New Polish Tax Reforms Bring Much-Needed Structural Certainty Allowing Direct Issuances by Polish Issuers

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New Polish laws, effective 1 January 2019, have reformed the tax treatment of a number of different taxable business activities. In particular, the Ministry of Finance has addressed the considerable uncertainty surrounding Poland’s current withholding tax regime. For issuers who can meet the relevant requirements, direct issuances by Polish entities are now possible without withholding, so long as the legal requirements are met, eliminating the need for structuring using finance company structures. While the laws bring welcome certainty to bond issuers, the reforms also strengthen anti-avoidance rules, and questions remain about the treatment of structures that pre-exist the new reforms.

New Exemption for 20% Polish Withholding Tax

On 1 January 2019, Poland enacted a new tax regime that introduced sweeping changes in a number of areas. Most importantly for international bond issuances, these new laws provide a framework for Polish issuers to issue international bonds directly with no obligation for issuers and agents to collect Polish withholding tax (“WHT”) and a Polish income tax exemption for interest paid to non-Polish tax residents.¹ The bonds may be issued by either Polish joint-stock companies (Spółka Akcyjna (S.A.)) or limited liability companies (Spółka z ograniczoną odpowiedzialnością (sp. z o. o.)).

In order to qualify for such beneficial treatment:

- The bonds must be issued in 2019 or later and have at least a one-year maturity;
- The bonds must be admitted to an EU regulated market (such as the main markets of the Luxembourg or Irish Stock Exchanges, which we would expect to qualify, or an alternative trading system, as defined in

¹ Payment of interest on bonds issued by Polish issuers or discount on bonds are treated as Polish source income; with the issuer or its agent obliged to pay WHT, subject to applicable WHT relief under the EU Interest-Royalty Directive or double taxation treaties.
the Act on Trading Securities of 29 July 2005, in Poland or in a country that is a party to a double taxation treaty with Poland. The bonds must be listed and admitted to trading by the first interest payment date;

- Polish and non-Polish corporate or individual tax residents may be bondholders; however, only non-Polish tax residents can benefit from an income tax exemption (other than non-Polish tax residents who, on the day on which income is received, are entities affiliated with the issuer of the bonds and hold, directly or indirectly, together with other affiliated entities, more than 10% of the nominal value of such bonds);

- The remitter (issuer or agent) is released from the obligation to collect WHT in Poland regarding a particular issuance of bonds (which covers payments to Polish and non-Polish tax residents), on the condition that the issuer:
  - informs related parties of the conditions under which an income tax exemption applies; and
  - no later than the day when the first interest or discount on the bonds are paid, the issuer submits a statement to the Polish tax authorities that the issuer has exercised due care in informing related parties about the conditions of the income tax exemption related to those entities (such statement can be submitted only once for a given series of bonds).

### Previous Approach to Withholding Tax

Before the changes to the law, Polish companies issuing bonds directly would be required to pay 20% WHT on any interest payments to non-Polish bondholders. To structure around this requirement, the Polish company (“PolCo” in the below diagram) would typically set up a finance company (“FinCo”) in a jurisdiction that did not apply withholding tax to payments of interest. FinCo would issue bonds to non-Polish bondholders with payment for the bonds made to FinCo, which would then transfer the funds to PolCo in the form of intercompany loans or bonds. Payments of interest and repayments of principal would be made via back-to-back payments to FinCo on such intercompany loans and then paid onward to bondholders.

So long as FinCo was a resident of an EU country or a country that signed a double tax treaty with Poland with an exemption applicable to interest payments, and had satisfied the necessary Polish conditions and formalities, the practice was that interest was paid from Poland to FinCo (as shown below) without Polish WHT (FinCo has offer located in Sweden or Luxembourg). This structure could reduce the WHT payable significantly (from the original 20% to 5% or a full exemption), making issuing bonds a viable option for Polish companies. However, legislative reforms, such as the July 2016 amendments to the Tax Ordinance Act, instituting the General Anti-Avoidance Rule (“GAAR”), gave the Ministry of Finance the right to reject any structure or arrangement where tax savings were the primary purpose. This meant that from 2016, even though the Polish tax authorities did not explicitly reject these structures, those structures were under considerable doubt, unless significant investments and other actions were taken. This uncertainty had a dampening effect on both the ability of Polish issuers to issue bonds and cast doubt on existing structures as the legislation did not “grandfather” in existing structures.

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2 The requirement to list on an EU-regulated market at closing would represent a change to market practice for most European high-yield issuers, who tend to choose exchange regulated markets, such as the Global Exchange Market (GEM), Euro MTF or The International Stock Exchange, but we believe that that transaction parties should be able to comply with the requirements without major increased costs or timing implications.
Anti-avoidance Rules Also Strengthened

In exchange for clarity on Polish direct issuances, the Polish government has strengthened the 2016 GAAR regulations with the incorporation of both fiscal and custodial penalties and additions to the list of factors the tax authorities consider when scrutinising a transaction. The list of factors under the GAAR regulations now include: an unjustified division of operations; the use of intermediaries despite a lack of economic or commercial grounds for their presence; and the creation of an entity which does not conduct actual business activity. These additions enlarge the number of pre-existing transactions that the tax authorities are entitled to review.

If Polish tax authorities find a GAAR violation, they are now permitted to impose greater fiscal and even custodial penalties. The fiscal penalties are calculated as a percentage of the unjustified tax benefit, and Polish tax authorities are able to impose, among others, penalties ranging from 10% to 40% of the unjustified tax benefit.

Effect on Existing Structures

The new tax regulations do not “grandfather” existing structures (subject to some limited transitional measures that may apply, as detailed below). Given that the new tax regime also includes stricter penalties for structures that GAAR considers “artificial,” we would advise analysing all existing structures where a bond has been issued by an issuer with substantial Polish operations to determine whether there are any concerns under GAAR.

Real Financial Centre

To address GAAR concerns where bonds have been issued by a FinCo and then on-lent to other Polish group companies, issuers can consider whether it is appropriate to add substance to the FinCo by endowing it with staff, assets and capabilities sufficient to allocate economic risk to the FinCo. It is essential to emphasise that a non-Polish SPV created specifically for the purpose of transferring proceeds from the bond issuance to the Polish operation in a “back-to-back” mechanism would be insufficient. The FinCo undertaking real financial activities with its own assets and personnel will be key to determining whether the FinCo would qualify as a real financial centre.

Refinancing

So long as there are good economic reasons, as opposed to just tax savings, bond issuers can consider refinancing as a means of complying with the new GAAR requirements and benefitting from the new tax reforms.

An issuer could refinance its existing bonds using bank loans from financial institutions, as most of Poland’s double taxation treaties include a 0% withholding tax rate on payments of interest to banks. As bank loans to non-financial institutions (for example, to funds) may not be covered, we believe that refinancing via a bond structure that complies with the new Polish tax law exemption may be more straightforward for large international refinancings where issuers would like to access non-bank investors.

Transitional Provisions of the 2019 Tax Reforms

Certain bond issuers may benefit from transitional provisions incorporated in the 2019 tax reforms. These transitional provisions provide relief for Polish companies regarding their bond structures with non-Polish FinCos, which allows them to pay a lump sum 3% WHT instead of the standard 20% WHT. The new tax reform establishes a comprehensive list of additional requirements which include, among others: (1) the Polish issuer’s loan or issue of bonds to the FinCo has a repayment day or maturity date no shorter than one year; (2) the Polish issuer and the FinCo are affiliated entities as defined by Polish law; and (3) there is a legal basis for the exchange of tax information between Poland and the FinCo’s tax residence. We believe that these requirements, and others, could significantly limit the number of issuers able to benefit from this transitional provision; so each situation should be analysed on a case-by-case basis.
Conclusion

Overall, we believe the long-awaited new tax reforms bring much-needed certainty. In the period after the 2016 reforms, Polish companies considering new international bond issues were faced with a large number of unpalatable risks. These new reforms now provide Polish companies with a clear and regulatory compliant means to once again issue bonds internationally. However, questions still remain about the treatment of existing structures. The introduction of new penalties under GAAR means that the Polish tax authorities continue to look carefully at structures they consider artificial or created for tax avoidance purposes.
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