IISJ CZ-WNS
INTERNATIONAL INTERDISCIPLINARY SCIENTIFIC JOURNAL CZ-WNS
internationalscientificjournalnews.eu

ISSUE 1, pp. 36-54

Damian Kuchta

Lodz University of Environmental and Life Sciences

damiankuchta7@o2.pl

TITLE: FINANCIAL INSTITUTIONS IN POLISH LEGAL SYSTEM

Summary: The aim of this article is to present the Polish system of financial institutions and its legal framework. Most attention will be given to banks. Taxation of financial institutions in Poland should be examined taking into account the provisions included in the Corporate Income Tax Act of 15 February 1992 (hereinafter: CITA) and the Tax on Goods and Services Act of 11 March 2004 Other statutes, such as the Banking Law Act of 29 August 1997 which contains legal definitions of terms such as “a bank” or “a credit institution”, should also be considered. In general Polish regulations regarding the taxation of financial institutions are adjusted to the European Union law, although some issues may raise justified doubts.

1. Financial institutions – general issues.

Financial institutions of diverse nature are of key importance for the development of the financial system of a country. Their role in the general economy is also very significant, much greater than it would appear from their share in domestic employment. In practice, their function as an intermediary between capital holders and enterprises that are willing to make use of this capital is essential for the development and functioning of the economy. Individuals, as well as enterprises, are in possession of financial surpluses. These surpluses are often temporary. A difficult task for financial institutions is the transformation of these surpluses in a way that enables them to be used for execution of investments. It is not possible on a small scale, however it can be done when well-functioning institutions are able to combine the capital of large numbers of individuals and legal persons. Financial institutions are thought to be wealthy and in possession of their own financial means. In fact they are among the wealthiest companies of the country, possessing considerable equity capitals - over two thirds of the high profits of the most Polish financial institutions are used by their owners for accumulation of the equity. Analysis of the liabilities shows that even in very wealthy financial institutions, equity capitals are only a small part of the money at their disposal. In practice, profits of financial institutions are generated by the right use of means of their customers or indirect banking operations.

1.1. The concept of financial institutions according to national legislation.

The term "financial institution" on the grounds of both European and Polish law is not uniform. Under European legislation, the term relates to all legal entities, institutions of credit, investment and insurance character providing financial

services on market terms. Article 1(5). of the Directive 2000/12/EC of The European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions limits the range of this term to entities that are neither credit institutions nor investment firms, and whose basic activity is carrying out financial services listed exhaustively in the directive as being subject to mutual recognition between countries. Such separation is justified by the need to adopt the definitions of certain terms for the use of a given legislative act. In doubtful cases precise determination of the meaning of this term must occur on the basis of comprehensive analysis of a given actual and legal state.

Legal definitions of the term "financial institution" are also non-uniform on the grounds of the Polish law. The broadest subjective scope has been attributed to this term in Art.12(1)of the Act of 4 September 1997 on the Branches of Government Administration[1] whereby the branch of financial institutions is competent in matters of banks, insurance companies, mutual funds and other financial institutions as well as the functioning of the financial market. Due to the character of this Act, this term applies only to legal entities with their seat in the territory of the Republic of Poland. Article 4(7) of the Code of Commercial Partnerships and Companies of 15 September 2000 (hereinafter CCPC)[2]attributes a similar meaning to this term, without limiting it to the territory of the Republic of Poland. The Code of Commercial Partnerships and Companies counts banks, funds (mutual funds, investment funds, pension funds), companies of such funds, insurance companies and brokerage houses as financial institutions – those with seat in the territory of the Republic of Poland or another member state of the Organization for Economic Co-operation and Development. The above-mentioned definitions describe financial institutions in broad sense and also apply to those legal entities that are not financial institutions within the meaning of Article 1(5) of the Directive 2000/12/EC or Article 4(1)(7) of the Banking Law Act.

[1] Journal of Laws 2016, item 543.
[2] Journal of Laws 2016, item 1578.

The definition of a financial institution formulated in Article 4(1)7 of the Banking Law Act is modelled after the resolution of Article. 1(5) of the Directive 2000/12/EC. This also applies to exclusion of the term 'bank' and 'credit institution' from its subjective scope – it was necessary due to the fact that in case of the European regulation credit institutions are subject to exclusion and the term 'bank' has a narrower subjective scope than the term 'credit institution'. Despite introducing a new definition of a financial institution, it does not correspond fully with the European solution. This lack of conformity relates to activities listed in Article 4(1) of the Banking Law Act. Share of those in the income from the enterprise determines whether a given entrepreneur can be classified as a financial institution. Annex I, to which the Directive 2000/12/EC refers, allows for financial institutions to (among others) grant loans (mortgage and consumer). Such a solution was not acceptable on Polish grounds, due to the fact that granting loans, as a banking operation in the strict sense has been exclusively attributed to banks.

*1.2. Operating principles of financial institutions in accordance with the Banking Law***.**

In the development of Polish commercial banking, two legal acts have been a significant breakthrough: the Banking Law and the Act of 29 October 1997 of the National Bank of Poland.[3] The laws reintroduced a two-tire banking system, thus rejecting completely the monobank model that had been functioning for 40 years.[4] In the nineties, commercial banks were largely influenced by the central bank- the National Bank of Poland (NBP). The scope of NBP activity was very broad and encompassed not only

[3] Journal of Laws 2016, item 1988.

[4] The model of a monobank is a one-step banking system. It is typical for countries with command-and-quota socialist economy. Another type is a two-tiered model of a banking system. The key quality of this system is the isolation of the issue function from the services rendered to the people. Therefore, in this model, a division exists between the central bank and the commercial bank.

operations reserved for central banks, such as issuing the national currency of the Republic of Poland, extending refinancing loans to banks, taking deposits from banks, conducting monetary settlements, managing foreign exchange operations, or providing banking services for the state budget. In certain areas, the central bank competed with newly established commercial banks, influencing their range of activity. These areas included: operating bank accounts in foreign currencies for domestic and foreign entities, accepting deposits, extending credits and loans. It should be noted that the new role of the National Bank of Poland (it performs regulative functions towards banks, which are aimed to secure the deposits in the banks and the stability of the bank sector) is connected with the development of domestic banking system and financial market.

Functions of banks determine its role in the market. Generally, banks are intermediaries on financial market but also occur as depositories or guarantors.

The definition of bank was general at first. The Banking Law of 1989 constituted that banks were "independent and self-financing organizational units, having legal personality, operating on the basis of legal acts and statues." Mentioned definition did not make an explicit distinction between banks and other entities. This problem was solved in the Banking Law binding since 1998. According to the definition given by this act "bank is a legal person incorporated in accordance with the provisions of law, acting on the basis of authorisations to undertake banking acts that expose to risk the financial resources entrusted to it under any redeemable title." As mentioned aboveThe Banking Law of 29 August 1997 provides for two-tier banking system. The adoption of this idea does not prohibit the creation of specialised banks. In Poland specialisation has various forms: mainly

functional and regional. Specialised banks are characterized by limited range of activity, types of operations and customers. It must be noted that one type of specialised bank has been established by a legal act – the mortgage bank. Competitors of mortgage banks are commercial banks. The competitive advantage and strong position of commercial banks is a result of financing loans with cheap deposits.

Article 5 of the Banking Law Act sets the object of activity of banks. The term ‘banking operation’ is not normatively uniform. Its diversity arises from using different criteria.Due to the objective character, two types of banking operations can be distinguished: banking operations in the strict sense (core banking activities, or basic banking activities), and banking operations in the broad sense(additional). Their ‘banking’ character depends (every time) on whether they are executed (by the bank) in accordance with Article 2 of the Banking Law Act. Banking operations (in strict as well as in broad sense) are executed as a part of economic activity of banks. This term should be interpreted in accordance with its normative definition included in Article 2 Act of 2 July 2004 On Freedom of Economic Activity.[5] According to definition included in the mentioned article, banking operationis an example of earning service activity, executed in an organized and continuous manner. The term of services executed by credit and financial institutions, functioning on European grounds, so-called financial services, includes banking operations as well as operations indicated in Article 6 of the Banking Law Act. The legislator’s use of non-uniform terms of imprecisely specified meaning leads to interpretative doubts, which may be used by the banks for broadening their privileges.

In case of lack of suitable norms of the banking law, as well as in the area

[5] Journal of Laws 2016, item 1829.

that it does not regulate, in matters regarding banks, laws regarding entrepreneurs and their business activity will apply.

2. Banking sector in Polish financial market.

The aim of this subchapter is to characterize banks in the context of the financial market in Poland. Institutional structure of Polish banks is created by two legal acts: the Act of the National Bank of Poland and the Banking Law Act. The financial market consists of transactions of exchanging money for a financial instrument (and inversely) but also exchanging a financial instrument for another one. The aim of these activities is to make profit and protect against risk. The financial market is composed of many various kinds of financial instruments, buyers and sellers of the instruments, as well as resources simplifying and carrying through these transactions.

The Polish market is dominated by banks in two aspects – regarding the value of assets and the number of transactions. Assets of financial institutions rose in the years 1998-2006 by about 196%, in the same time in banking sector by about 113%. The growth of the banking sector was the slowest among all financial institutions. On the other hand the most dynamically evolving entities were pension funds. The decreasing share of the banking sector in general assets of financial institutions in Poland was induced mostly by a change in preferences of households which is connected with the way of investing surplus funds. Surpluses were spent especially on consumption, which was beneficial for economy. A similar trend was continued in subsequent years.

The analysis of the level of development of the Polish market can lead to the conclusion that the role of the banking sector may decrease in contrast to

other segments of the market. However, it must be emphasized that banks are still the dominating institutions.

2.1. Basic rules of the income tax system of domestic banks.

The Corporate Income Tax Act (in action since 1992), despite its functioning for several years, in practice, is still a source of many problems. This is mainly not because of new and developing economic structures, but because of changes being made to the statute by the legislator.

Article 1 of the Corporate Income Tax Act regulates the subjective scope of the tax, including legal persons amongst its taxpayers and also specifies the type of the tax, prescribing that income is the tax base. Income may be reduced by deductions listed in the statute. In the process of interpreting CITA provisions it must be taken into account that an intrinsic characteristic of income tax is reduction of gross income by tax deductible expenses. Any exceptions to this rule, especially those indicated in Article 16 of the CITA should be interpreted strictly so as to minimize exceptions to the main rule. Taxpayers of the CIT are legal persons as well as share-holding companies in organization. In accordance with Article 33 of Polish Civil Code (hereinafter: the CC)[6], legal persons shall be the State Treasury and those organizational entities upon which special provisions of law confer legal personality. The above-mentioned regulations relate closely to banks, which, in accordance with the Banking Law Act, are "legal persons, established in accordance with the applicable laws, operating under authorization to perform banking transactions involving any risk for the funds entrusted to the bank and repayable in any way."

[6] Journal of laws 2016, item 380.

The rules for the taxation of banks, that, on the grounds of Polish law, are legal persons, have been regulated in the CIT Act. In general, they do not differ from the rules for taxation of other legal persons. It should be noted, however, that some differences occur, which have been described in subchapter 1.2.1.Article 6 of the CIT Act lists the units that are subject to a subjective exemption, those include the National Bank of Poland. The entities listed in that article do not file a tax return. According to the general rules, the subject of taxation with income tax is the income, regardless of the type of source of income, from which it has been derived. In case, the taxpayer has incurred loss in a tax tear, their income in the following five tax years may be lowered by the amount of that loss, given that the amount the income is lowered by in any of those years may not exceed 50% of the amount of the loss (article 7 of the CITA). As regards exemptions (Article 17 of the CITA), objective exemptions are provided in the CIT Act, including those for taxpayers such as public benefit organizations. In the case of such taxpayers, only the income allotted for the realization of those statutory aims is subject to exemption from tax.

The tax base consists of the income derived by a legal person (the revenue lowered by the deductible costs) in a given tax year, with the possibility of performing certain deductions.

According to Article 18(1)(6) the tax base is income after the deduction of 20% of the amount of loans. In order for the lost loans to be considered while settling the tax base, they should be qualified as lost and included in the deductible costs.

The tax rate is 19% of the tax base subject to Article21 and 22. The taxpayers and withholding agents do not supply tax declarations during the tax year, but are obligated to advance payments. This is also the case when

the income tax is collected within a lump-sum method. During the tax year the taxpayers can also calculate the tax advance payments in a simplified form (art.25(6-10) CITA). The payment of the advances is, then, dependent on the input tax specified in the tax return filed in the year preceding the given tax year or the return supplied in the year preceding the given tax year by two years.

Taxpayers are obligated to file the declaration regarding the amount of income (loss) derived in a tax year until the end of the third month of the following year and until that date pay the input tax or the difference between the input tax from the income specified in the declaration and the sum of advances due for the period from the beginning of the year (Article 27 CITA).

2.2. Differences between banks and commercial companies in the context of income tax rules.

Differences between banks (or financial institutions) and other commercial companies should be examined in the context of provisions regarding tax exemptions. Allowances and exemptions are not obligatory construction elements of the tax. They are not, thereby, essential elements of the tax norm, which means they are a significant, but not independent, element of this norm. In the moment of introduction of an allowance, it becomes an additional construction element of the tax, influencing the size of the tax burden.

According to Article 6(1)2 of CITA, the National Bank of Poland is exempted from corporate income tax. Article 1 of the Act of on the National Bank of Poland, defines the National Bank of Poland as the central bank having legal personality. Consequently, being a legal person separate from the State Treasury, it is in the subjective scope of taxation with the corporate

income tax. Due to its tasks and the intention for part of its annual income to be paid to the State Budget, said exemption has been introduced.

Investment funds operating pursuant to the provisions of the Act of 27 May 2004 on Investment Funds (hereinafter: the IF) are also subject to exemption. In accordance with Article 3 of IF, an investment fund shall be a legal person whose sole business consists in investing funds raised by offering units or investment certificates to the public or – in the cases defined in this Act – by private placement of investment certificates, in securities, money market instruments and other property rights. Exemption of income of such funds is due to the method of their operation. Thereby income, derived by the fund participant, is only taxed once, on the level of the entity deriving income from participation in such fund. Thus, if an individual should derive factual income from such a fund, they would be taxed only with the personal income tax. If the participant was a legal person, their income would be only taxed with the corporate income tax.

Another significant regulation wherein a different regulation regarding banks has been adopted are the deductible costs. It is indicated in the doctrine, that an expense may be treated as a deductible cost, if it fulfills the following conditions:

1. It has actually been incurred.
2. Its incurring occurred in order to derive income or preserve or protect the source of income.
3. It is not included in the catalogue of expenses not treated as tax deductible costs, listed in art. 16(1) of the CITA.

Special regulations regarding banks, distinguishing them from other legal persons, including corporations, also have to be noted. Deductible expenses in banks, alongside with expenses treated as deductible costs on the basis of

regular rules, are also the following expenses indicated in art. 15(1h) of the CITA:

1. The general banking risk provision (according to Article 130(1) of the Banking Law, banks can create a general risk reserve. It serves for the coverage of an unidentified risk associated with conducting banking activity and is created and resolved on the basis of an assessment of this risk, especially accounting for the size of the amount due and the off-balance sheet liabilities.

2. Loss from selling debts under credits (loans) sold to a securitization fund or an investment fund company establishing a securitization fund (securitization of the liabilities in accordance with the regulations provided in Article 92a of the Banking Law should be understood as the sale (transfer) of the debt to an investment fund company that is the securitization fund or to a securitization fund).

3. Some amounts obtained from realization of collateral for securitized debts covered by a subparticipation agreement (the object of this agreement is the transfer of all liabilities received by the bank from a specified pool of debt or specified debt to the securitization fund).

It must be noted that the abovementioned regulation is not the last difference between banks and commercial companies. Article 12 (6) CITA states that revenuein banks is the amount equivalent to general banking risk provision established in accordance with the Banking Act, released or utilized otherwise. Revenue is also amount equivalent to released or reduced provisions, referred to in Article 16.1.26 CITA[7], previously classified as

[7] Article 16.1.26 states expensens which are not treated as deductible costs: expenses on provisions established to cover debts, the unrecoverability of which has been proved as credible, with the exception of those provisions established to cover: **a)** in organizational entities, referred to in subparagraph 25 (b) of art.16: - credits (loans) due though unrecoverable;- credits (loans) classified as lost **b)** guarantees or warranties for repayment of credits and loans, granted by a bank

deductible costs. Banks may establish a banking risk provision. It serves as means for covering of an unidentified risk connected with executing bank activity and is established and dissolved based on the assessment of this risk, taking into account especially the size of the active debts and granted off-balance-sheet obligations. The general risk provision created by the bank is considered a deductible cost. If the provision is dissolved or allotted for different purposes from those for which it was created, the sum equal to the value of the provision which was considered a deductible cost before will now be included in the revenue. Article 16(1)26 of the CIT Act introduces special regulations for banks regarding provisions created for covering the amounts due. Dissolution or lowering of such provisions results in the creation of revenue. If, however, such an amount due meets the conditions for deeming it irrecoverable (Article 16 (1)25 CITA), the value of this amount due is included in the costs, as deducted irrecoverable amount due.

Summary

From the analysis contained in presented article it is clear, that the Corporate Income Tax Act is of key meaning for the taxation of financial institutions. In Poland definition of a financial institution itself is adapted to the EU regulations, although some differences may be noticed. Among financial institutions, the banks are of key meaning, and even though research shows that their role is decreasing, in the sector of financial institutions their position is still very strong. The regulations regarding banks are mostly included in the Bank Law, which regulates matters such

after 1January 1997, due though unrecoverable;**c)** guarantees or warranties for repayment of credits and loans, granted by a bank after 1 January 1997, classified as lost, **d)** 25% of credits and loans classified as doubtful and 25% of guarantees or warranties for repayment of credits and loans classified as doubtful - granted by a bank after 1 January 1997;**e)** 50% of credits and loans classified as doubtful and 50% of guarantees or warranties for repayment of credits and loans classified as doubtful.

as the subjective and objective scope. It should also be stressed, that the differences between banks and companies on the grounds of the corporate income tax regard mostly two matters – the special role of the central bank which NBP is, and the costs of obtaining the income. National Bank of Poland as the central bank has legal personality and is in the subjective scope of taxation with the corporate income tax. Due to its tasks and the intention for part of its annual income to be paid to the State Budget the NBP is exempted from corporate income tax. Second significant matter wherein a different regulation regarding banks has been adopted is the deductible costs.

Bibliography

1. Bany K., *Modelowa Konwencja w sprawie podatku od dochodu i majątku*, WoltersKluwer business, Warszawa 2010.
2. Gomułowicz A., Małecki J.(2010), *Podatki i prawo podatkowe*, LexisNexis,
3. Koperkiewicz-Mordel K., Chróścielewski W. (2006) , Nykiel W., *Polskie prawo podatkowe podręcznik akademicki*, Difin.
4. Małecki P., Mazurkiewicz M. (2011), CIT Podatki i rachunkowość. Komentarz,Wolters Kluwer business.
5. Mariański A., Nykiel W. (2011), *Komentarz do ustawy o podatku dochodowym od osób prawnych*, ODDK.
6. Medyński M. (2011) p.7., *Prawo bankowe. The Banking Law*, C.H. Beck, Warszawa.
7. Stefański M.(2006), *Kierunki ewolucji sektora bankowego w Polsce po 1989*, Włocławek;
8. Schab I. (2007), *Statistical appendix to the study:-'Polish Financial Services Market as Compared to the EU'*, typewritten copy, Warszawa;

Legal acts

1. Act of 29 October 1997 of the National Bank of Poland, Consolidated version Journal of Laws 2016, item 1988.
2. Act of 2 July 2004 On Freedom of Economic, Consolidated version Journal of Laws 2016, item 1829.
3. Act of 4 September 1997 on the Branches of Government Administration, Consolidated version Journal of Laws 2016, item 543.
4. Banking Law Act of 29 August 1997, Consolidated version Journal of Laws 2002, No. 72, item 665, amended.
5. Code of Commercial Partnerships and Companies of 15 September Consolidated version Journal of Laws 2016, item 1578.
6. Corporate Income Tax Act of 15 February 1992 r., Consolidated version Journal of Laws 2016, item 1888.
7. Polish Civil Code, Act of 23 April 1964, Consolidated version Journal of laws 2016, item 380.