

# Estonian CIT for all companies and at lower rates

## I. Taxpayers face numerous changes in the taxation with so-called Estonian CIT

The government has adopted and submitted to the Parliament the tax part of so-called Polish Deal. The draft proposes, among other things, solutions aimed at further development of an alternative taxation system – a lump sum tax on income of capital companies, i.e. the so-called Estonian CIT. The changes will include: extension of the list of entities entitled to lump sum taxation to include limited partnerships and limited joint-stock partnerships; removal of the need to incur certain investment outlays as a condition for the application of lump sum tax provisions; removal of the requirement relating to the upper limit of income of taxpayers covered by the lump sum tax, and in consequence also of tax liability assessment; greater flexibility of deadlines for payment of the tax liability with regard to so-called preliminary adjustment, and in some cases also abolishment of the obligation to pay such liability; reduction of tax rates.

## II. No more revenue limits and restrictions in categories of companies

The amendment provides for extended applicability of the lump sum income tax regulations and significant easing of conditions precedent for both initial and continued application of the lump sum income tax system. Currently, so-called Estonian CIT is only available to capital companies, i.e. in practice the joint stock and limited liability companies only. According to the new regulations, the right to this form of taxation would be granted to all companies subject to CIT, that is – in addition to the aforementioned – also to limited and limited joint-stock partnerships. The amendment will also abolish the revenue thresholds which limited access to lump sum taxation. This means that companies will be able to use this form of taxation regardless of the amount of income they generate. Currently, lump sum taxation is only available to entities whose revenues, as stated in the provisions, do not exceed PLN 100 million.

## III. New deadlines for payment of lump sum tax on profit distributions

The new regulations also provide for more flexible deadlines for the payment of tax liabilities with respect to so-called preliminary adjustment. The deadline for payment of the lump sum tax on account of net profit will also be modified - according to the proposal, it will be due by the 20th day of the following month after such income was paid out in whole or in part or otherwise committed, but no later than by the 20th day of the seventh month of the tax year in which the income was so distributed. This applies both to lump sum tax on income on account of distributed profit and on account of profit allocated for coverage of losses, and to lump sum tax on distributed income on account of net profit. Besides, the provision entitles the taxpayer to pay a lump sum on that account at one time, in an amount equal to the lump sum due on the income on account of net profit by the end of the third month of the tax year following the last year of lump sum taxation. Besides, the act defines deadlines for the payment of: lump sum tax on income from undisclosed business operations, lump sum tax on income on account of hidden profits and on account of non-business expenses, lump sum tax on income on account of change in the value of assets.

From January 2022, any capital company, regardless of its size, will be allowed to choose settlement under the rules of Estonian CIT, i.e. lump sum tax on income.

Also the settlement of such lump sum tax is to become easier, and the tax rates will be reduced to 10 and 20%. When settling PIT, partners in such companies will also deduct a part of the lump sum tax paid by the company.

## IV. A definition of distributed income on account of net profit will be introduced

According to the general structure of so-called Estonian CIT, lump sum taxation only takes place at the moment when income on account of net profit is distributed, i.e. when profits are transferred out of the company and reach broadly understood shareholders. Therefore, as part of the amendment, definition of distributed income will be added to the CIT Act. As follows from that definition, distributed income on account of net profit is the part of income on account of net profit that has been allocated for distribution in any form, including, in particular, distribution to shareholders, coverage of losses arising in a period other than the period of lump sum taxation, payment of share-related remuneration, or increase of the share capital.

## V. The list of so-called hidden profits that increase the lump sum tax base will be expanded

With regard to determining the lump sum tax base, a new introduction to the list will be added defining the so-called hidden profits. Currently, hidden profits are understood as cash, non-cash, paid, gratuitous or partly paid performances, made in connection with the right to a share in profit, other than distributed profit, whose direct or indirect beneficiary is the shareholder / partner or an entity related directly or indirectly to the taxpayer or to such shareholder or partner. After the amendment, hidden profits will mean cash, non-cash, paid, gratuitous or partly paid performances, made in connection with the right to a share in profit, other than distributed profit, whose direct or indirect beneficiary is the shareholder / partner or an entity related directly or indirectly to the taxpayer or to such shareholder or partner. Some of the specific types of hidden profits listed in the provision will also change (loans and credit; remuneration paid out of profit), and new categories will appear: additional payments, interest on a share, profit to supplement a partner's capital share, payments in case of reduction of a partner's capital share.

## VI. Taxpayers will no longer be required to report capital expenditures

The amendment provides for withdrawal from the requirement that the taxpayer should incur certain capital expenditures as a condition for application of the lump sum tax provisions. This is done by deletion of the provision (Article 28g of the CIT Act), which originally introduced such requirement. As a reminder, taxpayer subject to lump sum taxation is currently obliged to incur direct capital expenditures exceeding 15%, but no less than PLN 20,000 over 2 consecutive tax years of the lump sum taxation, or 33%, but no less than PLN 50,000 over 4 tax years, in relation to the initial value – as determined on the last day of the tax year preceding the two-year or four-year period of lump sum taxation, respectively – of fixed assets included in groups 3–8 of the Classification of Fixed Assets and Intangible Assets, excluding passenger cars, means of air transport, floating stock and other assets serving primarily the personal purposes of shareholders or members of their families.

## VII. The lump sum tax rates will be reduced to 10% and 20% respectively

Another significant change within the scope of so-called Estonian CIT is reduction of the lump sum tax rates. Currently, the rate is 15% of the tax base for small taxpayers and taxpayers with average revenues not exceeding the maximum revenues defined for small taxpayers, and 25% of the tax base for other taxpayers (as a reminder, the regular CIT rate is 9% and 19%). However, the rate may be reduced by 5 points (that is, to 10% and 20% respectively) if certain capital expenditures are incurred. After the change in regulations, the rate will amount to 10% of the tax base for of small taxpayers and taxpayers starting their business activity, and 20% for other taxpayers. However, due to withdrawal from requirements concerning investments, further reduction of the tax will no longer be possible.



## VIII. Partners will be able to deduct from their PIT a part of the lump sum tax paid

Amendment of the rules of lump sum taxation of income entails the need to also change the taxation of partners of such companies with PIT. As a result of the changes, the lump-sum tax calculated on the revenues gained by a partner from payments of the company's distributed profits during the period of the lump sum taxation on the companies' income (if arising from distribution of profits for that period duly separated in the company's equity) will be subject to reduction by an appropriate amount determined in accordance with the new regulations. Besides, the rule is to be introduced that withholding agents collecting lump sum personal income tax on paid receivables on account of the company's distributed profits generated during the period of lump sum taxation of the company's income will be obliged to take such reduction into account. Here, partner means a shareholder of a limited liability company, a joint-stock company and a limited joint-stock partnership, as well as the limited partner and the general partner of a limited partnership.



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## IX. When paying PIT, small taxpayers will deduct up to 90% of the lump sum tax, while others – 70% only

Pursuant to the new regulations, the PIT reduction to which a partner shareholder will be entitled is to amount to 90% of the product of that partner's percentage share in the company's profit, calculated as at the date when the right to distributed profit was acquired, and the lump-sum tax due on the company's distributed profit from which such revenue was derived: for small taxpayers or taxpayers commencing business activity, whose profits are subject to lump sum taxation on the company's income at the rate of 10% or 70% of the product of the partner's percentage share in the company's profit, calculated as at the date when the right to distributed profit was acquired, and the lump sum tax due on the company's income from its distributed profit from which the income was obtained, and for other taxpayers whose profits are subject to lump sum taxation on the company's income at the rate of 20%.

We also reported on other changes to so-called Estonian CIT in our previous tax alerts.

For details of the solutions described above, please contact our Experts.

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

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