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Draft on taxation of income of controlled foreign companies (CFC)

The governmental department of finance is conducting legislation works on a draft of a new act changing the act on PIT and CIT. The draft stipulates introduction of taxation of income of controlled foreign companies (Controlled Foreign Corporation, CFC). The draft is now under cross-ministerial discussions and public consultations.

CFC regulations are an internationally accepted mechanism of fighting tax fraud which may occur in relationships among related entities and which consists in declaring income from the activity conducted in a given country as income of entities subject to tax jurisdiction of countries in which preferential taxation rules are applied.

The most crucial aspect of such solution is the obligation to include in the tax assessment basis of state residents (natural persons or PIT taxpayers) income of the controlled foreign entities which have their seats or management in a country with a lower taxation rate than that of the country of the main entity's residence.

The authors emphasize that the above regulations have been applied by many EU member states including Germany, France, UK, Sweden, Denmark, Finland, Portugal, Spain and Italy as well as many countries outside of Europe such as USA, Canada, Japan, New Zealand, Indonesia, Mexico, RPA, South Korea, Argentina, Brazil, Israel, Turkey and China. The provisions referring to the CFC have been also included in a draft of a European Commission directive on common consolidated tax assessment basis for companies.

The draft introduces an obligation for Polish residents to present income of the controlled foreign companies in a separate tax statement and to tax such income with 19% tax rate. The income of such companies is determined on the basis of the Polish act on PIT (if the partner is a natural person) or act on CIT (for a legal entity).

CFC stands for companies which meet three criteria related to the level of control (25% of share in the capital, voting rights, or share in profit), type of revenue obtained by the foreign company (50% financial revenue) and location of the foreign company in a country with a low tax rate (lower by 25% than CIT rate in Poland). Moreover, a controlled foreign company is defined as any company having its seat in a country listed in the index of countries and territories which use unfair tax competition published by the Minister of Finance by way of a decree.

The abovementioned provisions will not apply in case of taxpayers who control foreign companies located within a EU member state or within the European Economic Area state if a foreign company conducts its actual business activity there.

The provisions stipulate additional exemptions i.a. regarding foreign companies' incomes with revenues not exceeding EUR 250,000. Moreover, to prevent double taxation of the same incomes, the provisions also introduce a possibility not only to deduct income tax settled by a controlled foreign company, but also to reduce tax assessment basis by the amount of dividends gained from the controlled foreign company and revenues from the sale of shares of the controlled foreign company.

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