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Tax authorities to limit debt financing costs

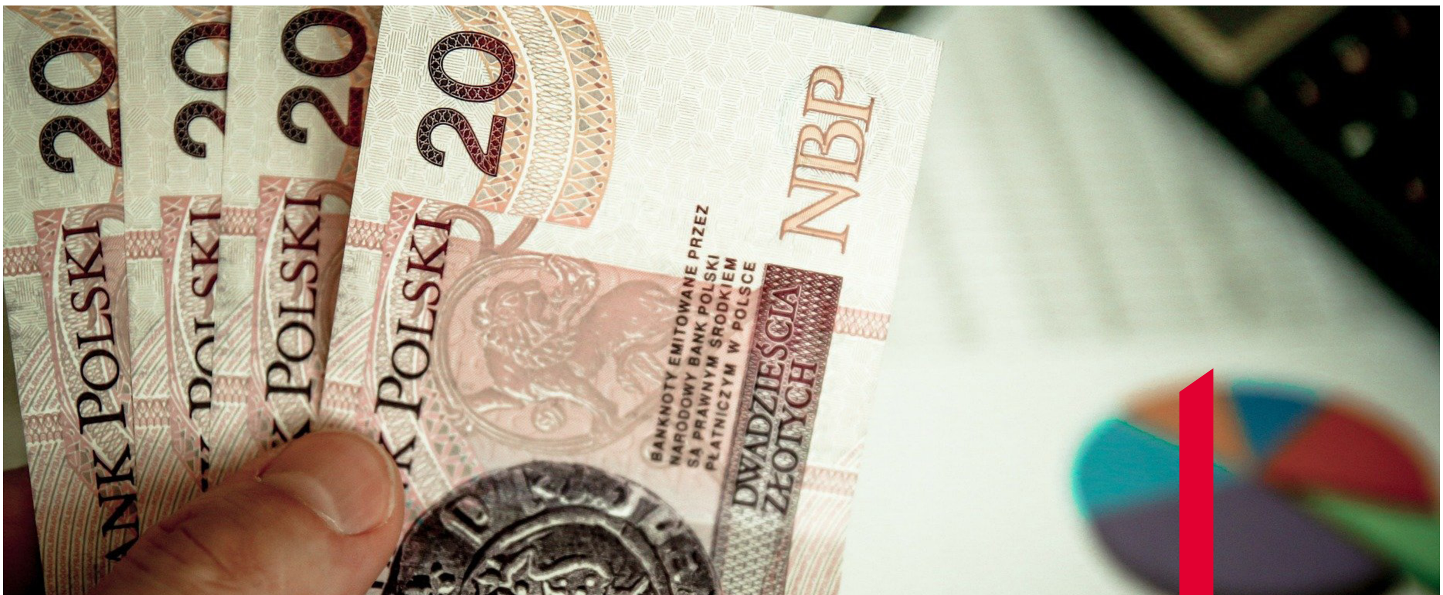
I. Polish Deal to change debt financing cost limit setting methods

The government's amendments to numerous tax regulations prepared as part of the so-called Polish Deal, which have already been passed by the Sejm and are now in the Senate, will change the provisions on debt financing. Debt financing consists of lending money from third parties or financial institutions, from private and public sources, in order to finance business operations. The objective is to obtain external funds for business operations or company investments. Under the statutory provisions in effect since 2019, expenses associated with debt financing have been classified as expenses that cannot be fully included in tax-deductible costs (are limited). These limitations are the result of implementing EU regulations: Council Directive (EU) 2016/11641).

II. Debt financing costs are all forms of external company financing

EU regulations define "external borrowing costs" (debt financing) as all types of costs of obtaining and using funds from third parties, including unrelated parties, such as in particular interest, including capitalized interest or interest recognized in the initial value of a tangible or intangible asset, fees, commissions, bonuses, the interest element of lease payments, late charges and costs of securing liabilities, including the costs of derivative financial instruments, irrespective of for whom they have been incurred. Interest revenues are defined as revenues from interest, including capitalized interest and other economically equivalent revenues corresponding to debt financing costs. The definition is quite broad and open. The list is only a sample enumeration.

After the effective date of the Polish Deal, excess debt financing will be tax-deductible at no more than 30% of the so-called tax EBITDA or PLN 3 million. Thereby the tax authorities are implementing their own interpretation of the application of this limit, which had thus far been disputed by administrative courts.



III. Exceeding debt financing costs must be excluded

Binding regulations provide that taxable persons are required to excluded from tax-deductible costs that portion of debt financing costs which exceeds 30% of the amount corresponding to the excess of total revenues from all revenue sources less interest revenues over total tax-deductible costs less tax-deductible depreciation and amortization charges taken in the tax year, as well as debt financing costs not included in the initial value of the tangible or intangible asset (so-called tax EBITDA). “Exceeding debt financing costs” are considered to be the amount by which the taxable person’s debt financing costs that are tax-deductible in the tax year exceed the taxable person’s interest revenues that are taxable in that tax year.

IV. Tax authorities and administrative courts count debt financing limit differently

In accordance with binding regulations, the limit does not apply to that part of the excess of debt financing costs which does not exceed PLN 3 million in a tax year, and if the taxable person’s tax year is longer or shorter than 12 months, the threshold is calculated by multiplying PLN 250 000 by the number of started months in the taxable person’s tax year. In addition, the limit does not apply to financial enterprises. According to the tax authorities, the limit should be understood to mean that the taxable person can either deduct the value determined by the limit of exceeding debt financing costs (30% of EBITDA), or the value determined by the PLN 3 million threshold, whichever is higher. Administrative courts have thus far had a different opinion. According to the courts, the limit should be understood to mean that it does not apply to that portion of debt financing costs which does not exceed PLN 3 million in a tax year.

V. As of the new year, a formula will be used to calculate excess debt financing

After the regulations change, excess debt financing will be tax-deductible at an amount that does not exceed 30% of the so-called tax EBITDA or PLN 3 million. This is because the new regulations will provide that taxable persons are required to exclude from tax-deductible costs that portion of debt financing costs which exceeds: PLN 3 000 000 or an amount calculated using the formula specified in the regulations, i.e.: [(P - Po) - (K - Am - Kfd)] x 30%. In addition, the amended regulations provide that where a taxable person’s tax year is longer or shorter than 12 months, the exclusion associated with debt financing is to be calculated by multiplying PLN 250 000 by the number of started months in the taxable person’s tax year.

VI. Amount of limit to depend on five factors

The values used to calculate the debt financing cost limit are: “P” is the total value of taxable revenues from all revenue sources, “Po” stands for interest revenues; “K” is the total of tax-deductible costs before reductions; “Am” are depreciation/amortization charges deducted in the tax year; “Kfd” stands for debt financing costs not included in the initial value of tangible and intangible assets, charged to tax-deductible costs in the tax year, before reductions.

RAFAŁ KOWALSKI
Head of Tax Department
tel.: +48 22 543 16 00
Rafal.Kowalski@bdo.pl

VII. Additional limits to apply to transactions with related parties

In addition, the amended regulations provide that where a taxable person’s tax year is longer or shorter than 12 months, the amount of the exclusion associated with debt financing is calculated by multiplying PLN 250 000 by the number of started months in the taxable person’s tax year. The amendments also prohibit the inclusion in tax-deductible costs of the costs of debt financing obtained from a related party (as defined in transfer pricing regulations) insofar as it is designated (directly or indirectly) for capital transactions, including the acquisition of shares or rights and responsibilities in a general partnership, contribution, buy-back of shares for redemption, etc. As you can see, the regulation introduces the concept of “capital transactions”.

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

BDO spółka z ograniczoną odpowiedzialnością sp.k., ul. Postępu 12, 02-676 Warszawa;
tel.: +48 22 543 1600, fax: +48 22 543 1601, e-mail: office@bdo.pl