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REPORT

From:	General Secretariat of the Council
To:	Permanent Representatives Committee
Subject:	Code of Conduct Group (Business Taxation) - Report to the Council = Approval

Poland's rollback of the Investment Zone (PIZ) (PL013)

1. Background

1. End of 2019, the Group assessed the measure PL013 - Polish Investment Zone (PIZ)[1] as harmful[2] for failing criteria 1a, 2a, and 3.

2. Three elements of the PL013 measure were found deficient:

   i. A partial ring-fencing as regards the business services sector;

   ii. A lack of an adequate employment requirement; and

[1] Report to Ecofin: https://data.consilium.europa.eu/doc/document/ST-14114-2019-INIT/en/pdf
ADD3 to the report to Ecofin: https://data.consilium.europa.eu/doc/document/ST-14114-2019-ADD-3/en/pdf

[2] respect of the preferential treatment of income of entities in the service sector.

iii. The possibility for IP related income to benefit from the tax exemption without complying with the 'modified nexus-approach' requirements.

2. Rollback measures notified

3. The Polish authorities notified the amendments brought to the Act on support of new investment (SNI)[3] and the Regulation of the Council of Ministers[4], in order to remove the harmful features of the regime (see notification WK 633/2022 INIT, copied below).

3. Adequacy of the rollback measures notified

Regarding the ring-fencing elements

4. The amendments introduced to remove the ring fencing elements are twofold:

- The two qualitative criteria under the criterion of sustainable economic development, which had been considered harmful by the Group, were removed:

  o reaching an appropriate level of sales outside the territory of the Republic of Poland;

  o establishing a centre of modern services for business with a range going beyond the territory of the Republic of Poland.

- As a replacement, four new qualitative criteria were introduced which provide for creating significant added value for the region where the new investment will be implemented by:

  o using the potential of human resources;

  o establishing regional links;

  o robotization and process automation;

  o new investment in renewable sources of energy with the proviso that the costs incurred as part of this investment in renewable energy sources will not constitute eligible costs of the investment implemented under the support decision and the investment will not benefit from other forms of support.

5. This amendment entered into force on 31 December 2021.

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[3] Act of October 29, 2021 amending the Act on Personal Income Tax, the Act on Corporate Income Tax and certain other acts, which enters into force on 1 January 2022.

[4] the Regulation of the Council of Ministers of December 28, 2021 amending the regulation on state aid granted to certain entrepreneurs for the implementation of new investments (Regulation of the Council of Ministers), announced on December 30, 2021 and entered into force on December 31, 2021

6. In view of the abolition of the two qualitative criteria with ring-fencing effects, it is the Commissions Services' view that the rollback measures notified by Poland are sufficient and adequate to put aside the harmfulness arising from this element.

<u>Regarding the substance criterion</u>

7. Two amendments were introduced in order to comply with the third criterion. They entered into force on 1 January 2022.

Regarding the adequate employment requirement

8. The measure lacked an adequate employment requirement. The measure provided only for an employment factor, which was not mandatory[5]; it did not require the creation of any new jobs, nor a minimum number of such (new) jobs.

9. The amendments state that the decision on support also stipulates the conditions that an investor must meet in respect of the *creation…of **a certain number of new jobs in connection with the implementation of a new investment**, for a specified period of time.*

10. The new rules aim to ensure that entrepreneurs benefitting from the tax exemption will be obliged under an act of statutory rank to create new jobs in connection with the new investment and maintain the level of employment for a specified period. Moreover, if during this period the decision on support is changed, it cannot result in a reduction of the employment level specified in the decision by more than 20%.

11. It is the Commissions Services' view that the requirement to create a 'certain number of new jobs' for a certain period of time is sufficient and adequate to put aside the harmfulness arising from this element. More specifically, the pre-determination of a fixed number of new jobs cannot be required. Such number (and type) of new jobs will depend on each investment, investment amount, duration, type of business sector concerned. Moreover, each decision on support will stipulate on a case-by-case basis the obligation to create new jobs and the extent of such obligation (number of jobs). In addition, the rules ensure that such new employment is also maintained for a specified period and the Ministry in charge monitors this.

Regarding the requirement of the *modified nexus-approach* when it comes to incomes derived from qualified intellectual property rights

[5] Employment costs could be taken into account, if chosen, for the calculation of minimum investment expenditure.

12. The assessment of PL013 measure concluded that the taxpayers investing under the PIZ regime had the possibility to benefit from the tax exemption applied *to IP related income without an adequate substance or nexus requirement, and from a very wide category of IP assets*.

13. The amendments notified, which would apply to any IP income derived under the PIZ regime, make an explicit reference to the Polish IP regime, thus limiting the benefit of the PIZ measure only to the qualifying income and qualifying assets, as defined and determined under the IP regime. We recall that the Group assessed in 2019 the Polish IP regime (PL012) and found it in line with the nexus-approach and therefore not harmful.

14. It is the Commissions Services' view that the link to the Polish IP regime is sufficient and adequate to put aside the harmfulness arising from this element.

4. Follow-up

The COCG agreed that the rollback measures are sufficient and adequate to put aside the harmful features of the PL013 regime, and that the rollback should thus be considered complete.

Annex: Rollback notification **WK 633/2022**

"The amendments to the Act on SNI addressed (1) a requirement of modified nexus approach when it comes to incomes derived from qualified intellectual property rights (IP regime) and (2) an adequate employment, in the following way:

(1) The requirement of modified *nexus* approach when it comes to incomes derived from qualified intellectual property rights (IP regime)

To eliminate the harmfulness in this area we introduced the amendments to the Act on SNI which consists in adding the paragraph 2 to Article 3 as follows:

"The provisions on corporate income tax or the provisions on personal income tax shall also apply to incomes from intellectual property rights received by the entrepreneurs carrying out a new investment on the basis of a decision on support."

Pursuant to the provisions of the CIT Act, a taxpayer receiving income from qualified intellectual property rights is obliged to determine the amount of qualified income from qualified intellectual property rights according to the *nexus* ratio, which is calculated separately for individual income from qualified IP. The structure of the nexus ratio indicates that conducting R&D activity aimed at creating a qualified IP asset by the taxpayer itself is more beneficial. In accordance with the *nexus* approach, the benefits from the tax allowance depend on the scope of research and development activities undertaken by the taxpayer itself - the tax advantage occurs if there is a connection between the income qualifying for the allowance and expenses incurred in order to obtain it. The rules of application of the IP regime in Poland are consistent with the guidelines developed by the OECD under the Base Erosion and Profit Shifting initiative included in the report on Action 5 - *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*.

Thus, the amendment to the provisions of the Act on SNI directly indicates that taxpayers carrying out a new investment on the basis of a decision on support and receiving income from intellectual property rights is obliged to apply the relevant provisions of the CIT Act, relating to taxation of qualified income from qualifying intellectual property rights in a preferential manner, including the *nexus* ratio, the calculation and application of which is one of the basic principles of using the IP regime in Poland.

(2) The adequate employment

To eliminate the harmfulness in the area of an adequate employment in relation to carrying out a new investment in PIZ the following amendments to the Act on SNI were introduced:

In the Article 15 paragraph 1 subparagraph 1 was replaced by the following:

(The decision on support specifies the period of its validity, the subject of economic activity and the conditions that the entrepreneur is obliged to meet, regarding:)
„1) creation by an entrepreneur of ***a certain number of new jobs in connection with the implementation of a new investment****, for a specified period of time;".*
Moreover, in Article 17 paragraph 4 is replaced by the following:
"The minister competent for economy, at the request of the entrepreneur, may change the decision on support, but the change may not:
1) ***relate to a reduction in the level of employment specified in the decision on support on the date of its issue, by more than 20%****;*
2) result in increasing the maximum amount of eligible costs specified in the amended decision on support."

This amendment directly indicates that it is not possible to change the decision on support if it could result in a reduction of the employment level specified in the decision on support by more than 20%. These amendments ensure that entrepreneurs benefitting from the tax exemption will be obliged under an act of statutory rank to create new jobs in connection with the new investment and maintain the level of employment for a specified period of time.

The above mentioned provisions are included in the Act of October 29, 2021 amending the Act on Personal Income Tax, the Act on Corporate Income Tax and certain other acts, which enters into force on 1 January 2022

The amendments introduced in the Regulation of the Council of Ministers leading to the **abolition of preferences addressed mainly to non-residents (ring fencing) concern**:

- Abolition of the right to reduce the quantitative criterion by amending § 4 para. 4 point 1 letter b) of the regulation of scientific research and development works, specified in section 72 of the PKWiU (Polish Classification of Goods and Services) and research and development activities, respectively, within the meaning of Article 4a point 26 of the CIT Act, as a qualifying activity for a 95% reduction in the required eligible costs. Deletion of this type of activity is justified due to the fact that under Section 4 of COMMISSION REGULATION (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, there is specific aid for research, development and innovation.

From 2016, national regulations allow entrepreneurs conducting research and development activity to benefit from R&D relief, while a taxpayer who benefits from a tax exemption in a tax year under the Act on SNI is entitled to deduct only in relation to eligible costs which are not included by the taxpayer in the calculation of tax-exempt income under these provisions.

Nevertheless, we see the added value of R&D activities within the Polish Investment Zone. Entrepreneurs will still be able to obtain 1 point for conducting research and development activities under the criterion of sustainable economic development, where:

i. 1% of operating costs incurred by the entrepreneur in a given tax year are the costs of research and development activities, respectively, within the meaning of Article 4a point 26 of the CIT Act or the purchase of research and development services classified as services in the field of scientific research and development works, within the meaning of the provisions on the Polish classification of products and services, or
ii. employing, as part of the new investment, employees conducting development work, respectively, within the meaning of Article 4a point 28 of the CIT Act will be 2% of the equivalent working time of all employed employees.

- Removal of 2 qualitative criteria under the criterion of sustainable economic development, both for new investment in the service sector and in the industrial sector considered by the Group to be potentially harmful:

    o reaching an appropriate level of sales outside the territory of the Republic of Poland;

    o establishing a centre of modern services for business with a range going beyond the territory of the Republic of Poland.

- Introduction of 4 new qualitative criteria with significant added value for the region where the new investment will be implemented, in place of the criteria considered potentially harmful:

    o using the potential of human resources;

    o establishing regional links;

    o robotization and process automation;

    o new investment in renewable sources of energy with the proviso that the costs

    incurred as part of this investment in renewable energy sources will not constitute eligible costs of the investment implemented under the support decision and the investment will not benefit from other forms of support.

The above mentioned provisions are included in the Regulation of the Council of Ministers of December 28, 2021 amending the regulation on state aid granted to certain entrepreneurs for the implementation of new investments (Regulation of the Council of Ministers), announced on December 30, 2021 and entered into force on December 31, 2021. We will deliver the English translation of the Regulation of the Council of Ministers within the next two weeks."