

Successful penetration of foreign markets

Part 1 (of 4)

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Germany is not only one of the world's leading exporting countries in terms of industrial products, but also as far as the "export" of production (facilities) and the opening-up of new foreign markets is concerned, German companies have read the signs of the times. Within the framework of a four-part series of articles we will point out the advantages and risks involved with such expansion. This will be illustrated by an example of expansion to Poland assisted by our experts – the country which exemplifies the future chances in Eastern Europe with its thriving economy and its optimism. It forms a bridge to the Eastern European market not least because of its approximately 40 million inhabitants and its central location. Part 1 of the series will outline the legal and tax conditions in Poland. Parts 2, 3 and 4 will familiarize the reader with the advantages and drawbacks of expansion to Poland under company, fiscal and labour law.

Situation: Carl Müller, the owner of "Müller Transformatoren AG", is in a bad mood: increase in company taxation – cut in company taxation; the German Federal Government is undecided as to which policy to pursue. He now considers transferring part of his production abroad. Carl Müller sells a large number of his transformers in Poland; it thus seems reasonable to consider expansion in Poland. However, is it really worth it? What opportunities are there at all and which formalities have to be observed?

A. General considerations

Carl Müller already has some specific ideas for his expansion:

He considers indirect activities such as marketing his products via catalogues and mail order (also Internet market platforms), including annual trade fair participation, to be inadequate. The same goes for the secondment of sales representatives. Therefore it is necessary to establish a permanent branch to supply the Polish market. He wants to set up an "extended workbench" and equally provide an organization for doing further business with Eastern European countries (for example by establishing a holding company). In order to achieve these aims he will have to second German employees and take on more Polish staff. These employees are to run production and set up a marketing network for the company's other products. Carl Müller could also imagine establishing a joint venture with a Polish company.

In order to put Carl Müller's ideas into practice the formation of a legally independent company suggests itself. Carl Müller could set up a German company which will operate on a cross-border scale. However, it would seem more logical to establish an independent company in the target country, that is in Poland. Carl Müller's decision is affected by many factors for both alternatives offer advantages and disadvantages. With cross-border transactions the actual problems, such as the question of liability and costs, have to be borne in mind. The question of establishment in Poland is, of course, affected by the regulations under tax, company and labour law there. These factors thus have to be identified, checked and weighed up against each other prior to the concrete implementation.

B. Poland - member of the EU

Poland has been a member of the EU since 1 May 2004. The entire EU law, for example the freedom of establishment, the freedom to provide services and the free movement of goods, now also applies in Poland. However, there are still some transitional periods or time limits for certain areas provided (for example acquisition of property and real estate). In addition, Poland has modernized or adjusted its national legislation to EU law in recent years. Every entrepreneur can carry on a trade or business in Poland. Every foreign entrepreneur can settle in Poland and is treated like a Polish entrepreneur. Every foreign company that is registered in Poland is treated like a Polish company and is entitled to any admissible tax relief and all development programmes. Poland has created a number of Special Economic Zones. Companies that settle there benefit from certain tax benefits. Apart from establishing the company headquarters in the respective development area, it is often required to invest a certain minimum amount. The exact promotion possibilities have to be examined in detail for every individual case. After Poland's accession to the EU, the hitherto very favourable promotional terms have been a bit restricted, however, the existence of the development areas has not been challenged.

C. Company law in Poland

In its essential features, the Polish company law is similar to the German one. It distinguishes between partnerships and corporations.

Classic forms of partnerships are the civil-law association, the general partnership and the limited partnership (Spółka komandytowa, abbr.: sp.k.), also in the form of a partnership limited by shares. Especially the limited partnership as a commercial partnership differs only little from its German counterpart (KG). One step up the "integration ladder" would be the formation of a Polish limited partnership in the form of a limited commercial partnership with a limited liability company as general partner. What is special about it is that the general (personally liable) partner can be a German limited liability partner (GmbH) but also any other European corporation. This makes expansion considerably easier for German entrepreneurs since they are certainly more familiar with the German GmbH than with the Polish Sp. z o.o.

Classic forms of Polish corporations are the Polish limited liability company and the joint stock company. These company types are also very similar to the German models.

The Polish limited liability company (Spółka z ograniczoną odpowiedzialnością, abbr.: Sp. z o.o.) may be established for any admissible purpose; an economic reference is not imperative. The minimum nominal capital is PLN 50,000 (approx. EUR 12,500) and the lowest permitted value of a share is PLN 500 (approx. EUR 150). Contracts on the shares require authentication of signature by a notary public. The registration fee is PLN 1,000. According to statutory provision, the registration must be published in the Official Gazette, for which a fee of PLN 500 has to be paid.

One-man limited liability companies are also admissible in Poland. These, however, involve more stringent recording requirements. Contracts of the sole shareholder with the limited liability company require authentication of signature by a notary public. The sole shareholder has to provide certain information for entry in the commercial register.

The same liability regulations apply to business operations of Polish limited liability companies being formed as they do to German "GmbHs in Gründung".

The notarial formation deed must stipulate the following: the business name and registered office of the company, the objects of the business operations, the life of the company, if established for a definite time period, the amount of the share capital, information as to the capacity (or lack thereof) of a partner to hold more than one share, the number and nominal value of shares subscribed for by individual partners. Apart from that, the deed should

contain information on in-kind contributions and any arrangements by which partners have been granted special advantages and/ or by which additional duties have been imposed on partners.

The share capital of a joint stock company (Spółka akcyjna, abbr.: S.A.) must be not less than PLN 500,000 (approx. EUR 130,000) and the nominal value of a share must be at least PLN 1. The notarial formation deed must stipulate the following: the business name and registered office of the company, the objects of the business operations, the life of the company, if established for a definite time period, the amount of the share capital, the amount of the capital paid in prior to registration, the nominal value and number of shares stating whether these are bearer shares or registered shares, in the case of special shares their number and the vested rights if necessary, the incorporators' names and addresses, the number of members of managerial and supervisory bodies or at least their maximum and minimum number as well as the designation of the body appointing the members, and at least the approximate costs of the company formation.

D. Tax law in Poland

The following short survey is to outline the tax regulations in Poland. Parts 2 and 3 will deal with this matter in more detail and suggest tax benefits.

I. Income tax

Natural persons who have permanent residency in Poland or whose temporary residency has exceeded 183 days in a given calendar year are liable to income tax on their total revenue, regardless of their origin. Foreigners who are temporarily residing in Poland are liable to tax only on revenue obtained in Poland (limited tax liability). Like in Germany, partnerships are treated as "transparent". That means that the income is determined at company level and is then allocated to the individual partners each according to their share. As partner of a Polish limited partnership, Carl Müller would be liable to pay income tax with his personal shares of the limited partnership in Poland.

Like the German tax law, the Polish tax law differentiates between various types of income (e.g.: income from trade or business, income from self-employment, income from investment, etc.). The tax scale comprises three brackets of 19%, 30% and 40%. What is remarkable and special about the Polish income tax regime is that there is the possibility of flat-rate taxation. Businessmen can opt for this taxation model with the consequence that their other income can no longer be balanced with their income from trade or business, but that the income from trade or business will be subject to a flat tax rate of 19%. Special expenses will no longer be allowed for and husband and wife will be assessed separately to tax. The maximum income tax rate on business profits in Poland is 19 %.

II. Corporation tax

Legal entities with their registered office or management board located in Poland are subject to the taxation of all revenue, regardless of their origin. Non-resident taxpayers are liable for payment of taxes only on the revenue obtained in Poland.

The corporation tax rate is 19%. The income is determined as the difference between receipts minus business expenses; the cash principle shall apply. What is striking from a German point of view is that withholding tax is levied on the gross amount of some types of income (e.g. 19% on dividends and interest and 20% each on payment of royalties as well as income from intangible services).

III. Tax on civil law transactions

Formerly termed "stamp duty", it was renamed "tax on civil law transactions" in 2001. This tax applies to certain civil law transactions such as loan agreements, creation of a mortgage, sale of real estate or partnership agreements. Tax rates vary between 0.1% and 2%.

IV. Value-added tax

The VAT system is basically based on the principles of the 6th VAT Directive and was approximated to the European system to the greatest possible extent until Poland's accession to the EU. The basic tax rate is 22%. Apart from the basic rate, there is a preferential rate of 7% applicable to some services.

First summary:

The basic data of the Polish tax system arouses Carl Müller's interest but he requires more information to make a sound decision. He, however, now knows that he might have to reckon with a tax burden of 19%. For liability reasons he tends to transact business in Poland in the form of a limited liability company under Polish law. However, since there are still some open questions, he asks his advisers for further statements. The advisers announce that they will present Carl Müller with various models for the planning and implementation of his cross-border expansion.

To be continued ...