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### **POLAND'S ENTERPRISE ENVIRONMENT – A POLISH VIEW**

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**ABSTRACT:** The paper briefly presents environment for business in Poland as of the end of the year 2005. A few comments, however, on its evolution in the course of the transition period are also made. The paper broaches administrative, legal and financial requirements to start and run business activities by both natural and legal persons. In addition, it presents government support schemes for investors. A brief description of the scope of the grey economy and corruption completes the picture of the business environment. The topic has been approached from the foreign investor's perspective. Although foreign investors are subject to the same laws as domestic (Polish) ones, in a limited number of cases they are treated differently than the latter. These cases, and specifically land purchase and employment of foreign citizens, are reviewed.

**KEY WORDS:** Business climate, industrial policy, state aid, grey economy, Poland.

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**TIIVISTELMÄ:** Tässä tutkimuksessa tarkastellaan lyhyesti Puolan yritys ympäristöä vuoden 2005 lopun tilanteen mukaan ja esitetään joitakin kommentteja tämän ympäristön kehityksestä siirtymätalouksena. Tutkimuksessa esitellään hallinnolliset, juridiset ja rahoituskelliset edellytykset yritystoiminnan aloittamiseksi ja harjoittamiseksi sekä luonnollisten että juridisten henkilöiden tapauksessa. Lisäksi esitellään julkisen sektorin tukijärjestelmät investoinneille. Lyhyt kuvaus harmaan talouden ja korruption laajuudesta täydentävät kuvan yritys kentästä. Aihetta lähestytään ulkomaisen investoijan näkökulmasta. Vaikka ulkomaisia investoijia koskevat samat lait kuin kotimaisia eli puolalaisia, eräissä tapauksissa edellisiä kohdellaan eri tavalla kuin puolalaisia. Tutkimuksessa tarkastellaan näitä tapauksia sekä erityisesti maan ostamista ja ulkomaisen työvoiman palkkaamista.

**AVAINSANAT:** Yritysilmapiiri, elinkeinopolitiikka, valtionavustukset, harmaa talous, Puola



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The paper has been proof-read by James Cabot.



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Foreign investors are subject to the same laws as domestic (Polish) ones. The Law of 2 July 2004 on Economic Freedom guarantees foreign natural and legal persons from the European Union and the European Free Trade Agreement zones belonging to the European Economic Area (EEA) the same rights as domestic investors to start, run and close business activities in Poland. In the case of entrepreneurs coming from other countries, the principle of reciprocity is employed, i.e. equal rights are adopted vis-à-vis entrepreneurs from countries with which Poland has ratified international agreements. There is one exception, however: foreign investors are treated differently than domestic ones in the case of land purchase (see Section 6 below). Employment of foreign citizens is also restricted; however this is relevant equally for domestic and foreign-owned companies registered in Poland (see Section 5).

## 1 TYPES OF BUSINESS ENTITIES

There is a variety of legal forms of business available in Poland and foreign investors (as Polish ones, if they come from EU or EFTA zones) are free to choose the one that fits them best, within the limits of the law<sup>1</sup>. Besides limited liability and joint stock companies, there are the following options: general partnership (registered partnership), limited partnership, professional partnership, limited joint-stock partnership. Foreign investors can also establish branch offices (foreign subsidiary) or set up a representative office.

Individuals have the additional option of setting up a natural person business (sole proprietorship), which has been the most popular form of business activity for Polish citizens since the departure from the command economy in the autumn of 1989. Nowadays there are 2,763,000 sole proprietorships registered<sup>2</sup> and they constitute 77.3% of all business entities. There are a number of reasons for the popularity of this legal form of business activity: a favourable tax regime (see Section 4), lower than usual contributions to the pension system (see Section 5.2), simplified accounting, quick and cheap registration (see Section 2). However a sole proprietorship is a convenient legal form for small scale business activity only, due to its unlimited personal exposure of an entrepreneur to business risks.

Investors from countries for which the principle of reciprocity does not apply have a limited choice and may establish in Poland only a limited liability company, a joint stock company, a limited partnership or a limited joint-stock partnership; they may also join such companies already registered in Poland (through purchase of shares or interests).

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<sup>1</sup> In some sectors - banking and insurance being good examples - there is only one legal form of enterprise.

<sup>2</sup> As of 31 December 2004, CSO (2005a). The number of active sole proprietorships is by far smaller than the number of registered ones stated below.



## 2 REGISTRATION

### 2.1 Registration of a business activity by a physical person

Registering of a sole proprietorship is an easy and low-cost procedure (25 euro), unless the activity is licensed. An individual has to fill in a short form and deliver it to the Business Activity Register run by the municipality (gmina) bureau<sup>3</sup>. The gmina administration has no power to refuse (unless some information is missing in the form) and must place the new business entity in the register within 14 days, though in practice this usually requires less time. As of 1 January 2004 an entrepreneur may ask the gmina administration to accept and forward his/her applications to the Central Statistical Office to receive a Statistical Identification Number (called REGON) and to the tax office to receive a Taxpayer Identification Number (so called NIP). The other three steps required for establishing a sole proprietorship include: opening of an account at a Polish bank<sup>4</sup> and notification of the Social Insurance Institution (ZUS). The third and last one is the application for required permission or license (see Section 3). Further improvement will take place from 1 January 2007, when the time limit for processing the application by the gmina office will be shortened to 3 days and the process of building a “one-stop shop” within the Business Activity Register will have been completed. Under this new system all applications (which must currently pass through the four different government institutions listed below) will be processed at the local administration bureau<sup>5</sup>. Outside of the “one-stop shop” only the application for a permit/license will remain. Starting from January 2007 on-line registration will be available as well.

### 2.2 Registration of companies and partnerships

The registration of business entities - other than the sole proprietorship - has changed for the better in the course of the 15 years of transition<sup>6</sup>, yet remains a time consuming and costly procedure.

Establishing a limited liability company, for example, requires nine steps. Since 1 January 2004, as in the case of sole proprietorships, three formalities may be fixed in one place: an entrant may place in the National Court Register (NCR) also applications for REGON and NIP<sup>7</sup>. The registration takes at least 31 days (plus additional time for obtaining a licence or permit, if necessary), while in the most liberal economies this period is much shorter<sup>8</sup>.

The most difficult part of the registration process for all kinds of companies is dealing with the National Court Register, which is – like all other courts in Poland -very formalistic and hesitant to communicate with an applicant, with the result that the check-up of an application and accompanying documents is prolonged. The extreme recommendation

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<sup>3</sup> Gmina is the smallest administrative unit in Poland. Gminas are grouped in districts (poviats) and poviats in provinces (called voivodships), which are the largest administrative units. There are 2,478 gminas, 379 poviats and 16 voivodships.

<sup>4</sup> The law intentionally requires that every business entity have a bank account.

<sup>5</sup> This is envisaged by the the Law of 2 July 2004 on Economic Freedom; which gives the government thirty months to create the technical facilities necessary for “one-stop shop” business registration.

<sup>6</sup> During the 1990s, the commercial court had 3 months to process the application of a new company, while now the formal limit for the centralized National Court Register (which took over the duties from commercial courts in 2001) is 14 days.

<sup>7</sup> Further improvements have been announced for January 2007 (as described above).

<sup>8</sup> In Australia - 2 days, in Canada -3, Denmark – 4, USA – 5 (World Bank, 2005).

(Balcerowicz, 2004) is to replace the court-run procedure with an administrative one<sup>9</sup>; however this option seems to be difficult to implement after the huge investment made a couple of years ago in the establishment of the National Court Register. A more modest option, if the court registration is to stay, would be to release an entrant from the costly obligation to use a notary before submitting deed of association or statute of a company to the NCR and to make this voluntary.

The relative cost of the whole registration procedure (the cost of a receipt of licence/permit excluded) for a limited liability accounts for 20.6% of GDP per capita, which is very high as compared with the cost in the countries with regulatory environment most favourable to business<sup>10</sup>. Poland ranks 23 in the EU-25; only in Greece and Hungary are registration cost higher (35.2% and 22.9% respectively) (World Bank, 2005).

Besides the relatively high cost of registering companies, Polish law imposes high requirements for initial capital: for a limited liability company and a limited joint-stock partnership it is 50,000 zloty (12,500 euro). This amount accounted for 237.9% of GDP per capita in 2004, and made Poland the most restrictive country in the EU-25 in this respect (World Bank, 2005). Greece, ranked second, had a rate close to two times lower than Poland (125.7%).

For a joint stock company the minimum initial capital required to be collected before registration is 500,000 zloty (125,000 euro) and this is a very restrictive level if the EU directive settled the obligatory minimum capital at 25,000 euro, which is five times less than in Poland.

### 3 LICENSING

Administrative control over access on the part of entrepreneurs to business activities has evolved very much in the course of the transition period (Balcerowicz, 2004). Yet the scope of government intervention in the freedom to start and conduct business is still large. A second important observation to make is that information about licenses and permits is very much dispersed so it is not easily accessible: except for the general law that settles the general rules of licensing (and this is done by the Law of 2 July 2004 on Economic Freedom), there are numerous parliamentary laws and ministerial regulations stemming from the laws that settle rules for specific activities. The total number of those legal acts may be 1,000<sup>11</sup>, which gives a rough picture of the complexity and non-transparency of this area of regulation. Furthermore, terminology used for administrative control exercised in individual types of activities does cause problems, and unification is very much desired, though we may hardly expect it to be undertaken as it would require a huge revision of the law.

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<sup>9</sup> Such a recommendation was made last year by CASE team that worked out the complex reform program that should be introduced in order to improve macroeconomic fundamentals and the competitiveness of the Polish economy in the context of the enlarged EU.

<sup>10</sup> In New Zealand, USA and Canada the relative cost of establishing a limited liability company does not surpass 1% of GDP per capita).

<sup>11</sup> This number is actually unclear. Paczocha (2004) provides the estimate of 1,000.

Administrative control over access to some business activities currently takes different forms: issuance of a concession or a permit, registration of a business entity in the register of so called “regulated activities”, issuance of a license, and regulation of professions.

### 3.1 Concessions

Concession is the strongest instrument in the hands of the government, as it gives some discretionary power to the deciding body of the government. Therefore it is good that the number of activities subject to concessions is very limited and that the new Law on Economic Freedom cuts this number from eight to six areas. These areas are:

- Search, exploration and excavation of minerals and mineral material; non-tank storage of substances in mounds and storage of waste in underground mines;
- Manufacturing and trading in explosives, weapons and ammunition, as well as in goods and technology for military or police use;
- Production, processing, storage, transmission, distribution and trade in fuels and energy;
- Protection of people and property;
- Air transportation;
- Broadcasting of radio and television programmes.

Altogether in these six areas there are 31 activities for which a concession is a must in order to be able to conduct a business.

It is important that a concession is granted for no less than 5 years (unless otherwise requested) and up to 50 years. The Law says that all entrepreneurs may apply and all must be treated equally. In order to be considered, entrepreneurs must prove that they fulfil conditions specified in the relevant law. The new rule (introduced in 2004 by the Law on Economic Freedom) is that if the number of concessions to be granted is limited and lower than the number of applications, then a public tender must be announced. The winner should be the company that offers the highest concession fee.

The cost of application differs and the process is time consuming: the authority granting the concession alone may use up to 2-3 months to take a decision.

### 3.2 Permits

A permit is an instrument of administrative intervention that is friendlier to the entrepreneur, as it does not – at least formally - leave room for discretionary decisions. To obtain a permit a business person or a company must prove that it complies with specific conditions that are written down in the provisions.

Currently, access to 73 areas of business activity is under direct administrative control and within these areas there are 191 permits in total for specific activities that need to be obtained in order to be able to conduct the business (Paczocha, 2004). Most permits are granted by governmental bodies, and some are in local government domain (like road transportation, tourism services, and sales in alcoholic beverages).

Obtaining a permit is costly: besides the fee for submitting application and receiving the permit, there are costs related to collecting all documents required by the law. The authority that issues permits has from 1 to 3 months to process the application and grant the right to conduct the controlled business activity.

### 3.3 Regulated activities

This is a new category and one that is not clearly defined. It has been introduced by The Law on Economic Freedom of 2004 for a group of 34 activities listed under this Law. All of them under the previous legal regime were subject to permits. The difference between the permit and the status of the regulated activity is that while to get a permit a business person or a company has to deliver all necessary documents to prove that he/she/it complies with conditions required, in case of a regulated activity the solemn statement (in writing) suffices. The governmental body running the register of a regulated activity is obliged to enrol the business entity in the register in 7 days time after receiving the request. If it fails to do so within 14 days, the entrant may start the activity without being registered; though the subject authority must be informed of this fact. The approach adopted is a revolutionary one: less bureaucracy, a cheaper and quicker procedure. However there is also the stick: if an applicant does not in fact meet the conditions, i.e. his statement is found dishonest during the audit, there is a severe penalty in place. This includes removal from the register and a 3-year ban on conducting the activity.

### 3.4 Regulation of professions

Market entry and conduct of 131 professions is regulated in Poland. This is much more (by 40%) than it was in pre-transition times when 93 professions were regulated (Paczocha, 2004). New on the list of regulated professions are those occupations that did not exist under the command economy, like stockbroker, real estate appraiser, or actuary.

Usually these are government bodies that supervise the entry and removal from the registers, as well as the conduct of professionals. However, in a number of cases, these rights have been passed to professional societies. The membership of these societies is mandatory and their objective is to ensure that their members adhere to the legal, merit and ethical rules regulating the professions. However, in the case of the legal professions (legal counsellor, attorney, notary) bad practices have been observed in recent years. The relevant societies, by internal regulations, have limited entry, controlled prices, banned advertising of services and decided on the territorial allocation of legal services. These have increased costs for customers and made legal services unaffordable for the poor, while limiting the freedom of legal service providers to choose the occupation and to offer legal services. On top of this, nepotism in the selection of candidates for the legal professions has been proven, which has received much publicity. This has helped to build public support for the liberalization and reform of the legal societies. In August 2005 the Parliament passed the Law on the Legal Professions that relaxed the entry and introduced state examinations (replacing examinations administered by the professional societies). Despite an outcry from current members of the legal societies and the Minister of Justice (a legal attorney himself, and chairman of the National Council of Legal Attorneys since 1995), the President has signed the Law.

## 4 TAXATION

Taxation is uniform across the country, with the exception of rates variations which are allowed to occur at the local tax level<sup>12</sup>. Local taxes do not play a significant role, however. Foreign companies and individual persons running businesses registered in Poland pay the same taxes as Polish legal and natural persons, unless an agreement on avoidance of double taxation has been signed between Poland and the country of origin of a foreign investor, stipulating a different option.

The main taxes in Poland are: corporate income tax (CIT), personal income tax (PIT), value added tax on goods and services (VAT), excise tax, stamp duty (tax on listed civil law transactions). The two main local taxes are real estate tax and road vehicle tax, which is imposed on trucks and buses only.

Taxes, their rates, and the responsibilities and rights of taxpayers may be and are imposed by parliamentary acts only.

Taxpayers may appeal to the tax chamber against the tax decision of the local tax office or fiscal audit office. In case of unsatisfactory decision of the tax chamber, a taxpayer may submit an appeal to the Regional Administrative Court. Since 1 January 2004, the Supreme Administrative Court has had the power of review over decisions of the Regional Administrative Court.

Until recently, taxpayers were not able to receive advance rulings, while interpretation of tax liabilities, due to the complexity of tax regulations, has been a big problem. Taxpayers might have asked their tax office for clarification of their cases, however questions should have been clear-cut and taxpayers had to present their understanding of their tax obligations; otherwise their application would have been sent back to be completed. However, information received from the tax office at the taxpayers request was not a binding ruling; the taxpayer was, at the end of the day, responsible for his tax obligation. Having the ruling was helpful in the sense that in cases where a decision by the tax audit differed from the one presented in the tax office information, the taxpayer was released from paying penalty interest on tax arrears and penalty liability.

Under pressure of entrepreneurs' organizations and despite strong opposition from the Ministry of Finance, which is responsible for taxation, in the course of preparation of the Law on Economic Freedom, this practice has been stopped. Poland has followed the example of developed market economies and as of 1 January 2005 a taxpayer may apply to his/her/its tax office for a binding ruling. This makes the Polish tax law foreseeable<sup>13</sup>.

The tax office is obliged to deliver the ruling within 3 months. Failure on the part of the tax office to meet this deadline works in favour of the taxpayer, whose interpretation put forward in the application is by law considered to be correct and binding. In the first six months of the rule of this Law ca 40.200 applications were submitted<sup>14</sup> which is a sign of the complexity and lack of clarity in tax law. This number was 30% larger than in the same period of 2004, when the previous rule of non-binding information was in force. Every second application dealt with VAT, while 30% requests regarded PIT, which points to

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<sup>12</sup> Since local communities may establish rates below the ceiling rate set by the parliament (or by decree of the Minister of Finance).

<sup>13</sup> Tax experts say that, from the point of view of investors, the foreseeability of tax law is more important than tax relief.

<sup>14</sup> Official data delivered by the Ministry of Finance at the press conference. See <http://www.informacje.strefa.pl/podatki/info/news?inf=650195>.

these segments of the Polish tax laws as most complicated and least transparent. Interestingly, in a majority of cases, the rulings were in line with the taxpayers' interpretations.

One of the arguments against the introduction of binding rulings raised by the Ministry of Finance was that the tax administration may not be able to cope with the applications which were expected to be numerous and that the other duties of the tax offices will suffer. According to the official statement of the deputy Minister of Finance<sup>15</sup> in charge of taxation, 3,881 tax offices' employees were shifted to deal solely with taxpayers' applications and 233 employees in tax chambers. The Minister admitted, however, that the rulings have been made on time.

#### 4.1 Tax regimes for natural persons running a business

Individuals running a specific business are favoured as they may choose the simple taxation, which is either *tax charter* or *quota revenues tax*, or may decide to pay PIT instead. The opportunity for choice has been reduced in the past seven years however, and more activities have gradually been placed under the PIT regime (see Section 4.3 below).

The tax charter is the simplest tax. It does not require an entrepreneur to maintain accounts for external purposes. There is a lump sum that has to be paid monthly and its value is established and announced on a yearly basis. The tax depends on the type of activity, the number of employees and the localisation of the business. Generally it is rather low, though it is applicable to a limited number of activities, mostly to services for population. An additional criterion for choosing the tax charter is that a business has to be small in terms of employment: for each type of activity there is an upper limit on the number of employees, varying from 0 to 5.

Quota revenues tax may be adopted by individuals who either (1) run business activity, or (2) perform independent services of certain types, or (3) rent real estate, and under the condition that their yearly revenues from business activities in the preceding year did not exceed a specified limit, which for the year 2004 was the equivalent of 250,000 euro. The owner of a business pays a quota tax according to a flat rate, which varies from 3% (for trade) and 5.5 % (manufacturing and construction) to 20% (artistic, literary, scientific, educational, journalistic activities, copy rights and managerial services), and revenues with VAT deducted constitute the tax base. Payments are due monthly and accounts required by tax law are very simple – only the revenues have to be registered.

It is important to note, that economic activity in agriculture (including agro-tourism) has not been taxable, i.e., farmers (individuals) do not pay income tax unless they also run activities other than agriculture.

#### 4.2 CIT

Companies registered in Poland are subject to corporate income tax; according to Ministry of Finance there were 249,345 companies that were under the CIT regime. The tax rate is 19%, and this is a substantial improvement as compared to 40% rate during the first years of the transition. Starting from 1997 the rates were gradually cut. The recent and substantial cut from 27% (in 2003) to 19% (as of 1 January 2004) was for sure influenced by the good practices in other emerging economies. Currently a number of transition economies have the same or yet lower CIT rate than Poland: the leaders are Lithuania, Latvia, and Bulgaria with a rate of 15%, Hungary and Romania – 16%, Slovakia -19%.

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<sup>15</sup> After the first quarter of 2005, see <http://www.twoja-firma.pl/wiadomosc/9585.interpretacje-podatkowe-jak-pomasle.html>.

The effective rate (i.e. after deductions) was in 2004 by 2.1 percentage points lower and accounted for 16.9% (Rzeczpospolita daily, 10 August 2005). CIT is due on a monthly basis.

### 4.3 PIT

The tax year for individuals is the calendar year and PIT is due on a monthly basis. Polish employers are obliged to calculate, withhold and pay the tax advances due on the remuneration of their employees. Individuals who receive incomes from abroad are obliged to pay advances themselves. Individuals are obliged to fill in an annual income statement in four months time after the year is over, calculate yearly tax due and pay the difference between the tax due and advances paid or request for the amount overpaid.

Individuals who themselves run business activities (sole proprietorship) and choose PIT tax regime or are subject to PIT by law (i.e. cannot choose another tax system for themselves, see Section 4.1.) currently have two options: they may either opt for one rate PIT of 19%, but in doing so they cannot use any tax benefits. In 2004 there were 200,500 individuals running business that chose 19% PIT (Gazeta Wyborcza daily, 6-7 August 2005). The option of one rate PIT for businessmen was introduced on 1 January 2004, together with the lowering of the CIT rate. Since then a unified rate of 19% applies to business, independent of their legal form.

Tax reliefs remain available for those individual businessmen who declare to pay PIT on the regular base, which is progressive and has three rates: 19-30-40%. Regular PIT is also obligatory for individuals who are not running business activities on their own account (i.e. for employees). Altogether in 2004 there were 23.8 million taxpayers under the progressive PIT regime.

The regular PIT system (with three tax rates) has been complicated due to tax reliefs. Furthermore since its introduction in 1992 PIT has been an unstable system, since tax reliefs were subject to numerous changes that went in different directions (Balcerowicz 2003). Increases in benefits were always the results of competition for popularity of parties represented in the parliament, while cuts in tax benefits, freezing of a non-taxable income and threshold limits for higher rates, and increases in tax rates<sup>16</sup> were forced by the deteriorating state of public finances.

In the most recent three years, tax benefits have been gradually limited and currently the main ones are the joint (with a spouse or with a child in the case of a dependent parent) filing, different housing reliefs, and deduction from taxable income of expenses for using the Internet. Interestingly, since 2003 taxpayers may decide to pay 1% of their annual tax to organizations that have the charitable status. The PIT burden is high in nominal terms: a non-taxable yearly income is very low (2,790 zloty, which is equivalent to 697 euro) and threshold limits for higher rates are low as well: already for yearly income above 37,024 zloty (9,256 euro) 30% tax rate is applied, while 40% rate is established for net income exceeding 74,048 zloty (18,512 euro). The effective rates, however, are substantially lower: for taxpayers falling in to the first rate it is 13.5% (in 2004) (vis-à-vis nominal 19%); for the middle group it is 18.6% (vis-à-vis 30%) and for the third 28.7% (vis-à-vis 40%) (Gazeta Wyborcza daily, 6-7 August 2005).

The PIT burden is high in relative terms as well: in 2004 5.2% of the taxpayers falling in the medium and highest rates contributed 40.5% of the total PIT budgetary revenues (Gazeta Wyborcza daily, 6-7 August 2005). The Polish personal income tax system is restrictive also if compared with other transition countries which have reformed their tax sys-

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<sup>16</sup> The case in the years 1994-1996.

tems in recent years, reduced tax rates, and in some cases replaced progressive tax with proportional one<sup>17</sup>.

#### 4.4 VAT

Value Added Tax was introduced in Poland in July 1993. At the start of VAT operation companies with revenues up to four billion old zlotys (then ca 218,000 USD) were exempt from VAT. The general trend for the whole period is self-evident: more and more business entities pay VAT and the threshold has been reduced to such an extent that only very small enterprises are VAT-exempt. Currently a business entity has to register for VAT once its annual turnover on transactions subject to VAT exceeds 10,000 euro.

VAT law has been subject to significant changes in 2004 in connection with Poland's accession to the EU. Currently, Polish regulations are in line with EU directives. The VAT base has been substantially enlarged and VAT is levied on every supply of goods and services, unless the transaction is by law exempt (see below). Exports and imports to and from EU member states were replaced with so called intra-community supply and acquisition. The rules for VAT recovery were changed. New rules on the place of taxable supply of goods and services were adopted. As a result of these profound changes, the VAT environment is not stable, as there are many interpretative controversies and various practices of the tax authorities. This explains why requests for binding rulings are made most often with regard to VAT regulations.

There are four VAT rates; the primary one is 22%, and it has been in use from the very beginning of VAT operation in Poland. This rate, which is one of the highest in the EU, is charged on most goods and services. A reduced 7% VAT rate is imposed on the sale of some foodstuffs, medicines and goods used in health care, certain children's goods, hotel and catering services (until 31 December 2007), construction and repair services for households (also until 31 December 2007), some passenger transportation services, municipal services (water supply, sewage treatment, street maintenance) and fertilisers. 3% VAT rate is imposed on (primary) agricultural produce; the extension of VAT to agriculture was made in September 2000 after a heated debate and despite pessimistic forecasts of price increases for food. A reduced 0% VAT rate is levied on the sale of books and certain (professional) magazines. 0% rate is applied to the intra-community supply of goods and services, exports of goods, some international transport services and services related to international transportation. Sale of some services is exempt from VAT: this is true of research and development services (until 2007), educational and cultural services, some financial and insurance services. In their cases the supplier cannot recover input VAT incurred in relation to these services.

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<sup>17</sup> Slovakia and Romania, for example, have introduced proportional PIT, with 19% and 16% rates respectively. Hungary has eased the tax burden by cutting the number of rates to two and lowering them to 18% and 38%. The Czech government very recently (in September 2005) took a decision to lower in 2006 the first two (out of four) rates to 12% and 19% from the current 15% and 20%.



## 5 LABOUR AND LABOUR COST

### 5.1 Employment of a foreigner

As already mentioned this area is under administrative control. To be employed in a company registered in Poland (whether domestic or foreign) a non-Polish citizen must have a work permit. There are four cases when the work permit is not required, and these are when a foreigner:

- Has received a permit to settle in Poland, or
- Has a refugee status (which is very difficult to obtain), or
- Is a UK, Irish or Swedish citizen<sup>18</sup>, or
- Is an EU national (other than UK, Irish, and Swedish) and has worked on a work permit in Poland for at least previous 12 months.

Work permit is issued by the voivod, i.e. the government nominated head of the voivodship, with jurisdiction over the territory where the applicant company is registered. The work permit is a detailed one: it is granted for a specified and limited period, to a defined person (to be employed) and a defined company (employer), for a specified position and type of work. The procedure is a long one (it consists of three stages which, taken together, last at least 3 months), troublesome for both potential employee and employer (many documents needed) and costly. Also the final result is not foreseeable, as the final decision is left for the voivod, who may reject the application, even if the documentation is complete and all conditions are fulfilled.

The main purpose behind limiting the access of foreigners to the domestic labour market has been the protection of jobs for Polish citizens, which has to be seen in the context of the unemployment rate in Poland. With 19.1% registered unemployment by the end of 2004<sup>19</sup> Poland ranked first in the EU-25. Thus, an applicant's task is to convince the voivod that for specified reasons the work can best be done by a specific non-citizen. The lengthy procedure, in which the (state) Labour Office is involved, is designed to check if the job can be performed by a Polish specialist in the field, who is looking for a job.

The labour market protection regulation requires big and wealthy companies to bear the costs and risks of fixing work permits for highly qualified specialists from abroad. This severe regulation of employment of foreigners has turned out to be totally ineffective in the case of jobs requiring fewer qualifications and for which remuneration is poor. Faced with a lack of interest on the part of Polish workers to take jobs, as well as high social security payments, entrepreneurs employ foreigners illegally. This is possible in less controlled industries (like construction, restaurants, and personal services). Some 50.000 to 300.000 foreigners are estimated to work illegally in Poland (Frelak, 2005), mostly of Ukrainian origin. The real number might be even higher<sup>20</sup>.

Interestingly, public opinion is generally positive toward foreigners working in Poland, and there are no political parties that are against job immigrants (Frelak, 2005). Therefore recommendations for easing job protections for Polish citizens and relaxing migration pol-

<sup>18</sup> These EU member countries are treated preferentially because they have opened their labour markets to Polish citizens.

<sup>19</sup> This was despite decent economic growth in the years 2003-2004. In July 2005 the rate decreased to 17.9% ([http://www.stat.gov.pl/dane\\_spol-gosp/praca\\_ludnosc/stopa\\_bezrobocia/index.htm](http://www.stat.gov.pl/dane_spol-gosp/praca_ludnosc/stopa_bezrobocia/index.htm)).

<sup>20</sup> There have been 589,000 visas granted by the Polish consulates in Ukraine in 2004, and it is reasonable to assume that non-business trips must have been rather seldom.

icy are in fact welcomed by the public. This issue has not, however, yet been raised by any political party or the government.

## 5.2 Social security payments

Social security contributions have been a serious financial burden for companies in the entire period since transition was initiated in Poland in 1990. After the recent cuts in CIT rate and PIT rate for individuals running businesses (see Sections 4.2 and 4.3 above), social security contributions have become the main problem. First, the rate of this contribution has been high and currently constitutes from 38.54 to 41.43% of the salary. Social insurance in Poland covers pension, disability, accident and sickness insurance and payments for each type of insurance are calculated separately according to obligatory rates. On top of these four an employer pays two labour taxes: since 1990 2.45% of salary is contributed to the Labour Fund, established to finance pro-employment programmes organised by the specialised governmental Labour Bureau, and since 1993 a small tax (currently 0.15% of the salary) collected by the Fund for Guaranteed Employees Benefits, which pays salaries to employees when their companies are in financial distress and do not have cash to service their debt vis-à-vis workers.

The second important feature of the social security system in Poland is that in the course of time the base for its calculation has gradually widened (for details see Balcerowicz 2003). The reason has been that the government, faced with the necessity to cover the growing spending on pensions, tried to close the possibilities of entrepreneurs escaping from social contribution payments by choosing non-taxed types of work contracts. What remains an option for employers is to request their employees to establish one-person businesses and then to sign contracts for their services. This option is profitable for both parties.

There has also been a change for the better, however. As of 1999 there is an upper limit of the cumulative annual individual's earning over which the social contributions until the end of the current year are substantially lowered (to 6.02% - 8.91%), since only accident and sickness contributions and two labour taxes are due. For 2005 this limit is fixed at the level of 72,690 zloty (i.e. 18,174 euro)

It is worth adding that, until 1999, it was the exclusive responsibility of an employer to pay social security contribution for employees, i.e., employees did not participate in this payment at all. In the 1999 pension reforms two important changes to social security contributions were introduced. The first one is positive: the payment of social security contribution now is shared by an employer and an employee, though the responsibility for contribution calculations and money transfers to the Social Security Fund was imposed solely on employers. The second change is negative: in connection with the pension reform it is an employer who has been burdened with much extra paper work to be carried out monthly and without financial compensation.

In the case of sole proprietorships the owner has the right to declare the amount of his monthly income (wage) which is to be subject to social security contributions. However there is a minimum level of social security contributions (equal to 60% of the average salary in the enterprise sector) that have to be paid by all entrepreneurs for their insurance. Currently (Autumn 2005) the amount of the minimum monthly social security contribution is 666.61 zloty (166.6 euro).

To enhance job creation recently a new incentive has just been introduced. For the new entrepreneurs – natural persons establishing sole proprietorships after 24 of August 2005 monthly contribution to the pension system per employee has been substantially decreased (to 254.70 zloty, i.e. 63.5 euro) as compared with the general rate. For the first 24 months

of their activity they will pay to ZUS 30% of the minimum wage, while the old sole proprietorships are bound to pay 60% of the average salary for the enterprise sector. As a result one may expect increase in employment in SME sector, some of it being only a shift from the grey into the legal (formal) economy. However one may also foresee closure of existing enterprises and new registrations just for the sake of profiting from this tax privilege.

### 5.3 Minimum wage

A minimum wage has been in effect in Poland since 1956 and has remained in force after the departure from the command economy in the years 1989-90, despite waves of criticism by entrepreneurs and labour economists. The basis of calculation is a 'social minimum' (measured by a minimum consumption basket) and price increases. The minimum wage is generally considered to be high: in the years 1997-2002 it accounted for 29.8-37.0% of the average wage in the enterprise sector. This year (2005) it is 849 zloty (approximately 212 euro) which is 35% of the average salary. Despite the vast differentiation in living costs and average wages between regions, the minimum wage is uniform across the country. For these two reasons companies, especially those situated in regions with lower labour costs, get round the minimum wage by manipulating the number of hours worked, i.e., an employee works full time, but signs a contract for less than full time.

In July 2005 the parliament, completing its four year term and facing the parliamentary election campaign, changed the law to make it (in fact as we know formally) more favourable to employees. The law proposal has been submitted by deputies and against the opinion of the government and employers associations. Under the new regulation the minimum wage will grow faster than under the current one as it will be linked not only to increases in prices, but also to GDP growth forecast. The aim is that the minimum wage will gradually grow until it reaches 50% of the average salary.

## 6 REAL ESTATE OWNERSHIP

To buy real estate (i.e. land, building, apartment, office space) in Poland, a foreign investor needs to have prior permission from the Minister of Internal Affairs and Administration (MSWiA); the additional approval of the Minister of Defence is required. In the case of farmland the approval of the Minister of Agriculture is also necessary.

The permission is required also in the case of acquisition by a foreign investor of shares in a company registered in Poland, if a company owns real estate or holds the right to long-term lease of real estate. This requirement does not hold in the case of shares traded on the stock exchange.

This general rule applies to real estate that is placed on an area exceeding 0.4 ha of land; plots below this size may be bought freely without administrative intervention, but only if they are to be used for company's statutory purposes.

MSWiA is obliged to process an application and make a decision within a limit of two months and in the case of real estate in a Special Economic Zone (see Section 7.1) within one month. These limitations may not be respected if the documentation required is incomplete, and this reason might have explained delays in some huge privatisation dealings in 1998-2001, and might have been used on purpose in some cases as well.

Permissions ceased to apply to foreign investors (both individuals and companies) coming from EU member countries once Poland joined the European Union, i.e. from 1 May, 2004. However, under the pressure of some political parties (especially the Polish Peasant Party) hostile to liberalization of land trade, the Polish government introduced two permanent exceptions to the general freedom to buy real estate. Purchase permit is required in the case of farmland and woodland and this rule will be in force until May 2016. The second exception is for second homes – here the purchase is conditional to obtaining the permit. This rule has been fixed for 5 years from the date that Poland joined the EU, i.e. until 30 April 2009. However, there are exceptions to this requirement. In the case of farmland and woodland the permit is not required for a leaseholder that has the contract for seven years (in the western regions of the country) or 3 years (in other regions) and who directly conducts agricultural activity and also lives in Poland legally. As far as “second homes” are concerned, EU citizens may buy these without permit if they can prove to have lived in Poland legally and continuously for four years or if they need the property in order to run a tourism activity.

Office rental may be a good replacement for the troublesome permit procedure, especially as the office market has flourished in recent years, and as a result rents have decreased substantially as compared to the first half of the 1990s, while technical standards have increased by far. Rental contracts have also become more standardised, and thus more secure.

## **7 INVESTMENT SUPPORT**

There are two main support schemes for investors: investment grants and tax exemptions for entrepreneurs investing in economic zones.

### **7.1 Special Economic Zones**

The opportunity to create special economic zones was established by the Law on Special Economic Zones, which was enacted in 1994 after a fierce debate and under the pressure of local lobbies wanting to attract investment into their regions. The introduction of the Law drew much attention from both researchers and policy-makers. The policy-makers then in power viewed it as an effective instrument of regional policy aimed at enhancing investments in regions with substantial structural unemployment. The main argument against SEZ raised by opponents of the Law was that the creation of favourable conditions in selected enclaves would distort competition (Balcerowicz, 2003).

During the first three years of the operation of the Law, 17 economic zones were established. In 1997, however, with a new and liberal government in power, this process was stopped. Companies established in an SEZ and reinvesting profits were exempt from taxes for half of the period for which the particular zone has been established (most for 20 years, a few for 12). Furthermore, for the subsequent 10 (or 6) years the companies were promised tax relief of 50% on reinvested profits. The tax exemption was conditional: a company must have invested a minimum amount of money and created a minimum number of new jobs. Moreover, companies investing in special economic zones were usually exempt from the payment of local taxes

Since 1999 the SEZ issue was the hardest area in the Poland-EU negotiation chapter on competition, as the rules applied in Poland were not in line with the criteria used for state aid in the EU. The final outcome of the negotiation was that the area covered by SEZ (6325 ha) will not be enlarged, however all SEZ will operate for the full period envisaged originally, i.e. until 2015, 2016 or 2017. The privileges that may be offered to new investors have been reduced as compared with the original ones. Since 2001, when the revised Law on Special Economic Zones came into force, large enterprises investing in SEZ can obtain state subsidy in the form of exemption from CIT or PIT at the amount of 50% of the investment value, while for medium-sized enterprises the limit is 65%. Investment value may not, however, be less than 100,000 euro and must remain for at least five years in an SEZ. Investors may choose another state aid option: exemption from CIT or PIT of up to 50% (large enterprises) or 65% (medium ones) of the value of the labour costs of the new staff employed over two years and under the condition that new jobs will be maintained for at least five years.

The original SEZ program assumed that the total area of SEZ will be populated fully in five years time and investors will create 100,000 jobs (Ministry of Economy and Labour, 2005). These expectations turned out to be unrealistic. In the first seven years interest was rather small, and only since 2002 has there been a substantial increase in business activity in the 14 SEZ that are currently in operation. As of 31 December 2004 there were 429 enterprises established in SEZ. They have invested 20 billion zloty in total and created 77,600 jobs (Ministry of Economy and Labour 2005). It is obvious that the scale of the program is rather small. Moreover, it is not clear how many jobs would have been created anyway, i.e. without special incentives. What we know is the relative and direct volume of subsidies obtained by investors, which until 31 December 2004 accounted for 8% of the investment outlays incurred by companies in SEZ.

Only 54.8% of the total area of SEZ is being occupied (the figure differs very much for individual SEZ), so there is still much room for new investors. The Ministry of Economy and Labour is positive about new investments, as it has registered rising interest in the past year. However as the whole program is to expire in 2017, the last investment may be expected to be made in 2011.

Interestingly, SEZ are occupied mostly by FDI: their share in total investment volume was 79%. American and German companies dominate, with each having a share slightly above 20% of the total amount (Ministry of Economy and Labour, 2005).

## **7.2 Investment grants**

Investment grants targeted at enterprises (foreign and domestic) are a new instrument used to support investments. Investment grants were introduced in 2002 by the Law on the Financial Support of Investment and were in line with the EU competition policy (Cukrowski and Jakubiak, 2004). Due to Poland's accession to the EU the Law was amended in 2004 and grants are now available under the Sectoral Operational Programme Increase of Enterprises' Competitiveness and are co-funded by the European Regional Development Fund and the Polish state funds.

Investment grants may be extended to investors that satisfy one of the following conditions:

- their investment is in the range of at least 10 million euro;
- they invest a minimum of 500,000 euro to modernise or grow an enterprise and this contributes to the retention of a minimum of 100 jobs for five years;
- they create at least 20 new jobs for a minimum of five years;

- they introduce technological innovations;
- their investment improves the natural environment;
- they invest within an industrial or technology park.

If one of the above listed conditions is met, an investor may obtain an investment grant of a maximum of 25% of the eligible investment costs. This limit is smaller for investments in big cities where investment tends to concentrate: for Warsaw and Poznan – it is up to 15%, for Cracow, Wroclaw, Gdansk, Gdynia and Sopot – up to 20%. Small and medium-sized enterprises are treated preferentially, as they may receive additionally equivalent of 7.5% of the eligible investment expenditures.

Another option available is an employment grant, which is extended per each job created and up to a maximum of 4,000 Euro.

In case of both: investment and employment grants business activity or employment must be maintained for at least five years after the completion of the investment.

The submissions are reviewed by Ministry of Economy and Labour twice a year.

Besides the grants described above, there is a number of support instruments aimed at SMEs that operate in Poland and start-ups using advanced technologies. The Polish Agency for Enterprise Development is in charge of those instruments (see next Section).

### **7.3 Governmental institutions extending support to investors**

There are two government agencies whose role is to support private sector growth in Poland. The Polish Agency for Enterprise Development (PARP) was established in 2001<sup>21</sup> to enhance entrepreneurship and human resources development. Currently programmes undertaken by PARP are focused on:

- small and medium-size enterprises sector,
- export,
- regional development,
- promotion of modern technologies, and
- job creation, counteracting unemployment and human resources development.

The instruments employed include:

- direct grants to SMEs,
- grants to independent organizations supporting SME sector (these are some 150 co-operating business counselling centres grouped in the National Services Network; and 16 Regional Financing Institutions)
- facilitation of access for entrepreneurs to knowledge, training, economic information,
- advisory services.

PARP uses both budgetary funds and EU funds assigned to supporting entrepreneurship and human resources development; in fact it is responsible for the implementation of the programmes financed with the EU structural funds (Sectoral Operational Programme Increase of Enterprises' Competitiveness).

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<sup>21</sup> It took over the tasks and human resources of the Polish Foundation for Small and Medium Enterprise Promotion and Development, which was active in the years 1996-2000 and focused its activities on the SME sector.

The second government agency facilitating business activity in Poland is the Polish Information and Foreign Investment Agency (PAIIZ), which in 2003 took over the tasks of the previous two state institutions: the Polish Agency for Foreign Investment and the Polish Information Agency. PAIIZ's mission is to encourage FDI into Poland by assisting with all the administrative and legal procedures during the investment process. The Agency searches for appropriate locations for foreign investors intending to operate business in Poland, among others, and prepares individual investment packages in cooperation with the European Commission. The Agency's second task is to create a positive image of Poland and to promote Polish brands of products and services abroad. As compared with its predecessor, PAIIZ is very active, also in offering access to a variety of information relevant for prospective investors. Its web site ([www.paiz.gov.pl](http://www.paiz.gov.pl)) is well used for this activity. By opening its 16<sup>th</sup> office (in Poznan) last June, PAIIZ completed the foundation of a nationwide network of Investors Assistance Centres, which work as a one-stop-shop for investors that are considering establishing companies in individual voivodships. These centres cooperate closely with the regional governments.

## 8 GREY ECONOMY

According to estimates by the Central Statistical Office, the grey economy in Poland accounts for 13.2% (in 2003, which is the latest estimation available). It has been slowly but constantly decreasing (by 1.1 percentage point in the last four year period (2000-2003) for which estimations were done (see CSO, 2005b). The decrease in the relative size of the grey economy may be explained by shrinking legal room for unregistered activities in recent years (more activities were subjected to VAT, and cash registers were introduced for some services that, until recently, were not obliged to use them). Another reason may be a growing market (due to good macroeconomic performance Poland in recent years) which does not force enterprises to cut costs that much.

The main incentives to hide (parts of) commercial activities remain high contributions to the pension system (as discussed in Section 5.2) and high VAT rates (see Section 4.4). As for the first incentive, it is worth noticing that, according to government estimates, close to 1 million people worked in the grey economy in 2004 and this was 7.7% of official employment (total number employees, employers and self-employed) which was 12,737,000 (CEO, 2005a, Table 82).

The majority of grey economy revenues are generated by registered companies (9.4% of GDP); unregistered individuals contribute the remaining 3.8 % of GDP (CEO, 2005b, Appendix 4). By industries the main contributor is trade and repairs together with hotels and restaurants (6.3% of GDP), while construction ranks second in creating unregistered revenues (in the range of 2.2%). Interestingly, income generated in the grey economy is more often used for investment than consumption, which is a positive sign.

## 9 CORRUPTION

According to Transparency International in 2004 the Corruption Perception Index (CPI) for Poland was only 3.5 on a scale of 0 to 10, where 0 indicates high corruption and 10 indicates no corruption. Poland ranked 67 globally, and lagged behind all other new EU member-states<sup>22</sup>.

Corruption has been an issue of public importance for the past decade and is vividly discussed not only in public but also in private. Investigative journalism has emerged in the past several years and plays an outstanding role in disclosing dirty contracts, corruption and nepotism in politics, central and local governments, police, courts, business, and public medical care. The mass media is important in the context of an ineffective judicial system, as it forces prosecutors to start up or speed up investigations. However, the mass media itself is also accused of being corrupt, and of accepting payments for biased publications. The NGO sector has also developed a role in fighting corruption, since an “Anti corruption programme” was initiated six years ago to build watch-dog civil activities and promote clean government on the local level<sup>23</sup>.

Despite an anti-corruption media campaign and some protective measures taken by the Parliament and the government, corruption is not only perceived to be a serious problem, but also a growing one. According to the recent public opinion poll (May 2005) corruption ranks fourth on the list of the most severe social problems in Poland (after unemployment, poverty and the poor state of the health care system), while four years ago it was ranked sixth (Kubiak, 2005). During the last five years, for which regular surveys done on a country wide sample of adults exist, politicians (i.e. party activists, deputies and senators, local deputies are regarded to be the most corrupt; followed by the health care system and then the judicial system (Kubiak, 2005).

Interestingly, there are striking differences between the popular perception of corruption and individual experiences. The first is that individual experience tends not to support that corruption is as pervasive as it is thought to be. The second difference is that individual experiences indicate that since 2000 the scope of corruption remains at the same level, which is supported by three indicators. It turns out that each year the same portion of adult Poles (14-17%) have admitted to paying bribes. A steady percentage of people (21-23%) surveyed in the years 2002-2005 have admitted to personally knowing people that take bribes; this was actually down from five and six years previous, when 26 and 30% said so. The third proof is the stable share of the adult population that declares that they were offered a bribe (5-7%).

From investors' perspective it is important to note, however, that it is individuals running business activities that are most exposed to corruption. Nearly every second entrepreneur declares (as of May 2005) to know people that take bribes, while every fifth person in the whole population of adult Poles says so (Kubiak, 2005). 36% of businessmen admit to giving bribes, and this is 2.4 times more than the figure for the whole population. Interestingly, entrepreneurs also take bribes (14% admit to doing so) and this happens twice as often as the whole population. As far as businessmen' perceptions are concerned, they share the common view that politicians are the most corrupt. However, they regard public administration (central and local) as more corrupt than does the adult population (Kubiak, 2003). As they are, by nature of their occupation, more often exposed to contacts

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<sup>22</sup> See <http://www.transparency.org/cpi/2004>.

<sup>23</sup> See <http://www.batory.org.pl/english/corrupt/index.htm>.



with public officers, this research finding is an important indication. For 38% of entrepreneurs (as of June 2003) corruption (of public administration) was a barrier to the operation of their business, and ranked sixth on the list of 17 barriers enumerated. The others more prominently listed were tax arrears (no 1), economic slowdown (2), high personal income tax (3),<sup>24</sup> and difficult access to credits (4). Businessmen regard public procurement bids, licensing and customs clearance as the most corrupt economic spheres. Interestingly, they also experience corruption when supplying services or goods to private companies. In their opinion, in order to combat corruption in business, regulations must be simplified and clear so as to leave no room for interpretation.

## **CLOSING REMARKS**

The business climate for investment in Poland described shortly and incompletely in this paper is the outcome of the many reforms undertaken in the course of the 16 years of economic transition. The current business environment has also been influenced by changing economic policies focused to large extent on the alleviation of social tensions.

The business environment in the country should be viewed in a comparative perspective. Poland at the beginning of transition was a leader in the region, but in the last a couple of years has been lagging behind the late comers. Though Poland has made a substantial progress in many respects, other transition countries have reformed their economies faster - the Baltic countries and Slovakia being good examples here.

In order to further improve the investment climate in Poland and to facilitate economic growth, several changes need to be completed. The most important and urgent reform is fiscal consolidation, which should be focused on cutting budgetary spending. The decrease in spending would enable tax cuts and a decrease in social security contributions. Further changes in labour regulations are necessary to ease the rigidity of employment rules. There is a need to further deregulate the goods and services markets in order to ease the administrative burden imposed on investors. Privatization needs to be finally completed and, last but not least, the quality of public administration should be improved.

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<sup>24</sup> Let us notice that this survey has been done before PIT reform has been introduced as of 1 January 2004 (see Section 4.3).

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