CLIFFORD
CHANCE

Briefing note January 2017

Investment funds and REITs – new rules

Pursuant to the Act of 29 November 2016 on the Amendment of the Personal Income Tax Act, Corporate Income Tax Act and Act Amending the Act - Tax Ordinance and Certain Other Acts, which came into force on 1 January 2017 (the "Amendment"), the tax regime applicable to investment funds changed. Closed-end investment funds ("CIFs") and specialised open-end investment funds ("SOIFs") operating in accordance with the rules and investment constraints applicable to CIFs are subject to corporate income tax at the rate of 19% and only certain of their income is exempt from taxation. Open-end investment funds ("OIFs") and SOIFs operating in a standard way, i.e. applying the rules and investment constraints specified for OIFs, are still, as such, exempt from corporate income tax.

In parallel, the Polish government is planning to encourage long-term investment in real estate by introducing real estate investment trusts ("REITs") in Poland. According to the new draft Act on Real Estate Rental Market Companies (the "Draft Act"), companies which issue shares and invest the proceeds obtained from investors in the real estate market, are to be exempt under certain conditions from corporate income tax. However, the Draft Act has not been adopted yet and it is not certain when it will come into force and what its final wording will be.

To summarise:

- The Amendment retains the corporate income tax exemption for OIFs and SOIFs acting on terms appropriate for OIFs. In turn, COIFs and SOIFs acting on terms appropriate for CIFs enjoy an exemption with respect to the income obtained from those funds.
- The Amendment generally excludes from the exemption income earned by CIFs (and SOIFs acting on the terms of CIFs) from tax transparent partnerships without legal personality. This means that existing structures using CIFs and Luxembourg SCS partnerships commonly used until now cease to be tax-efficient because of the taxation of income earned by those partnerships at the level of the fund. Hence, solely from the tax point of view it seems that there is no justification for maintaining structures of this type.
- REITs might be a possible alternative for fund structures operating to date on the real estate market. However, firstly the act regulating vehicles of this type is still a draft and it is not known when and in what form the act will be enacted and come into force. Secondly, as the shares in companies with REIT status must be designated for trading on regulated markets, they are, to some extent, similar to OIFs (OIFs raise their funds through public offerings of the participation rights). Thirdly, neither the Draft Act nor any other legislation contain any procedure for converting an investment fund into a REIT. It means that changing of the legal form from an investment fund to a REIT would actually require liquidation of the fund and creation of a REIT from scratch. Consequently, a simple replacement of the existing structures that to date have been using CIFs by applying REITs will not work in most cases.

- In light of that, it must be stated that the Amendment (even assuming the introduction of regulations on REITs) make material changes to the tax regime applicable to investment funds, considerably limiting the possibility of optimising tax through their use.

Investment funds – new tax rules

The objectives of the Amendment regarding OIFs – exemption applicable to funds

The Amendment maintains the corporate income tax exemption for OIFs and SOIFs operating on the basis of the Act in Investment Funds, with the exception of SOIFs operating in accordance with the rules and investment constraints specified for CIFs.

Furthermore, the corporate income tax exemption continues to apply to investment funds established in an EU or EEA member state other than Poland, which comply with all of the following conditions:

- the fund is tax resident (even if it is tax exempt) in an EU or EEA member state other than Poland;
- the sole object of the fund's activity is the collective investment in funds, raised through public offerings of the participation rights in the fund, in securities or money-market instruments;
- the fund is authorised to operate on the basis of a permit granted by the relevant financial supervisory authority of the country where it is established;
- the fund's activity is subject to direct supervision by the relevant financial supervisory authority of the country where it is established;
- the fund's assets are held by a depository; and
- the fund is managed by an external regulated entity acting based on a permit granted by the relevant financial supervisory authority of the country where it is established.

This exemption does not, however, apply to funds:

- which conduct their activity in the form of a collective investment undertaking of the closed-end type or operate on the basis of the rules and investment constraints applicable to collective investment undertakings of the closed-end type; or
- whose participation rights are not, in principle, offered by way of a public offering, are not admitted to trading on a regulated market or introduced to an alternative trading system.

The objectives of the Amendment regarding CIFs – exemption applicable to income

The Amendment also provides for a general tax exemption covering the income (revenue) of CIFs and SOIFs operating in accordance with the rules and investment constraints specified for CIFs with the exception, however, of:

- income (revenue) from shareholdings in companies without legal personality or organisational units without legal personality (such as a company in the process of formation), established or having their management board in the Republic of Poland or another state, if pursuant to the provisions of the statutes or tax regulations of the state in which those companies or organisational units are established or have their management board, those entities are not treated as legal persons and are not subject in that state to income tax on the total amount of their income, regardless of the place where such income is earned;
- income (revenue) from interest on loans granted to those entities referred to above, including interest on other liabilities of those entities towards the fund;
- income (revenue) from interest on any participating interest in the entities referred to above;
- donations or other free-of-charge or partly free-of-charge benefits made by the entities referred to above;
- income (revenue) from interest (discount) on securities issued by the entities referred to above; and
- income (revenue) from the disposal of securities issued by the entities referred to above or disposal of any participating interest in those entities.

The same exemption (with the same exceptions) applies to the income of investment funds of the closed-end type established in an EU or EEA member state other than Poland whose participation titles are not publicly offered, which comply with all of the following conditions:

- the fund is tax resident (even if it is tax exempt) in an EU or EEA member state other than Poland;

- the sole object of the fund's activity is the collective investment in funds in securities or money-market instruments and other property rights;
- the fund is authorised to operate subject to a notification made to the relevant financial supervisory authority of the country where it is established;
- the fund's activity is subject to a direct control from the relevant financial supervisory authority of a country where it has its registered seat,
- the fund's assets are held by a depository; and
- the fund is managed by an external regulated entity acting based on a permit granted by the relevant financial supervisory authority of the state where it is established; the exemption applies so long as there is a double treaty between Poland and the state in which the tax payer is established which allows the Polish tax authority to obtain tax information from the tax authority of that other state.

Introduction of real estate investment trusts (REITs)

On 12 October 2016, the Polish Minister of Finance issued a Draft Act regulating REITs, thereby paving the way for the introduction in Poland of an investment structure which has been in existence in developed economies for a number of years. The aim of the Draft Act is to provide a regulatory framework for the regulation of REITs.

The qualifying conditions under Polish law

The overall objective of the draft guidelines for REITs is to stimulate investment in the commercial real estate sector. The guidelines are mainly aimed at providing an organised platform for retail investments.

The Draft Act aims to offer the status of a "real estate rental market company" (spółka rynku wynajmu nieruchomości) (an "SRWN") to real estate public companies that wish to operate as a REIT and that meet the specified legal requirements.

The most important rule is that 90% of a REIT's taxable income must be distributed to its shareholders in the form of a dividend. REITs provide a way to profit from real estate without directly owning it, which is one of the main reasons why REITs are attractive to investors.

For a company to qualify as an SRWN it must comply with the following:

- it must have a minimum share capital of 60,000,000 PLN;
- it cannot have any limitation on its duration;
- its shares must be admitted to trading on a regulated market in Poland;
- it has to be managed by a management board with a minimum of 2 board members;
- it must have a sufficiently diversified property portfolio, i.e. it must own at least three properties which are rented out, and the income generated must be from those rental properties;
- the object of its economic activity must be: leasing and sale of real estate and financial activities relating to the management of its shares or shares in other companies (subsidiaries);
- it must have not less than 70% of the balance sheet value of its assets in real estate, shares in its subsidiaries (as defined below) and shares of other regulated real estate companies;
- it must generate not less than 70% of its net sales from leasing or sale of real estate;
- it must have a balance sheet value of its obligations not exceeding 70% of the balance sheet value of its assets;
- not less than 90% of its profits must be paid to shareholders as a dividend each year, or, if the profit has not been paid to the shareholders as a dividend, it must be used to purchase other real estate, or shares representing not less than 95% of the share capital of a joint-stock company, limited liability company or a limited joint-stock company, in which real estate constitutes not less than 70% of the value of its assets; and
- a subsidiary of an SRWN can be a joint-stock company, limited liability company or a limited joint-stock partnership with its registered office in Poland, which meets certain conditions applicable to SRWNs and at least 70% of the balance sheet value of its assets is in real estate and provided an SRWN owns at least 95% of it.

Tax benefits of SWRNs

The essence of the special status of SWRNs is that it is exempt from corporate income tax. This is to eliminate double taxation of income from the lease and sale of real estate - at the level of the SRWN as the owner of the real estate and on the distribution of the profits derived from that income - at the level of the investors in the SRWN.

It is envisaged that the following income of SWRNs will be exempt from corporate income tax:

- income derived from the sale or lease of real estate;
- income derived from the sale of shares in subsidiaries of an SWRN or in other SWRNs; and
- income from dividends paid to a SWRN by its subsidiaries.

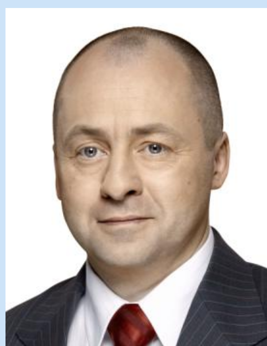
Moreover, the corporate income tax exemption will also apply to the income of an SWRN's subsidiaries from the lease or sale of real estate.

Dividends paid to the shareholders of SWRNs will, in principle, be subject to 19% withholding tax. In the case of foreign investors, the statutory 19% withholding tax on dividend payments may be subject to reduction under a relevant double tax treaty. The exemption from withholding tax on dividends provided for by the regulations implementing the Parent/Subsidiary Directive will not apply to dividends paid by SRWNs. Therefore, dividends paid by a SWRN will, in principle, be subject to 19% withholding tax unless a relevant double tax treaty provides otherwise.

Authors

Grzegorz Namiotkiewicz
Partner

T: +48 22 627 11 77
E: grzegorz.namiotkiewicz@cliffordchance.com



Tomasz Szymura
Counsel

T: +48 22 627 11 77
E: tomasz.szymura@cliffordchance.com

Nick Fletcher
Of Counsel

T: +48 22 627 11 77
E: nick.fletcher@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

Norway House, ul. Lwowska 19, 00-660 Warsaw, Poland

© Clifford Chance 2017

Clifford Chance, Janicka, Krużewski, Namiotkiewicz i wspólnicy spółka komandytowa

www.cliffordchance.com

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta* ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Linda Widyati & Partners in association with Clifford Chance.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.