

CIT AND COMMERCIAL LAW SIGNIFICANT CHANGES IN THE TAXATION OF PARTNERSHIPS STARTING ON 31 MAY 2021

On 30 September 2020, a draft act amending the laws on corporate income tax (CIT) was published, which will introduce changes in the tax rules applicable to partnerships.

It is highly likely that limited partnerships will become CIT payers from 31 May 2021. General partnerships may also be affected (i.e. they will become CIT payers) if they fail to meet the conditions specified in the new regulations.

As a consequence of these changes, the popular structure of a limited partnership with a limited liability company as a general partner, as the optimal structure to do business especially in family owned businesses, will become markedly less attractive.

Due to the very short period of time foreseen between the amendments' adoption and their entry into force, entrepreneurs may not be able to adequately prepare for the upcoming changes, including changing the form in which they do business, which may expose them to serious financial consequences.

What amendments are foreseen to CIT?

The draft amendments provide that income earned by a limited partnership, as well as by a general partnership which does not fulfill the conditions for an exemption, will be taxed both at the level of the partnership itself and its partners. Currently, the income of both limited and general partnerships is taxed only at the level of their partners, meaning that these partnerships are "tax transparent". This makes them an attractive form in which to do business for entrepreneurs, in particular family owned businesses. Compared to commercial companies (which are regulated by the Commercial Code), partnerships avoid the so-called double taxation of income earned by the company.

The above change is intended to apply to all limited partnerships, regardless of revenues generated, the legal status of their partners or their tax year (limited partnerships whose tax year is different to the calendar year will be obliged to close their books at the end of 2020).

In the case of general partnerships, the draft act provides that they will be subject to CIT unless all persons deriving profits from the partnership are disclosed to the tax authorities. In order to comply with this requirement where the partners are not natural persons, it may prove necessary to disclose a group's entire structure, irrespective of the jurisdiction in which a given partner operates. This will not always be possible, especially for large capital groups operating in jurisdictions where there is no obligation to disclose all of their shareholders and partners, and this may not be a desirable solution for companies doing business on a smaller scale either.

How to prepare for these changes?

Due to the relatively short period of time left before the amendments to the tax rules applicable to partnerships are expected to enter into force any reorganization measures planned by taxpayers should be undertaken as soon as possible.

However, there are significant limitations to the most obvious solution, which appears to be the transformation of a business from a limited partnership to a general partnership (which can be exempted more readily). In practice, the transformation process itself takes a minimum of three months. Moreover, such a change may have negative consequences for the partners on

account of their safe status as limited partners being replaced by full liability for all business related obligations.

Therefore, any reorganization measures require a careful analysis of both the potential benefits and any negative effects. However, these measures may not necessarily offset the expected tax losses. Such activities may also have an adverse impact on a business's daily operations and functions.

Reorganization tailored to the business's needs

The recommended course of action is to develop an optimal scenario from the perspective of both tax and commercial law, which will meet the needs of a given business, taking into account the specific characteristics of their business, such as its size or the risks associated with it.

Due to the very short timeline foreseen, it remains possible to rapidly prepare and implement interim solutions while continuing to work on an optimal scenario, which would require more time to develop and implement.

Where certain reorganization measures have already been implemented, or are in the process of implementation, it is worthwhile to further analyze them comprehensively in terms of their consequences for partners, and the possibility of mitigating risks related to them.

Status of the draft and planned entry into force

The legislative process is currently ongoing. On 7 October 2020, an attempt to reject the draft at first reading failed. The draft is currently being reviewed by the Public Finance Committee.

The new regulations are expected to enter into force on 31 May 2021.

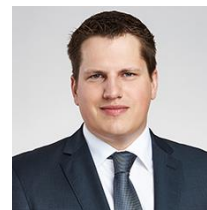
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Legal basis:

- > Draft Act to amend the Act on Personal Income Tax, the Act on Corporate Income Tax, the Act on Lump Sum Income Tax on Certain Incomes Earned by Natural Persons and certain other acts - Parliamentary document No. 642
- > Draft Act to amend the Act on Corporate Income Tax and certain other acts - Parliamentary document No. 643