

FAMILY FOUNDATION - A NEW SUCCESSION TOOL IN POLISH LAW

The Act on Family Foundations of 26 January 2023 (the "Act") introduces into the Polish legal system a long-awaited mechanism allowing, inter alia, succession of Polish family businesses, i.e. a family foundation. The law comes into force on 22 May 2023. In addition to facilitating succession, the Act enables the accumulation and safeguarding of family assets and the continuity of the business in a situation where the future heirs of the entrepreneur/owner do not wish to or cannot manage it directly or when they have different expectations and interests that are difficult to reconcile.

Below is a summary of the most important issues arising from the Act.

The essence of a family foundation

The purpose of a family foundation is to facilitate succession in family businesses. Until now, there has not been a comprehensive instrument in the Polish legal system that would provide protection against the fragmentation of property after succession during the life or upon the death of the owner. Succession under inheritance law often results in the division of controlling holdings in family companies between several heirs (which makes control and management difficult) or forces the sale of assets to satisfy heirs. When the circle of beneficiaries is numerous and the property is further divided by successive generations, its value may decrease significantly due to fragmentation.

A family foundation allows the integration of property (accumulation of capital) in one entity and its management so that it retains its value while at the same time providing livelihood for future generations.

The main objective of establishing a family foundation is to protect the family assets of the enterprise, ensure the continuation of its activities, use of the property by designated persons (including the immediate family) for generations and its management in accordance with the will specified by the founders in the statute. A family foundation is not created only for the founders, but also for the people around him/her, for a very long time.

Three main benefits of a family foundation:

- **the founders in planning the succession** - the founder is able to plan the succession in detail and has a real influence on the design of the foundation's structure, determining the circle of beneficiaries, rules regarding benefits and corporate governance as well as guidelines for investing assets;
- **integrity and protection of family property** - the assets of a family foundation are separate from the assets of the founders and the assets of the beneficiaries. This allows achievement of economies of scale, often unavailable to individual family members acting individually; and
- **tax-advantageous rules** - the structure of taxation of a family foundation takes into account, as a rule, family ties with the founders and is tax-neutral until the funds from the foundation are distributed. The establishment of a family foundation and transfer of assets to it is not taxed. A family foundation is liable to pay corporate tax only when the benefit is paid to a beneficiary or foundation's property is handed over.

Through the statutes, the founders define the detailed purposes of the family foundation. Such purposes may be strictly financial/economic, aimed at further developing the enterprise that is part of the assets of the family foundation or for benefits for specific persons who will be entitled to receive them from the family foundation (beneficiaries). The family foundation will also be able to provide services to public benefit organisations.

In practice, a family foundation should be considered as a mechanism of succession by owners of medium and large family businesses or owners of private assets of significant value, for the purpose of:

- protecting the property in the event of family disputes, and private law claims, arbitrary action of public institutions, legal and political instability;
- building a long-term plan for a company or asset;
- preserving the family nature of the company;
- protecting the shares against dispersion and their concentration in one entity;
- maintaining flexibility in the payment of benefits;
- protecting the assets against risks related to classic property succession (including inheritance, reserved share);
- being able to achieve family goals, not only company goals; and
- international tax planning.

Similar legal solutions in Europe

Family foundations, in a similar formula as adopted in Poland, have existed for years in Western European countries, including Malta, Austria, Liechtenstein, the Netherlands, Germany, Switzerland and Sweden. In common law countries (Great Britain, Ireland, but also, for example, Cyprus), the institution of a trust has a similar function. Thanks to a family foundation, Polish entrepreneurs will be able to use a similar instrument without having to transfer assets to a foreign entity.

Establishment of a family foundation

Only a natural person with full legal capacity or a group of such persons may set up a family foundation. A family foundation may be established based on:

- statements on the establishment of a family foundation - the founder or a group of several founders must make the statements before a notary in the form of a notarial deed; and
- a valid will - the founder may include in his/her will a statement on the establishment of a family foundation (obviously a foundation established in this way will have only one founder).

Upon making a statement on the establishment of a family foundation or announcement of a will, a family foundation in organisation is established. Until it has been entered in the register, it may manage its assets on its own behalf and, for example, it may acquire rights, incur liabilities, sue and be sued.

The establishment of a family foundation also requires: adoption of the statutes, preparation of an inventory of property, establishment of the bodies of the family foundation, contribution of the founding fund (before the entry in

the register of family foundations in the case of a family foundation set up in a founding act or within two years from the date of the entry of the family foundation in the register of family foundations in the case of a family foundation established in a will) and entry in the register of family foundations.

Statutes of a family foundation

The founders establish the statutes, which must be in the form of a notarial deed and specify at least:

- the name of the family foundation and its seat in the territory of the Republic of Poland;
- the specific purpose of the family foundation;
- the beneficiaries or how they are identified and the extent of the beneficiaries' rights;
- the rules for keeping the list of beneficiaries, the waiver of rights by the beneficiaries, the appointment and removal, and the rights and obligations of the members of the bodies of the family foundation, the rules for the representation of a family foundation by the management board or other bodies of the family foundation, and the rules for amending the statutes;
- the term of the family foundation, if any;
- the value of the founding fund;
- the entity authorised to approve the activities of the management board of the family foundation in organisation;
- the beneficiaries entitled to participate in the meeting of beneficiaries; and
- the allocation of the property of the family foundation after its dissolution, including the name of the beneficiaries entitled to the property as a result of the dissolution of the family foundation.

The statutes may also specify other issues, for example relating to the principles of cooperation between the authorities of the family foundation, the circumstances of dissolution of the family foundation, investment of the assets of the family foundation, as well as the creation of local units.

Authorities of a family foundation

A family foundation has the following authorities:

- the management board;
- the beneficiaries' meeting; and
- the supervisory board (optional, unless there are more than 25 beneficiaries).

Assets of a family foundation

The founders have to contribute the founding fund to the family foundation - a total of at least PLN 100,000, which may consist of funds, securities, and other rights that will serve to achieve the objectives of the foundation.

The foundation may receive a property by way of a donation or inheritance from any person. However, for income tax purposes, property contributed by:

- the founder or his/her spouse, descendants, ascendants or siblings, will be deemed to have been contributed by the founder;

- a common descendant, ascendant or sibling of more than one founder, will be deemed to have been contributed by all such founders equally;
- other persons - are considered to have been contributed by the family foundation.

Scope of business activity that a family foundation may undertake

A family foundation may carry out business activity only in the following areas:

- the disposal of property, if the property has not been acquired solely for the purpose of further disposal;
- the rental, lease or making available of property;
- acceding to and participating in commercial companies, investment funds, cooperatives and similar entities;
- acquisition and sale of securities, derivatives and rights of a similar nature;
- granting loans to beneficiaries and entities related to the foundation;
- trading in foreign means of payment belonging to the family foundation in order to make payments related to its activities;
- and in addition, only in connection with a farm:
 - the production of plant and animal products processed by non-industrial means (with certain restrictions); and
 - forest husbandry.

A family foundation and taxes

Taxation of family foundations has been regulated in the Act by amendments made to individual tax acts. The key amendments concern issues related to income tax payable by:

- legal persons; and
- Individuals.

The establishment of a foundation and the transfer of its assets is tax-free. At the same time, within the scope of the economic activity permitted by the Act, a family foundation will benefit from a subjective exemption from corporate income tax. As a result, the family foundation will not pay tax on capital gains obtained (for example, on dividends received, on income from the sale of shares or on the redemption thereof), or on interest on loans granted to related companies or beneficiaries.

On the other hand, a family foundation will pay corporate income tax in relation to:

- tax on income from buildings - family foundations with fixed assets in the form of buildings located on the territory of the Republic of Poland and delivered in whole or in part for use on the basis of a lease, tenancy or other agreement of a similar nature, with an initial value exceeding PLN 10,000,000 may be obliged to pay this tax;
- tax on the foundation's benefits and liquidation property - the payment of benefits to beneficiaries will be subject to 15% corporate income tax, regardless of which group the beneficiary belongs to;

- tax on liquidation property – if the family foundation is wound up, the income corresponding to the value of the property is reduced by the tax value of the property (i.e. the value not previously included in any form as tax-deductible costs, which would have been accepted by the founders for such a cost, if he/she/they had sold the asset for consideration fee immediately before it was contributed to the family foundation, to be not higher than the market value of this property) contributed by the founders. In such a case, the income tax is 15% of the tax base;
- conducting business activity beyond the permitted scope (mentioned above in the summary) - income from such activity is taxed at 25%.

In addition to the 15% corporate tax paid by the family foundation, the person who receives the benefit pays his/her own 15% personal income tax. This tax is a flat-rate tax. The said principle and rate of taxation will apply taking into account double taxation treaties to which the Republic of Poland is a party.

The Act provides for a mechanism allowing the exemption of received benefits from personal income tax in certain cases. Beneficiaries of the family foundation belonging to the immediate family of the founders, the so-called zero group (spouse, children and further descendants, parents and further ascendants, stepchildren, siblings, stepfather and stepmother) and the founders themselves, receiving benefits from the foundation, will benefit from a personal income tax exemption (the so-called "zero" tax group). Beneficiaries outside the family must take into account the obligation to pay personal income tax in the amount of 15% of the tax base.

However, this exemption does not apply to all funds received by such relatives. It applies only to the part of revenues corresponding to the proportion determined in accordance with a special inventory created on the basis of the Act, as at the date of obtaining income, i.e. in principle in proportion to the value of assets contributed directly to the family foundation by the founder.

In the Act, the amendments concerning of inheritance and gift tax are not significant, an exclusion from inheritance and gift tax on certain benefits received from foundations that, in principle, are subject to inheritance and gift tax, has been introduced. Therefore, inheritance and gift tax will not apply to benefits provided by a family foundation to beneficiaries in accordance with the principles of the foundation's operation, or to liquidation property of such a family foundation.

Even before it came into force, the Act was amended. The main amendments concern:

- a decrease in the personal income tax rate to 10% for beneficiaries outside the so-called "zero group", i.e. from groups I and II according to the Act on Inheritance and Gift Tax;
- not taking into account the costs of debt financing obtained from the family foundation up to the limit of the debt financing costs;
- taxation of benefits in the form of hidden profits and rental, lease or other agreement of a similar nature, the subject of which is an enterprise, an organised part of an enterprise or assets used to conduct business by the beneficiary, founder or related entity; and

- loss of the family foundation's right by to an exemption from corporate income tax, if it is not entered in the register within 6 months of the date of its establishment or the decision of the registry court refusing to register it has become final, while the loss of the right to the exemption occurs from the date of establishment of the family foundation in organisation.

Family foundation and inheritance law

In calculating the reserved share, the founding fund of a family foundation contributed more than 10 years earlier, counting back from the opening of the inheritance, is generally not added to the inheritance, unless the family foundation is the heir.

In addition, the assets of the family foundation are not taken into account in the calculation of the reserved share in the following cases:

- when calculating the reserved share, property in connection with the dissolution of a family foundation, received by persons who are not heirs or entitled to a reserved share more than 10 years earlier, counting back from the opening of the inheritance, is not added to the inheritance, unless the dissolution of the foundation took place during the life of the founders;
- when calculating the reserved share due to a descendant, the founding fund and property in connection with the dissolution of the family foundation are not added to the inheritance if their transfer took place at a time when the testator did not have descendants. However, the founding fund will be added if the transfer of property takes place fewer than 300 days before the birth of the descendant; and
- when calculating the reserved share due to a spouse, the founding fund and property in connection with the dissolution of the family foundation that were transferred before the marriage with the deceased are not added to the inheritance.

In addition, it is possible to spread the reserved share into instalments, defer its payment or even decrease it.

Register of family foundations

A foundation acquires legal personality upon entry in the register of family foundations kept by the Regional Court in Piotrków Trybunalski. If a family foundation is not registered within six months of the date the founding deed is drawn up or the opening of the will, or the court legally finally refuses to register it, a family foundation in organisation will be dissolved by operation of law.

The Ministry of Justice has already presented draft implementing regulations to the Act, which gives hope that the regulations will be issued and the register will be set up immediately promptly after the Act comes into force.

CONTACTS

Agnieszka Janicka
Partner

T +48 22 627 11 77
E agnieszka.janicka
@cliffordchance.com

Krzysztof Hajdamowicz
Counsel

T +48 22 627 11 77
E krzysztof.hajdamowicz
@cliffordchance.com

Tomasz Szymura
Counsel

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

Nikoletta Koziol
Associate

T +48 22 627 11 77
E nikoletta.koziol
@cliffordchance.com

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

www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street,
London, E14 5JJ

© Clifford Chance 2023

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571

Registered office: 10 Upper Bank Street,
London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ

Abu Dhabi • Amsterdam • Barcelona • Beijing •
Brussels • Bucharest • Casablanca • Delhi •
Dubai • Düsseldorf • Frankfurt • Hong Kong •
Istanbul • London • Luxembourg • Madrid •
Milan • Munich • Newcastle • New York • Paris
• Perth • Prague • Riyadh • Rome • São Paulo
• Shanghai • Singapore • Sydney • Tokyo •
Warsaw • Washington, D.C.

AS&H Clifford Chance, a joint venture entered into by Clifford Chance LLP.

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