerning goods, services or IP rights, made between related companies. Their focus is on the shifting of profit from one company to another through intercompany trade. If – according to the tax authorities - as a result of capital connections, the terms of trade that have been agreed or imposed vary substantially from those which would have been agreed between independent entities and, as a result, a given entity does not disclose any income or discloses an income that is smaller than might be expected in case such relations did not exist – the income of that entity and the tax due shall be assessed without taking into account the terms resulting from such connections. In such a case the income can be assessed by the tax authorities by way of estimation.

It is worth of note that upon an inspection tax authorities can demand the company to provide a transfer pricing documentation within 7 days. If not provided, the difference between the income declared by the taxpayer and that determined by the authorities shall be subject to a penal tax rate of 50%.

A typical transfer pricing documentation should comprise:

(a) description of the transaction, including foreseeable costs for each party as well as the form and terms of payment;

(b) an analysis of the different functions performed by each of the two parties to the relevant transactions, the risk involved for each party as well as each party’s assets;

(c) method and details of calculation of the price and the profit;

(d) economic strategy adopted, if relevant for the value of the transaction;

(e) profits expected with regard to purchase/sale of intangible services.

The obligation to draw up documentation arises if the value of a transaction or a series of transactions with a related party in a given tax year exceeds a certain threshold, depending on the share capital and the type of goods/services involved.

CONCLUSIONS

Each case is different and therefore companies should always review many factors before opting for a particular financing strategy for their Polish subsidiary. International tax planning can further complicate the picture. No matter what the ultimate choice, it is always important to plan first, then carefully implement.

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