

# Estonian CIT for more companies

## I. The Ministry of Finance has prepared draft amendments to the Estonian CIT taxation

The Ministry of Finance has announced a draft amendment providing for broader access to the so-called Estonian CIT. The draft provides for extended applicability of the lump-sum income tax regulations and significant easing of the conditions for both initial and continued application of the lump-sum income tax system. In particular, the amendment provides for: 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 the provisions on the lump-sum tax, while retaining the possibility of their incurrence in order to take advantage of the preferential lump-sum tax; removal of the condition relating to the upper limit of income of taxpayers covered by the lump-sum tax, and in consequence also of the accumulation of the tax liability; 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.

## II. Lump-sum income tax (Estonian CIT) with no mention of capital companies in its name

The name of Estonian CIT will change. Instead of the former name of lump-sum tax on revenue of capital companies, the name "lump-sum tax of revenues of companies" will be introduced. In the light of the proposed changes, the current name, "lump-sum tax on revenue of capital companies" ceases to adequately describe the catalog of entities entitled to apply the lump sum, as it is proposed that such catalog should include not only capital companies but also partnerships, i.e. limited partnerships and limited joint-stock partnerships which are CIT taxpayers. This is a material change, as only joint-stock and limited liability companies could benefit from the lump-sum tax so far.

As of January 2022, any capital company, regardless of its size, will be allowed to choose settlement under the rules of Estonian CIT, i.e. a lump sum on income of capital companies. This will be possible because the company revenue limit of PLN 100 million, required so far, will be abolished. Also limited partnerships and limited joint-stock partnerships will be offered the option to use the lump sum solution.

## III. No income limit for those willing to use the lump-sum solution

The amendment will modify the conditions to be met by the taxpayer who wants to pay the lump-sum tax. According to the current legislation, one of the conditions is that the total revenue from operations in the previous tax year should not exceed PLN 100,000,000, or that the value of the average revenue from operations, calculated as at the last day of the previous tax year covered by lump-sum taxation should not exceed PLN 100,000,000, where the revenue is calculated with output VAT taken into account. The amendment removes the requirement concerning the taxpayer's income (which means no more limits).

## IV. Obligations relating to the choice of Estonian CIT taxation have been defined

The amendment specifies the taxpayer's obligations relating to the choice of lump-sum taxation on income, which should be met as at the last day of the tax year preceding the first year of lump-sum taxation on income. Deciding to have its income taxed with a lump sum, the taxpayer is obliged to prepare information about its revenue, costs, income resulting from transformation and output tax in connection with the choice of lump sum taxation on corporate income. Besides, unchanged from the previous regulations, the taxpayer is obliged to separate within its equity (or the equity fund in the case of cooperatives) the amount of undistributed profits and the amount of distributed profits taken to reserves.

## V. The amendment will change the rules for calculating the income from transformation

As regards income from transformation, a change is proposed which modifies the current approach to such income: namely, the proposed provision stipulates that the income should be calculated not on the difference between the market value and the tax value of all assets, but only with respect to assets revalued for accounting purposes upon transformation, i.e. the difference between the value adopted for accounting purposes and the tax value. In this case, the tax value is defined as the value, not previously recognized as deductible in any form, which would be accepted by the taxpayer as such cost were the specific item disposed of against payment. Analogous regulations are to apply to taxpayers established by way of transformation into a company of a business operator who is a natural person and pursues business activity in his/her own name, or a company that is not a legal person.

## VI. Tax authorities introduce a definition of distributed income on account of net profit

The amendment introduces a definition of distributed income on account of net profit. According to the provision, distributed income on account of net profit is the part of income on account of net profit income that has been designated for distribution in any form, including, in particular, for distribution to shareholders, for coverage of losses arising in a period other than the period of lump-sum taxation, for payment of share-related remuneration, or for increase of the share capital or any fund in a cooperative. The adoption of such a definition is necessary for continuation of accounting of income on account of net profit after withdrawal from the lump-sum income tax system (the so-called Estonian CIT).

## VII. No more requirement to incur certain capital expenditures

The draft abandons the current obligation to incur certain investment outlays as a condition for conducting business activity within the lump-sum income tax system, replacing that condition for large taxpayers with the possibility (right) to incur such outlays in order to reduce the lump sum rate. According to the new regulations, if a taxpayer subject to the lump-sum taxation, other than a taxpayer who launches business activity and other than a small taxpayer, incurs direct investment outlays in the period of 2 consecutive tax years of the lump-sum taxation, or in the period of 4 tax years, in relation to the initial value of fixed assets included in groups 3–8 of the Classification, as determined on the last day of the tax year preceding respectively the 2– or 4–year period of lump-sum taxation, with the exception of passenger cars, means of air transport, floating stock and other assets serving mainly personal purposes of shareholders or members of their families, such taxpayer is entitled to apply preferential lump sum reduced by 5 points and thus amounting to 20 instead of 25%.





## VIII. More favorable rules for determining the value of assets

The definition of tax value of an asset will also be modified. Currently, it is limited to the value, not classified previously as tax deductible in any form within the meaning of Article 15 of the CIT Act or of Article 22 of the PIT Act, that a taxpayer would treat as such were the asset disposed of against payment. The proposal includes any costs or values charged to the net financial result in any form, i.e. also the costs and charges that arose during the period of taxation with lump-sum income tax.

## IX. The income catalog to be defined more carefully in the regulations

The new regulations clarify the catalog of revenues constituting the tax base. Currently, income from undisclosed business operations earned in a tax year is treated as subject of taxation with indication of the due date of payment of a lump-sum tax on such income. According to the proposed provision, it will constitute another tax base. Pursuant to the amendment, 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, whose direct or indirect beneficiary is a shareholder, partner or an entity related directly or indirectly to the taxpayer or to such shareholder or partner, and specifically: the amount of a loan (credit) granted by the taxpayer to a shareholder, stockholder or partner, including through funds established from profit, or to an entity related to the shareholder, stockholder or partner, as well as the interest, commissions, remuneration and fees on the loan (credit) granted by those entities to the taxpayer; remuneration paid from profit due on account of redemption of a share (stock), impairment of a share (stock), a partner's withdrawal from the company, decrease of a partner's equity share in the company; surcharges paid in case of merger or division of entities; interest on the equity share, paid to a shareholder by the company; profit allocated for supplementing a shareholder's equity share in the company; cash and non-cash benefits paid in case of reduction of a shareholder's equity share in the company.



## X. More favorable rules for accounting of the net profit in the year when lump-sum taxation is discontinued

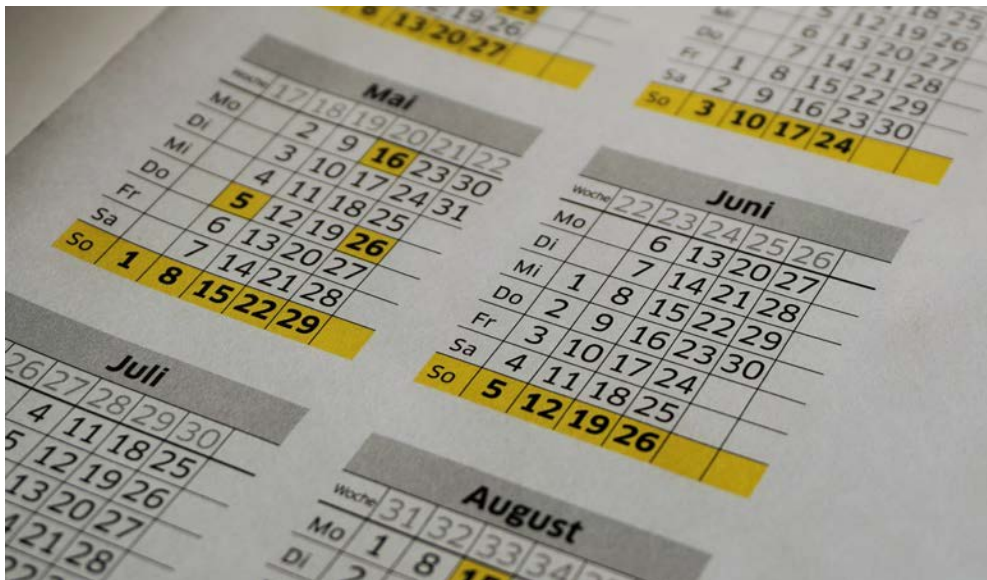
One of the tax bases of the lump-sum income tax is the income on account of net profit earned in the tax year in which the taxpayer withdraws from lump-sum taxation. Therefore, the amendment proposes a new solution where the taxpayer who earned income on account of net profit and, in the period following withdrawal from lump-sum taxation, committed such income in whole or in part will be obliged to file a tax return and to pay a lump-sum tax due on the value of the committed income on account of net profit by the 20th day of the month following the month in which the income was committed. If the income on account of net profit was committed after the sixth month of the tax year, it will be deemed to have been committed on the last day of that sixth month. The solution is more favourable compared to the one currently binding, where the obligation to pay tax on such income arises after the withdrawal from lump-sum taxation.



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## XI. New deadlines for payment of lump-sum tax on net profit distributions

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 payable by the 20th day of the month following the month in which such income was paid in whole or in part or committed in any other form, but no later than by the 20th day of the seventh month of the tax year in which the income was so committed. 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.



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