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Corporate reorganisations in practice

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Introduction

Our team has recently conducted a range of corporate reorganisations, including mergers (some cross-border), conversions and demergers (including demerger by spin-off). This experience has encouraged us to gather our knowhow in one place and discuss issues that are useful in practice.

Additionally, major changes in the regulations governing corporate reorganisations in Poland, which entered into force on 15 September 2023, expanded the spectrum of options for modifying corporate structures to meet the owners' business needs. On top of cross-border mergers, which were already addressed by the Polish regulations, cross-border conversions and demergers of companies and joint-stock limited partnerships were added.

In our report, we explore many issues worth examining at the stage of preparing companies for reorganisation.

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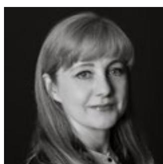

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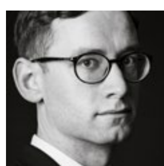

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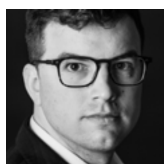

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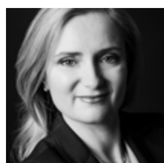

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Contents

5 What if the value or appraisal of assets changes during the course of a corporate reorganisation?
Dr Kinga Ziemnicka, Jakub Macek

14 Mergers of companies: How to simplify the process by arranging the capital structure
Łukasz Śliwiński, Monika Lutomirska

18 Share exchange ratio in reverse mergers of companies
Monika Lutomirska, Waldemar Oryński, Adam Strzelecki

21 Taking tax losses after a merger by takeover
Sandra Derdoń, Jakub Macek

25 Cross-border corporate mergers: Practical aspects
Marek Dolatowski, Monika Lutomirska, Dr Kinga Ziemnicka

31 New demerger by spin-off: The simplest of demergers and a practical alternative to the demerger by separation and in-kind contribution
Piotr Ząbkiewicz, Adam Strzelecki

36 Conversion of a joint-stock company into a limited-liability company: Practical problems
Cyryl Jachimski, Wiktor Zborowski

40 The impact of a conversion in corporate form on companies' financial reporting
Dr Kinga Ziemnicka, Mateusz Próchnicki

47 Administrative permits and corporate reorganisations: How to ensure business continuity?
Marek Dolatowski, Małgorzata Piekarska, Joanna Krakowiak

53 Debt-to-equity conversions in practice
Jakub Macek, Marek Dolatowski, Cyryl Jachimski

What if the value or appraisal of assets changes during the course of a corporate reorganisation?

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An appraisal of assets in the course of corporate reorganisations is a required element for determining their value when transferred from one company to another as a result of a merger or demerger. But the procedure for reorganising companies is often lengthy, and during the course of the procedure components of the transferred assets or liabilities may change due to ordinary or extraordinary circumstances. Or the appraisal itself may change. This raises a fundamental question of the extent to which the reorganisation documentation must be modified, including the draft terms of merger or demerger, and how these changes can be reflected in the accounting records without having to redo the entire reorganisation procedure.

This issue arose in the case of a demerger of a Polish company, accompanied by transfer of certain assets to a newly formed company. Originally, in the draft terms of demerger, the company adopted the balance sheet valuation of the transferred assets. Then, a market valuation was subsequently commissioned, which showed a significant difference in the value of the transferred assets. Was it permissible—and if so, under what conditions—to update the documentation to reflect the current data, while increasing the *agio* accompanying the acquirer's capital increase?

The argument for this possibility was simple: in the course of several months of reorganisation, normal business activity is carried out, as a result of which the value of the transferred assets may change. But the counterargument is that a change in the valuation methodology is not equivalent to a change in the composition or value of the assets, and the valuation provided in the reorganisation documentation is intended to set a value that is then carried over into the financial data of the acquirer and the rights of shareholders participating in the demerger, who rely on this data to take certain decisions in accordance with the procedure set out in the regulations.

Rules for determining the value of transferred assets

At this point, it is worth tracing the statutory regulations in Poland pertaining to the respective types of corporate reorganisations.

GO TO THE TABLE OF CONTENTS →

In the case of a **merger of companies**, the draft terms of merger must be accompanied by a determination of the value of the assets of the company being acquired or of the companies merging by forming a new company, as of a specified date in the month preceding the filing of the application for announcement of the draft terms of merger, and a statement with information on the accounting status of the company prepared for purposes of the merger as of the same date, using the same methods and in the same layout as the last annual balance sheet (Art. 499 §§2–4 of the Commercial Companies Code). In the statement, it is not necessary to present a new inventory, and the values shown in the last balance sheet should be amended only if necessary to reflect changes in the accounting records.

Among other things, in a **cross-border merger of companies**, the draft terms of merger should include information on the valuation of assets and liabilities transferred to the acquiring or newly formed company as of a specified date in the month preceding the filing of the application for announcement of the draft terms of merger (Commercial Companies Code Art. 516^3 §1(13)). Also, the draft terms of a cross-border merger should indicate the date of closing the accounting books of the merging companies used to set the terms of the merger under the Accounting Act (in particular, Art. 12(2) and following).

The **demerger** procedure requires the draft terms of demerger to include, among other things, a detailed description and allocation of property (assets and liabilities) and permits, concessions or exemptions attributable to the acquiring companies or newly formed companies (Commercial Companies Code Art. 534 §1(7)). Among other things, the draft terms of the demerger must be accompanied by a determination of the value of the demerged company's assets as of a specified date in the month preceding the filing of the application for announcement of the draft terms of demerger, and a statement with information on the accounting status of the company, prepared for purposes of the demerger, as of the same date (Art. 534 §§ 2–(4)) (subject to certain exceptions, for example an accounting statement is not required with consent of all shareholders of each of the companies participating in the demerger). As in the case of mergers of companies, the statement does not need to present a new inventory, and the values shown in the last balance sheet should be amended only if necessary to reflect changes in the accounting entries.

In a **cross-border demerger**, the draft terms of demerger should include, among other things, a detailed description of the property (assets and liabilities) and permits, concessions or exemptions of the demerged company, and a statement on their allocation to the newly formed company or companies,

GO TO THE TABLE OF CONTENTS →

or the method of their retention by the demerged company in the case of a demerger by split-up or a demerger by spin-off, including the provisions on the classification of assets or liabilities not allocated in the draft terms of cross-border demerger, such as assets or liabilities unknown at the time the draft terms were prepared, as well as information on the valuation of assets and liabilities attributable to each company participating in the cross-border demerger (Art. 550^6 §1(14)–(15)). Also, the terms of the cross-border demerger should indicate the date of closing of the accounting books of the company being demerged used to set the terms of the cross-border demerger under the Accounting Act (in particular Art. 12 (2), (3a) and following).

In the case of **conversion**, i.e. a change in the company's legal form, the draft plan of conversion should include, among other things, a determination of the balance sheet value of the company being converted as of a specified date in the month preceding submission of the draft terms of conversion to the shareholders (Art. 558 §1(1)). The draft terms of conversion must be accompanied by financial statements prepared for the purpose of conversion as of the same date, using the same methods and in the same layout as the last annual financial statements. In the case of conversion into a joint-stock company (S. A.), the draft terms of conversion must still be accompanied by a valuation of the assets and liabilities of the company being converted.

By contrast, in a **cross-border conversion**, the provisions require that the draft terms of merger include the repurchase price of the shares of a shareholder or partner who does not agree to the conversion, and the report of the management board of the company being converted should also include the method or methods used to set this price (Art. 580^4 §1(9) and 580^5 §3(1)).

The cited examples (the most typical ones) illustrate that depending on the type of reorganisation, the valuation duties are formulated somewhat differently, to adapt the requirements in this regard to the particular procedure and its effects on the entities involved. Apart from some cases, such as a conversion, where the balance sheet valuation is sufficient (with the exception of conversion to a joint-stock company), generally the regulations do not contain precise rules on the valuation methodology applied to determine the value of the transferred assets, and in particular whether it is possible to rely solely on the balance sheet value, or whether a market valuation or fair value under the Accounting Act should be applied. According to the general definition in Art. 28(6) of the Accounting Act, fair value is the amount for which a given asset could be exchanged or a liability settled in an arm's-length transaction between interested, well-informed, but unrelated parties.

GO TO THE TABLE OF CONTENTS →

In the section on mergers, the Accounting Act contains a number of regulations on determining the fair value of individual assets acquired, which, however, refer directly to the merger date, defined in the act as the date on which the merger is entered in the register for the head office of the acquiring or newly formed company. But determining the value of assets for the purpose of preparing the draft terms of reorganisation is done much earlier.

So it should be emphasised that entry and recognition of the transferred assets as of the date of registration of the merger or demerger in the accounting books of the acquiring or newly formed company is a separate matter, and should be conducted in accordance with the Accounting Act (for example, in the case of mergers, using the acquisition method or the pooling of interests method).

Also, in the legal literature, there is no uniformity as to which asset valuation methods should be applied for preparation of documentation required for corporate reorganisations. In practice, the method of valuing assets is generally chosen within the discretion of the management board. If there are no significant discrepancies in the valuation of assets depending on the adopted methodology or points of issue over valuation between shareholders, companies often adopt the carrying value derived from the accounting books, unless the regulations explicitly prohibit it, because it cannot be considered unlawful to determine the value of the company's assets on the basis of the balance sheet value. However, the same valuation method should be used for all companies participating in the reorganisation, to provide a uniform basis for determining the share exchange ratio (if such an exchange takes place).

Change in the valuation of assets during reorganisation

In answering the question of whether, in the course of reorganisation, in the documentation, it is possible to change the method of valuation of assets, transferred assets or liabilities as a result of a change in the valuation methodology, first of all we must examine the statutory regulations. The provisions clearly indicate that the value of assets should be determined as of a certain date in the month preceding the filing of the application for announcement of the draft terms of merger or demerger, and in the case of conversion, as of a certain date in the month preceding submission of the draft terms of conversion to the shareholders. Therefore, it should be assumed that the components of such assets as of the valuation date are known and the valuation itself should be prepared as of the date specified in the provisions.

GO TO THE TABLE OF CONTENTS →

Then, the prepared valuation constitutes the basis for determining, in particular, the exchange ratio or issue price of the shares taken up in the acquiring company (excluding situations where, for example, the merger is carried out without granting such shares on the basis of the amended provisions of the Commercial Companies Code) and the basis for making appropriate future entries in the acquirer's accounting books, particularly the amount of equity. In other words, since the valuation is required as of a certain date in the preceding month, it is not permissible to change the methodology of this valuation at a different date and use an amended valuation in the course of the ongoing reorganisation. And if the valuation materially affects the financial figures adopted in the draft terms of reorganisation, the procedure must be repeated. However, the foregoing refers to the corporate data and documentation required to carry out the reorganisation, which does not exclude updating the accounting records as of the date of the merger or demerger in accordance with the Accounting Act. Thus, it may happen that the corporate documents (including the draft terms of reorganisation and resolutions) will not change despite the new valuation, while the accounting data will be adjusted as of the record date based on the current valuation (with the proviso that the share issue price assumed in the corporate documents will not then be modified).

Change in the composition or value of the transferred assets

The case is different when there is a change in the composition or value of the transferred assets as a result of business conducted by the company after preparation of the draft terms of the company's reorganisation. Such a change might result for example from the sale of goods, inventory, purchase of semi-finished goods, or repayment of obligations, but also extraordinary events significantly affecting the value of the transferred assets.

We should note that determination of the asset value for the purposes of the draft terms of merger or demerger is prepared as of a certain date in the month preceding the filing of the application for announcement of the draft terms. This means that the value presented in the draft terms of reorganisation will generally be a historical value that may already be outdated on the day it is signed, let alone on the date of registration of the merger/demerger. Therefore, such changes do not result from the valuation methodology applied, but from specific events taking place after preparation of the draft terms of reorganisation. In such cases, it is necessary to assess to what extent these changes can be accommodated by appropriate updates to the documentation (for example, by exchanging one asset for another), by reducing or increasing the amount

GO TO THE TABLE OF CONTENTS →

of the *agio* in the case of a planned share capital increase (i.e. adjusting the issue price), or by appropriate accounting entries reflecting goodwill (positive or negative), and to what extent they affect the exchange ratio in such a significant way that, in the absence of shareholder approval, it is necessary to change all the documentation required for the reorganisation.

For this reason, the management boards of the companies involved in the reorganisation are required to inform each other of all material changes in assets and liabilities occurring between the date of the draft terms of merger or demerger and the date of adoption of the resolution on merger or demerger, so that they can then inform the shareholders of these changes. This is because such changes might not only affect the exchange ratio, but also for example lead to an excess or shortfall in the contributed assets relative to the issue value of the shares obtained in exchange. Then such differences can be reflected for example by adjusting the issue value, or in practice most often the amount of the *agio*, to reflect the changes in the value of assets contributed to the acquiring company.

However, the duty of the management board to notify such changes can be waived with the consent of all the shareholders of each company participating in the reorganisation. Similarly, the provisions governing corporate reorganisations require, in principle, that the draft terms of reorganisation be examined by an auditor, while also allowing waiver of this obligation in most cases, with the consent of all shareholders (waiver is not allowed, for example, in the case of conversion to a joint-stock company).

Other doubts involving asset valuation in connection with reorganisations

Other concerns have arisen surrounding the regulations on valuing assets transferred in the course of corporate reorganisations. For example, in the case of a merger of companies, determination of the value of assets applies exclusively to the company or companies being acquired, or the companies merging by formation of a new company. Therefore, in theory, it covers the entities that will lose their legal existence as a result of the merger, whose rights and obligations will be taken over via universal succession by the acquiring or newly formed company.

But the Supreme Court of Poland has recognised that the literal wording of these regulations is generally inconsistent with the transactional practice in corporate mergers, because as a rule, to correctly determine the exchange

GO TO THE TABLE OF CONTENTS →

ratio, it is necessary to determine the relationship between the values of the merging companies, i.e. to value the acquiring company as well (judgment of 7 December 2012, case no. II CSK 77/12, OSP 2013/10 item 96). In this ruling, the court employed a functional interpretation, holding that the valuation attached to the draft terms of merger serves to verify the correctness of the exchange ratio established in the merger plan, and therefore, "the valuations of assets of all merging companies, including the acquiring company, should be attached to the draft terms of the merger."

The court also correctly pointed out that the valuation of a company is not the same as the valuation of its assets, as the valuation of a company should also take into account the off-balance sheet elements affecting the company's market value (brand, goodwill, clientele, market position, knowhow, human capital, growth prospects, and capacity for market expansion). Thus the companies' transactional value for purposes of merger reorganisations should be determined by valuation of the companies involved in the procedure, and not just valuation of their assets.

By contrast, in the judgment of 31 May 2011 (case no. I ACa 328/11, Lex no. 1135394), the Łódź Court of Appeals held that even if a valuation of the assets of the acquiring company would be desirable under the economic conditions of the merger, no obligation to enclose such a valuation with the draft terms of demerger can be derived from the current wording of Art. 499 §2(3) of the Commercial Companies Code. In other words, even assuming an obligation to include a valuation of the assets of the acquiring company with the draft terms of merger, the mere violation of this obligation cannot constitute sufficient grounds for declaring the merger resolution invalid or setting it aside.

Tax aspects of valuation

The discussion above regarding the valuation of assets transferred in reorganisations have focused mainly on corporate aspects. But it is also worth looking at these issues from the tax perspective.

To determine the tax consequences of a reorganisation for certain entities (e.g. a shareholder of a merged or demerged company), the Corporate Income Tax Act uses the concept of "issue value." This term has a different meaning than that adopted in the Commercial Companies Code, and means the price at which shares are acquired, as specified in the company's articles of association

GO TO THE TABLE OF CONTENTS →

or equivalent document. Importantly, the issue value in this sense cannot be lower than the market value of the shares.

The "price" at which shares are acquired is determined in a corporate document, which is often created months in advance of restructuring. In turn, the moment when the tax liability arises, for which the issue value is relevant, is tied to the date of reorganisation (the merger date or demerger date). In this context, a question arises whether and how the tax consequences of the reorganisation are affected by the difference between the value derived from the corporate documents and the market value that arose between these dates.

The individual interpretations issued by the National Revenue Information Centre take the view that in the event of a merger, the assets of the company being acquired are converted into shares of the acquiring company. As a result, the price of taking up shares is the equivalent of the assets of the acquired company transferred to the acquiring company. This leads to the conclusion (as stated for example in the individual interpretation of 25 May 2023, no. 0114-KDIP2-2.4010.127.2023.2.SP) that "the issue value of the shares is considered to be 'the price at which the shares are taken up,' but 'not lower than the market value of the shares.' Therefore, if the value adopted for the purpose of the draft terms of merger is lower than the market value, in this case the issue value of the shares will be the market value of the assets of the company being acquired." A similar position was confirmed in the interpretation dated 18 May 2023 (no. 0111-KDIB1-3.4010.90.2023.3.PC).

These interpretations show a rational approach to defining the issue value and taking into account the natural changes in the value of corporate assets during the restructuring process, but some practical aspects of the process remain unresolved. In particular, it is not clear whether determination of the issue value requires preparation of a separate market valuation as of the day before the merger/demerger.

On the one hand, there are no regulations directly imposing such an obligation. Also, it would be unreasonable to expect a valuation to be prepared for the purpose of determining revenue which, in principle, is not taxable (restructuring activities are generally tax-neutral for income tax purposes).

On the other hand, the legislative technique adopted by the Polish parliament may raise doubts in this regard. For example, the market value of the assets received by the acquiring or newly established company, determined on the date of the merger/demerger, in the part exceeding the issue value of the shares granted to shareholders of the merged or demerged company, is deemed to be

GO TO THE TABLE OF CONTENTS →

revenue of the shareholder of the merged or demerged company. Following the foregoing reasoning, these values (market and issue values) should be the same, especially in a situation where control of the merged/demerged companies is retained by a single shareholder. It seems unreasonable to expect a separate determination of the market value in such a situation, also because the rule in reorganisations is to carry forward the tax value of assets adopted by the entity being demerged or acquired. Nevertheless, the regulations do not provide a clear answer to this question.

Conclusion

As may be seen, the legal issues related to the valuation of assets transferred in the course of corporate reorganisations in Poland are not interpreted uniformly. But on the practical side, close cooperation between the companies and their accountants, tax advisers and legal advisers is essential throughout the procedure to prepare the documentation and valuation methods that best reflect the companies' financial situation. If, on the other hand, a need arises either to change the valuation methodology or to adjust the value of the transferred assets, then further steps should be taken in such a way as to minimise the risk of failure of the entire procedure. The timetable for registering organisational changes is often planned far in advance, and properly prepared documentation definitely streamlines the entire process at the stage of entering changes in the National Court Register.

GO TO THE TABLE OF CONTENTS →

Mergers of companies: How to simplify the process by arranging the capital structure

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Usually, a merger of companies in Poland requires a number of legal steps and preparation of extensive documentation. This can make mergers complicated and costly, in particular if companies with different shareholding structures are involved. But in some cases the regulations allow the parties to simplify the procedure by excluding certain obligations—if certain conditions are met regarding the capital structure of the companies.

Simplified merger under prior law

Before 15 September 2023, the law allowed (as it still allows) a few simplifications of the merger process.

If the acquiring company (other than a public company) holds shares with an aggregate nominal value of not less than 90% of the share capital of the company being acquired:

- It is not necessary to pass a merger resolution—the rationale is that adoption of such a resolution requires a three-fourths majority of votes, representing at least half of the share capital, and since the acquirer holds at least 90% of the shares in the target, the result of voting on such a resolution is obvious
- The management boards of the merging companies do not have to prepare a written report justifying the merger (otherwise, the consent of all shareholders of the merging companies would be required)
- The draft terms of merger do not need to be examined by an auditor (otherwise, the consent of all shareholders of the merging companies would be required).

If the acquirer acquires a wholly owned subsidiary, it can take advantage of all the foregoing simplifications, and also does not have to include in the draft terms of merger:

- Information on the exchange ratio of shares in the target for shares of the acquirer or newly formed company, or the amount of cash contributions, if any
- The rules for issuing shares in the acquirer
- The date from which the shares entitle the holder to participate in the profit of the acquirer.

GO TO THE TABLE OF CONTENTS →

Further simplifications introduced by new provisions

The amendment to the Commercial Companies Code in Poland effective 15 September 2023 regarding corporate merger procedures introduced a new regulation governing the situation where one shareholder directly or indirectly holds all the shares in both the acquirer and the target or targets. This allows for further streamlining (in addition to the rules discussed above) where the merging companies belong to the same capital group or groups.

The newly added Art. 515[1] provides that the merger may be carried out without granting shares in the acquirer:

- When one shareholder directly or indirectly holds all the shares in the merging companies, or
- When all shareholders of the merging companies hold shares in the same proportion in all merging companies (in particular, this will be the case when entities belonging to different capital groups hold shares in companies as a result of engaging in various types of joint ventures).

The allocation of shares is unnecessary in such a situation, as the capital structure of the acquiring company will be consistent with the shareholding structure of the merging companies.

What if the structure of the companies does not meet the conditions for this new procedure?

In such cases, one option is to carry out the merger procedure in the standard way. But to make the task easier and significantly reduce the set of documents and steps in the merger process (which will cut the time and expense of the merger process), the capital structure of the merging companies can be adjusted to meet the conditions beforehand. Although this restructuring will require some additional steps before starting the merger procedure itself, it may nonetheless prove simpler and more efficient overall.

The capital structure of the companies to be merged can be reshaped through a series of transactions in the shares of the merging companies, so that ultimately the structure meets the conditions listed above, making the merger eligible for the simplified procedure.

Depending on the initial structure, this could take place, for example, through a transfer of shares between the shareholders of the merging companies. In addition to the need to comply with the form prescribed for this type of

GO TO THE TABLE OF CONTENTS →

agreement in the case of a limited-liability company (sp. z o.o.) and, in the case of a joint-stock company (SA), entering the changes in the shareholders' register, the share transfer agreement may be concluded in a simple form and contain only the basic provisions necessary to make the transfer effective. Thus the cost and timing of drafting and signing the transfer agreement may prove much more advantageous for the entities involved in the merger than starting it without taking such prior steps.

The final capital structure of the merging companies, and therefore also the scope of possible simplifications, largely lies within the discretion of the shareholders of the merging entities. Therefore, in the case of structures that do not allow the use of a simplified procedure, it is definitely worth considering whether it is possible to adjust them accordingly by implementing the solutions described above. Appropriately managing the merger process can make the process cheaper but also more efficient for the entities involved, while facilitating changes in the shareholding structures of the merging companies.

Thus, by way of example:

- If the shares in the merging companies are held by entities that do not belong to the same capital group, but the proportions of the shareholdings in the companies are not identical, "equalisation" of the shareholding levels in the companies may be considered so that the companies can take advantage of the simplifications provided for such a structure
- If the merging entities belong to the same group, but there is no level in the group at which the shares of the entities involved would be owned (even indirectly) by a single shareholder, the structure can be reorganised so that, at any of the ownership levels, all the shares in the merging companies are held by a single entity
- If the plan for the merger is that a shareholder of the target will not become a shareholder of the acquirer, that person's shares in the target may be transferred prior to the merger
- If the companies belong to the same group, the shares of the targets can be transferred to the acquirer to obtain a structure in which the widest range of available simplifications can be applied.

While a general principle under Polish law is that restructuring activities should be tax-neutral, this principle is limited in the case of a subsequent reorganisation process in which the company participates. A merger or demerger will not be tax-neutral for a shareholder who acquired shares in the company being acquired or demerged through a merger, demerger or exchange of shares, and then, in a subsequent merger or demerger involving that company, acquires shares of the acquiring or newly formed company.

GO TO THE TABLE OF CONTENTS →

Therefore, the measures aimed at simplifying the structure before the merger should always be analysed also in terms of their tax impact.

As shown by the examples mentioned above, there is considerable leeway in arranging the capital structure of the merging companies prior to conducting the merger. Thus, particularly in the case of complex mergers, this is certainly an option that can be considered to facilitate the reorganisation within the capital group.

GO TO THE TABLE OF CONTENTS →

Share exchange ratio in reverse mergers of companies

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An element of any proposed merger of companies in Poland is determination of the ratio for exchange of shares of the companies participating in the merger and the amount of additional payments, if any, unless there is no exchange of shares. But sometimes the parties do not have to set a share exchange ratio in the merger process.

Share exchange ratio mandatory, with some exceptions

The Polish Commercial Companies Code specifies the minimum elements that must be included in the draft terms of a corporate merger. This document contains the most significant arrangements between the companies for carrying out the merger. The information required by the code frames the terms needed for the merger procedure, and is the basis for implementing the merger.

But for certain types of mergers, the code waives the requirement to determine the exchange ratio of shares of the companies participating in the merger. The merging companies do not need to include this element in the draft terms of merger when:

- The acquiring company acquires its subsidiary, in which it owns 100% of the shares
- One shareholder directly or indirectly holds all the shares in the merging companies
- All shareholders of the merging companies hold shares in the same proportion in all merging companies.

The last two points are the result of the amendments to the Commercial Companies Code that came into effect on 15 September 2023.

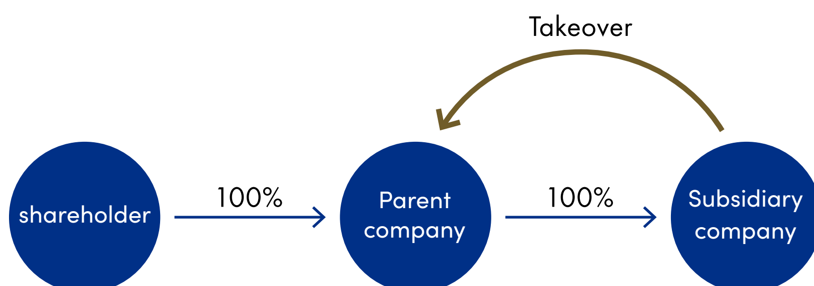
In simplified mergers of companies, the provision regarding the obligation to set a share exchange ratio is excluded by operation of law. This means that in the foregoing cases, the decision not to set a ratio does not depend on the companies participating in the merger.

However, the code also provides that this will not apply if no shares are exchanged in the course of a merger.

GO TO THE TABLE OF CONTENTS →

The need to determine the share exchange ratio in a reverse merger

A reverse merger, otherwise known as a downstream merger, involves a subsidiary taking over its parent company or a company without such status but holding any shares in the acquiring company. An example of a reverse merger structure is shown in the illustration below.



As a result of a reverse merger, a shareholder of the company being acquired who also indirectly has held a certain number of shares in the acquiring company becomes a direct shareholder of the acquiring company.

As explained above, in situations where (i) the acquiring company acquires its wholly-owned subsidiary, (ii) there is a single entity above the merger, or (iii) all shareholders of the merging companies hold shares in the same proportion in all the merging companies, the obligation to determine the share exchange ratio in the merger plan is excluded by law. However, in the case of downstream mergers, there are structures where the code does not allow for the possibility of waiving inclusion in the draft terms of merger the exchange ratio of shares of the company being acquired for shares of the acquiring company. Therefore, determination of the share exchange ratio in a reverse merger is carried out pursuant to the same provisions as an "ordinary" corporate merger. Here, the code does not offer different regulations that could be applied.

The basis for determining the exchange ratio is a comparison of the value of the merging companies' assets, which presupposes the need to value and

GO TO THE TABLE OF CONTENTS →

compare them. The Commercial Companies Code does not impose a specific method for making such a valuation. As a result (especially with less complex ownership structures), companies take various approaches to the valuation, although they very often choose to use the carrying values of assets, as it is relatively straightforward, although it may leave out elements that affect the actual value of a company, such as its ability to generate income or the market position of the company. Therefore, it is also worth considering other recognised methods of business valuation, such as income methods (discounted cash flow), comparative methods (e.g. stock market multiples), or asset methods (e.g. adjusted net assets).

With more complex ownership structures, for example when the merging companies have other shareholders, or they hold diversified assets, there may be other rationales for using valuation methods other than the carrying value. In principle, establishment of a share exchange ratio where there is a complex ownership structure primarily serves to protect the shareholders of the merging companies.

An interesting situation arises when the assets of the acquirer are smaller than those of the target, as, in principle, in a reverse merger, the existence of such an asset arrangement would justify granting the parent company's shareholders a smaller number of shares than they previously held in the parent company. Determining the share exchange ratio can pose difficulties, in particular when the methods adopted for valuing the companies' assets are different.

The possibility of setting the share exchange ratio without any connection to valuation (i.e. on the basis of freedom of contract) is a contentious issue in the Polish legal literature. While some argue that the merging companies may invoke the freedom of contract in determining the ratio, some categorically oppose this possibility. The rationale behind the latter position is that the merger procedure cannot be compared to a sale of shares. Unlike a sale of shares, a merger can affect interests beyond those of the companies themselves (such as shareholders and creditors).

Therefore, if it becomes necessary to determine the share exchange ratio in the course of a corporate merger, serious consideration should be given to the best valuation method for all of the parties engaged in the process. Indeed, a method accurately valuing the companies' assets should be the basis for determining the share exchange ratio. We analyse this issue in more detail in the article "What if the value or appraisal of assets changes during the course of a corporate reorganisation?"

GO TO THE TABLE OF CONTENTS →

Taking tax losses after a merger by takeover

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Under current regulations in Poland, in post-merger accounting, tax losses of the acquired company cannot be recognised. However, it is possible to take tax losses of the acquiring company, although this is not always the rule. In determining whether the acquiring company is entitled to take tax losses, it is necessary to assess whether the company's actual principal business after the takeover is wholly or partially different from that before the takeover. What, in essence, is covered by the notion of "actual principal business"? When should the principal business be considered to have changed "in part"?

The regulation and its purpose

Under the provisions in effect since 1 January 2021, in determining taxable income under the Polish Corporate Income Tax Act, the losses of a taxpayer which has acquired another entity are not taken into account when as a result of the acquisition:

- The taxpayer's actual principal business after the takeover is different, in whole or part, from the taxpayer's actual principal business before the takeover, or
- At least 25% of the taxpayer's shares belong to an entity or entities that did not hold shares in the taxpayer as of the end of the tax year in which the taxpayer incurred the loss.

The purpose of this provision was to curb tax optimisation in which taxpayers used another entity's tax losses to reduce their own tax liabilities. As pointed out in the explanatory memorandum to the bill introducing this provision, the pre-2021 rule allowing a taxpayer to recognise losses it had incurred itself may have been abused by various types of restructuring operations aimed at applying the taxpayer's loss against the income earned by another undertaking. In particular, a loss-making entity with no prospect of generating income in subsequent years, against which it could apply its accumulated tax losses, could acquire another (profitable) company only to reduce its taxable income by the value of past losses incurred by the acquirer.

The drafters also gave an example of a profitable company, X, a manufacturer of specialised medical equipment. To reduce its tax liabilities, the shareholders of X acquire the shares of Y, a company manufacturing agricultural

GO TO THE TABLE OF CONTENTS →

machinery, which has incurred significant losses in the previous years but does not promise to generate income in the future. Subsequently, Y acquires X, changes its name to the former name of X, and formally it is now Y—operating under X's name—that is the manufacturer of specialised medical equipment (it no longer produces agricultural machinery). As a result of this "restructuring," the income generated from manufacturing medical equipment is then reduced in Y by the tax losses incurred in the previous 5 years by Y when it manufactured agricultural machinery.

Is an analysis always necessary?

This example shows clearly the type of restructuring where the drafters sought to exclude the acquiring company's right to apply losses. But not all mergers resemble this example in the relevant aspects. Taxpayers conduct mergers for a variety of reasons, and their aim is not always to unjustifiably apply losses. Regardless of the reasons for the merger, if the acquirer has any tax losses it wants to claim, these provisions should be analysed in detail.

Actual principal business

The first condition excluding the right to recognise losses of the acquiring company is a change, in whole or part, in the principal business actually carried out by the acquiring company. The benchmark for examining whether a change has occurred is the actual principal business conducted before the takeover.

The CIT Act does not provide a legal definition of the notion of the "taxpayer's actual principal business," but it seems reasonable to assume that this should be understood consistent with the taxpayer's de facto business, i.e. first and foremost taking into account the scope of the business in fact conducted by the taxpayer. The predominant activity stated in the commercial register should play only a supporting role in this regard.

Simply adopting the predominant activity disclosed in the commercial register would be inappropriate, since the parliament did not directly use this approach, but instead used the previously undefined notion of "principal business." Thus this should be regarded as a freestanding concept, and the scope of the business actually performed should be taken into account, not just that disclosed in the register.

GO TO THE TABLE OF CONTENTS →

Partial change of business

For the taxpayer's (acquiring company's) right to settle losses to be effectively limited, the taxpayer's actual principal business must change, wholly or partly, from its principal business before the takeover.

For a total change, this provision does not seem controversial. A change in the entire scope of the taxpayer's actual principal business is relatively easy to identify.

But it is problematic to define what it means for the taxpayer to change its actual principal business "in part." Will even the slightest difference require exclusion of the losses?

Again, since there are no relevant legal definitions, when determining the taxpayer's actual principal business, we could refer to financial data and assume that if most of a company's revenue (more than 50%) is generated from a certain type of business, then that would be considered its principal business.

Thus, if after the takeover of another company and the start of a new, additional activity in a different area, the revenue from the new activity accounts for, say, 10% of the company's total revenue, and the revenue from the continuing activity accounts for 90%, it seems fair to conclude that there has not been even a partial change in the actual principal business conducted by the taxpayer. It can be argued that in this case the new activity is only a sideline.

The problem is in drawing the line. If the acquirer's principal activity is continued on the same scale as before the merger and the revenue from the new, additional activity account for some 10% (or less), the claim of no partial change in the core activity should, in principle, be justified. But what if the revenue from the new, additional activity makes up 15% or 20% of total revenue? Can the taxpayer continue to claim that it is a sideline? What if the taxpayer's core activity is conducted in two or more areas, and the newly added activity generates about 10% of its revenue—is that also significant?

There is certainly no simple answer to these and other such questions in the provisions. Each of these situations requires a separate analysis. It may also be helpful to apply for an individual interpretation. Based on the practice of the tax authorities known to us, the authorities are inclined to favour the view that not every change in a company's business after a merger is a change limiting the acquirer's right to apply losses.

GO TO THE TABLE OF CONTENTS →

Change of shareholder

The second condition which results in exclusion of the right to recognise losses of the acquirer is a change in its ownership structure. This involves a situation where at least 25% of the shares of the acquirer are held by an entity or entities that did not hold the shares as of the end of the tax year when the acquirer suffered a given loss.

In this case, the problem is not to decode the meaning of the provision, as it does not raise any particular doubts. The problem may be in applying this provision to reverse mergers, i.e. where a subsidiary acquires its own shareholder (shareholders of the target receive shares in the acquirer, i.e. the subsidiary). Thus, in most cases where this type of reorganisation is carried out, there will be a change in the ownership structure that precludes the possibility of claiming the acquirer's losses.

Certainly not every reverse merger is performed solely for the purpose of tax optimisation and taking advantage of accumulated losses, but under the current law in Poland, any reverse merger precludes the possibility for the acquirer to claim such losses. It does not seem acceptable to automatically apply this rule to all reverse mergers, in light of the purpose of the regulation, which was to limit abusive tax optimisation measures. After all, some reverse mergers are conducted for legitimate commercial reasons.

In individual interpretations known to us, the tax authority has rejected the position that the exclusion of losses should not apply when a reverse merger is performed for legitimate economic reasons because this would discriminate against reverse mergers. Nor did the authority uphold the position that in a reverse merger, when the existing shareholders are replaced by shareholders of the company being acquired who indirectly held 100% of the shares of the acquiring company, the exclusion of losses should not apply.

Conclusion

When preparing for a reorganisation in which the acquiring company has unused tax losses, it is worthwhile to make a detailed analysis and consider requesting an individual interpretation. With provisions that raise so many questions, failure to secure the taxpayer's position in the form of an interpretation runs the risk of later denial of the acquiring company's right to take losses.

GO TO THE TABLE OF CONTENTS →

Cross-border corporate mergers: Practical aspects

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The 15 September 2023 amendment to Poland's Commercial Companies Code introduced a number of changes to the cross-border merger procedure. Such a merger has its peculiarities because it is subject to the laws of more than one EU member state. During a cross-border merger, a number of practical aspects can significantly affect the speed and efficiency of the procedure.

In practice, cross-border mergers require close cooperation between companies and their financial and legal advisers. Our own practice has carried them out under the prior provisions, and we filed our last application for a certificate of compliance of a cross-border merger with Polish law a day before the amendment to the Commercial Companies Code in this regard came into force.

It is worth starting by pointing out the most important changes introduced by the recent amendment to the Commercial Companies Code.

The changes in provisions

First of all, we draw attention to the new requirement to obtain an opinion from the relevant tax authority on the merger (specifically, the head of the National Revenue Administration). According to the memorandum to the bill, issuance of such an opinion is intended to exclude the risk of abuse and tax avoidance in the reorganisation process. The authority will have one month to issue an opinion from receipt of the application, and this deadline can be extended for a further three months in particularly justified cases.

Additionally:

- The range of documents to be enclosed with the application for a certificate of compliance of a cross-border merger with Polish law has been expanded
- The registry court is given broader powers in the process of issuance of such a certificate (the court will verify whether the merger would effectively abuse, violate or circumvent the law, and the rules for dealing with such suspicions have also been specified)
- The need to file a cross-border merger plan with the registry court has been added, and the deadline for announcement of the plan has been extended (five weeks rather than one month before the planned merger resolution)

GO TO THE TABLE OF CONTENTS →

- The obligation to notify the company's shareholders twice of the intention to merge (the first notice no later than six weeks before adoption of a resolution on the cross-border merger, the second no less than two weeks after the first notice) is separately regulated
- After receipt of a certificate of compliance of the cross-border merger with domestic law, the cross-border merger is to be governed by the law applicable to the acquirer's head office
- The report of the Polish company's management board justifying the merger is to consist of two separate parts (for the shareholders and for employees), or the company may prepare a separate report for each group.

With the extended cross-border merger procedure, it is particularly relevant to be aware of the practical aspects that can impact cross-border mergers involving Polish companies.

Requirements for a cross-border merger plan

Cross-border mergers are based on EU provisions implemented into the legal systems of member states to harmonise the procedure in all jurisdictions involved.

But the legal systems of member states differ (e.g. in the legal form of a cross-border merger plan or how it is signed, or even its content, for example requiring the plan to specify the tax law applicable to the procedure). Also, each jurisdiction has certain customary norms under which such documents are prepared. This may significantly affect their content, complexity, form and method of representation at signing, or length. This is particularly evident in a situation where the target has its head office in Poland and the acquirer is a foreign company. Then, it is usually the entity from the other member state that is responsible for drafting the first plan, which will usually apply the provisions and customary content from its jurisdiction.

Therefore, when drawing up a cross-border merger plan, it is essential to ensure that the requirements arising from all jurisdictions involved in the procedure are met. If possible, it is worthwhile to adapt the plan for the procedure in Poland to the structure indicated in the Polish code, to facilitate the registry court's examination of the document. But in doing so, the same substantive content of the plan must be maintained across each jurisdiction. This is also key when translating plans, to avoid changes in meaning not intended by the drafters of the plan.

GO TO THE TABLE OF CONTENTS →

Coordination of procedures across jurisdictions

The differences between jurisdictions are not limited to the requirements and methodology for preparing a cross-border merger plan. They also involve deadlines and procedural requirements that must be met to ensure that the merger procedure is lawful and effective.

It is worth preparing a detailed action plan containing the elements from all jurisdictions, to clarify the differences in laws, required deadlines, documents and purely practical steps. This will isolate the risks arising from potential discrepancies between jurisdictions, so they can be addressed well in advance. Preparation of such a preliminary action plan should greatly simplify the subsequent stages of the procedure, so they can be scheduled to take into account all the steps necessary for mutual reconciliation of the procedure, increasing the efficiency of the actions and helping ensure that the procedure is successfully concluded.

Sometimes, the agreed action plan may require additional steps in a jurisdiction, even if no such obligation is provided for by the national law applicable to the company. For example, the absence of an obligation to adopt a merger resolution under the law governing the merged company does not mean that it is not worthwhile to adopt such a resolution anyway, just to be on the safe side, as it will help ensure that the merger decision is adopted in the standard, familiar manner in the given jurisdiction. This is particularly important from the point of view of the registration procedure before the authority of another member state (which may be accustomed to receiving certain documents, and raise doubts if it does not receive them or receives a document with unfamiliar form or content).

Differences in accounting rules

In various member states, the accounting rules and standards must also be borne in mind. Differences could materially affect the documentation, in particular with regard to valuation of the assets and liabilities of the merging companies, but also recognition of the value of contributed assets in the books of the acquiring company.

Under Polish law, the merger plan must include, among other things:

- Information on the valuation of assets and liabilities transferred to the acquiring or newly formed company as of a certain date in the month preceding filing of the application for announcement of the merger plan

GO TO THE TABLE OF CONTENTS →

- The date of closing the books of the companies participating in the merger used to set the terms of the merger, in light of the Accounting Act (and thus the date should be agreed in advance between the companies).

With regard to the valuation requirements and the timing of closing the books, the companies involved in the merger apply their own domestic law, while entry of the target's assets in the acquirer's books is carried out under the domestic law of the acquirer. The companies involved in a cross-border merger should agree on and use the same valuation method, to provide a uniform basis for determining the share exchange ratio, but also to facilitate proper accounting entries in the acquirer's books as of the merger date. This is not so straightforward. For example, while international provisions, as well as the Polish Accounting Act, generally dictate that the assets acquired in a merger should be assessed at fair market value, there may already be differences in the recognition of costs and thus in determination of the result. In this regard, close cooperation between the accountants or financial advisers of the companies involved in the merger is essential.

Examination of the need for merger approvals

An important practical aspect that should be taken into account when planning a cross-border merger is to verify whether the consent of other entities or bodies will be required to carry out the procedure. The companies should:

- Verify whether they have entered into contracts with change-of-control clauses or other provisions that might entitle the other party to terminate the contract in connection with the merger
- Check whether the merger will require the approval of state authorities, such as the national competition authority or (in Poland) the National Support Centre for Agriculture (KOWR) (especially in light of new regulations allowing KOWR to reach the shares of not only a company holding agricultural property, but also its parent company)—the need for KOWR approval may apply not only to the merged companies themselves, but also to the shares they hold in other companies that are owners or perpetual usufructuaries of agricultural property
- Examine the possibility of transferring to the acquirer licences and administrative permits held by the target, and the consequences of such transfer.

GO TO THE TABLE OF CONTENTS →

Deletion of the target company from the Polish register

In principle, when the acquirer is in another member state, the registry court for the acquirer's head office should notify the Polish registry court for the target, and this should result in deletion of the acquired company from the National Court Register.

But the practice shows that communications between the courts can be significantly delayed. As a result, a company that no longer exists may continue to appear in the register, which can be misleading to counterparties or state authorities. Thus it is advisable to inform the Polish registry court of registration of the merger abroad. A letter in this regard should include attachments confirming the fact of registration of the merger in the foreign register, e.g. an excerpt from the register. In our experience, this significantly speeds up the deletion of a Polish company from the National Court Register.

Additional remarks

Finally, we draw attention to general problems encountered in interjurisdictional procedures.

Regarding the official foreign documents needed for use in Poland, while exceptions exist to the need for additional authentication of documents (especially those issued by authorities of other member states), the Polish courts and state authorities often expect documents submitted to bear an apostille clause. So to avoid additional complications, it is advisable to obtain such a clause before submitting official foreign documents to the relevant court or office in Poland.

As for documents signed in front of a notary, it should be ensured that the notarial clause sufficiently attests the signatory's authority to sign the document. For this purpose, the rules of representation of the entity on whose behalf the documents are signed should be checked. This is particularly important for countries where these rules are not explicitly described in the registration documents. In such a case, it may be necessary to obtain additional documents (such as the articles of association or a resolution of a corporate body of the foreign entity). At the same time, it should be remembered that Polish notaries and registry courts may request the production of such documents in order to perform further actions on this basis. Therefore, it is worth preparing in advance for such an eventuality.

GO TO THE TABLE OF CONTENTS →

In addition, when documents are drawn up before a foreign notary, it should be determined whether the documents are signed in a form meeting the requirements of Polish law. Cases sometimes occur where documents issued under foreign law purporting to correspond to the Polish form do not actually meet the Polish criteria. For example, Spanish notaries issue copies of documents with notarised signatures in a form very similar to a Spanish deed. The lack of what the Polish authorities would regard as proper form poses a risk that the validity of the merger will be questioned.

In short, cross-border reorganisations should take into account not only the provisions of Polish and foreign law, but also the specifics of the documentation and established customs in the jurisdictions of the companies involved in the merger.

GO TO THE TABLE OF CONTENTS →

New demerger by spin-off: The simplest of demergers and a practical alternative to the demerger by separation and in-kind contribution

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On 15 September 2023, an amendment to the Commercial Companies Code entered into force, introducing into the Polish legal system a previously unknown method of demerging companies: the demerger by spin-off. The parliament was obliged to implement EU directives providing for the demerger by spin-off as well as additional methods for cross-border demerger.

What is demerger by spin-off?

Demerger by spin-off is a novelty in Polish commercial law, but, as our experience shows, it has already been used in practice. It draws heavily on the legacy of German legislation, which, even before entry into force of the EU directive, specifically provided for this method of demerger.

A demerger by spin-off involves a transfer of a portion of the assets of the demerged entity (which may be a company or a joint-stock limited partnership) to an existing or newly formed company or companies in exchange for shares of the acquiring or newly formed company or companies, **which are taken up by the demerged company**. As a result of the demerger, the acquiring company enters into the rights and obligations of the demerged company specified in the demerger plan (universal succession) as of the date of the demerger, including, by operation of law, all rights and obligations of the demerged company provided for in tax law. Permits, licences and concessions related to assets assigned to the acquiring company in the demerger plan are also transferred to the acquiring company, unless the act or decision granting the permit, licence or concession provides otherwise. The acquiring company can be either an existing company or joint-stock limited partnership, or a company newly formed in connection with the demerger by spin-off.

In a demerger by spin-off, the partners or shareholders of the demerged company do not take up shares in the company to which the assets of the demerged company are transferred. Newly created shares in the acquiring company are taken up directly by the demerged company. Against the backdrop of the provisions on changes in corporate form, the design of a demerger

GO TO THE TABLE OF CONTENTS →

by spin-off resembles a demerger by separation. The biggest difference is the limited participation in the demerger by the demerged company's partners or shareholders. As in the case of the demerger by separation, a company subject to demerger by spin-off is not dissolved as of the date of demerger.

Simplification

Carrying out a demerger by spin-off has been significantly facilitated by the law itself. In a demerger by spin-off, certain elements of the company's demerger plan are excluded because the shares in the acquiring company are taken up directly by the demerged company and not by its partners or shareholders. And for the same reason, the companies participating in the demerger by spin-off must include in the demerger plan information regarding the number and value of shares in the company or the acquiring or newly formed companies taken up by the demerged company. As a result, the plan for a demerger by spin-off does not have to include the following elements:

- The ratio for exchange of shares of the demerged company for shares of the acquiring or newly formed companies and the amount of additional contributions in cash, if any
- The rules for granting shares in the acquiring companies or newly formed companies
- Indication of the date from which the newly created shares entitle the holder to participate in the profit of the acquiring or newly formed companies
- Indication of the rights granted by the acquiring or newly formed companies to shareholders, partners, or persons with special rights in the demerged company
- Rules for distribution among the shareholders or partners of the demerged company of the shares of the acquiring companies or newly formed companies.

Additionally, the management boards of companies participating in the demerger are not obliged to prepare a written report justifying the company's demerger. Unlike a demerger by separation, where examination of the plan by an auditor can be waived (optionally, with the shareholders' consent), in the case of a demerger by spin-off the need for audit of the company's demerger plan is excluded by virtue of law.

GO TO THE TABLE OF CONTENTS →

At the same time, other simplifications will be allowed to be introduced with the consent of all the partners or shareholders of each of the companies involved in the companies' demerger. It is possible to skip:

- Attaching to the demerger plan a statement on the accounting status of the demerged company, prepared for purposes of the demerger as of a specified date in the month preceding the filing of an application for announcement of the demerger plan, using the same methods and the same layout as the last annual balance sheet
- Notification by the demerged company's management board to the management board of each acquiring company, or the newly formed company in organisation, of any material changes in assets or liabilities between the date of preparation of the demerger plan and the date of adoption of the resolution on demerger.

Demerger by spin-off as an alternative to demerger by separation or in-kind contribution of an organised part of an enterprise

Due to the foregoing simplifications, a demerger by spin-off may be an interesting alternative to carrying out a reorganisation in a group of companies, which under previous law would have to be carried out by a demerger by separation, in-kind contribution, or transfer of an enterprise or organised part of an enterprise.

In essence, a demerger by spin-off seems to most resemble an in-kind contribution, as the acquiring company issues shares to the demerged company in exchange for the assets it receives. However, the differences are significant, and therefore a decision to conduct a separation or an in-kind contribution should be preceded by meticulous legal, business and tax analysis.

As a rule, an in-kind contribution to a company includes solely assets. In contrast, in the event of a separation, the company's spun-off items include both assets and liabilities (for example contractual obligations). With an in-kind contribution, singular succession (contribution of individual assets to the company) takes place, which may require additional agreements between the company contributing certain assets and its creditors. Also, in the case of in-kind contribution, a broad tax succession does not take place. Similar restrictions will also apply to the disposal of an enterprise or an organised part of an enterprise. The advantage of a demerger by spin-off is the transfer of rights and obligations by virtue of law (partial general succession). The effect of general succession will be the transfer as of the date of spin-off of,

GO TO THE TABLE OF CONTENTS →

among other things, permits, concessions and exemptions, unless the law or a relevant decision provides otherwise.

Here, it should be pointed out that if the acquiring company is a joint-stock company (S.A.), both in-kind contributions and demergers by spin-off will, in principle, require an auditor's opinion under the provisions on in-kind contributions to joint-stock companies.

When is it a good idea to choose the demerger by spin-off, and how quickly can it be conducted?

During the company's existence, there are many situations where it is necessary to carry out restructuring. The reasons may include:

- A need for refinancing of operations
- A need to isolate specific business lines to optimise processes
- Starting joint activity with another undertaking
- The need to spin off part of the existing business in order to sell that part of the business.

Suppose a parent company spins off part of its business to a 100%-owned subsidiary. But the subsidiary has already been granted a number of permits that would have to be updated in the event of a change of shareholders (direct change of control). In such a scenario, if a separation were to take place, a need to update the permits would occur, as the shares in the subsidiary would pass to the shareholders of the parent company. The demerger by spin-off allows the parties to avoid updating the permits, as in that scenario the entities involved in the ownership structure of the subsidiary will remain unchanged.

Preserving the existing ownership structure after reorganisation may also be important, for example, for regulated entities in the capital market (investment fund companies) and financial institutions (banks), which will not be obliged to obtain a decision from the Polish Financial Supervision Authority on the lack of objection to implementation of the demerger, which might have to be obtained in the event of a change in shareholders.

Also, against the backdrop of state aid regulations, preservation of the existing ownership structure by a company that is the beneficiary of state aid may, at least in some situations, allow the state aid to be maintained, while avoiding the need to notify or obtain approval from the financing institution for reorganisation.

GO TO THE TABLE OF CONTENTS →

In business practice, a number of other situations certainly will occur in which a demerger by a separation will be the optimal solution.

Tax considerations should be taken into account when choosing the appropriate form of restructuring. To maintain the tax neutrality of the process (in the case of both in-kind contributions and demergers), it will most often be necessary to first internally spin off an organised part of the company. Depending on the assumptions made, allowing for the tax requirements (such as obtaining interpretations), it should be possible to carry out a demerger by spin-off within a minimum of three to four months.

The choice of the right legal form for a reorganisation will always be dictated first and foremost by the business needs, which must be effectively translated into the legal and tax levels. In this context, a demerger by spin-off creates new opportunities for reorganisation that were not available before the change of law and are worth considering at the initial planning stage.

GO TO THE TABLE OF CONTENTS →

Conversion of a joint-stock company into a limited-liability company: Practical problems

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Poland's Commercial Companies Code allows for conversion of a joint-stock company (SA) into a limited-liability company (sp. z o.o.), but many formalities are required and not always clearly regulated. Mistakes at any stage of the process may result in the court refusing to register the conversion. In this article, we describe the stages of the process and selected practical issues that may arise.

Draft terms of conversion—practical tips

To convert a company, financial statements must first be prepared as of a specified date in the month preceding submission of the draft terms of conversion to the shareholders. Then, the management board of the joint-stock company should prepare the draft terms of conversion and appendices, i.e. draft resolution on conversion, draft articles of association of the converted company, and the financial statements.

According to the legal literature, the draft terms of conversion should be prepared by the entire management board. This requirement protects against any member of the management board being excluded from the process, but also obliges all board members to be involved in preparing the conversion proposal.

Although the draft terms of conversion are prepared by the entire management board, adoption does not necessarily require unanimity. The draft terms may be adopted either unanimously or by a majority vote, depending on the company's rules for taking decisions outside the ordinary course of business (M. Rodzynkiewicz in A. Opalski (ed.), *Commercial Companies Code, vol. IV, Merger, demerger and conversion of companies: Criminal provisions, commentary on Art. 491–633* (2016) (Art. 557)).

In principle, the draft terms of conversion are prepared in writing. In such a situation, it is sufficient for the document to contain the handwritten signatures of the members of the management board of the company (all or a majority, as the case may be). However, in the case of a joint-stock company with a sole shareholder, the draft terms of conversion should be prepared in the form of a notarial deed. In practice, in single-shareholder companies, the

GO TO THE TABLE OF CONTENTS →

minutes of the meeting of the management board at which the resolution was passed adopting the draft terms of conversion, or the draft terms of conversion and annexes, are prepared in the form of a notarial deed.

The provisions do not require that the draft terms of conversion be examined by an auditor when converting a joint-stock company into a limited-liability company. (There is such an obligation in the reverse situation.)

Nor is there an obligation to publish the draft terms of conversion to allow a creditor to request security for its claims against the joint-stock company, even in the creditor has made a showing that satisfaction is threatened by the conversion. Pursuant to the Commercial Companies Code, the draft terms of conversion must be published only when converting into a simple stock company (PSA). But in practice, it has happened that in considering an application to register the conversion into a limited-liability company, the registry court has called on the applicant to provide statements from the management board that the draft terms of conversion were announced, or else the court will deny the entry. In such a case, it was sufficient to indicate in a letter to the court that the obligation to publish the draft terms of conversion did not apply to this type of conversion, and the lack of the requested statement of the management board could not result in denial of registration.

Notification of shareholders, adoption of resolution on conversion, and appointment of the authorities of the converted company

Once the draft terms of conversion have been prepared, the management board has to notify the shareholders twice of its intention to adopt a resolution on the company's conversion. The first notice should be given no later than one month before the scheduled date of adoption of the resolution, and the second notice no less than two weeks after the date of the first notice. The notice should include the essential elements of the draft terms of conversion, as well as indicate how the shareholders can access the full contents of the draft terms and appendices.

Next, the shareholders should pass a resolution on the company's conversion stating:
- The company's new legal form (in this case, it will be a limited-liability company)
- The amount of share capital

GO TO THE TABLE OF CONTENTS →

- The scope of rights (if any) granted personally to shareholders of the converted company
- The names of the members of the management board of the converted company (the same as in the previous company, or other persons, without restrictions)
- Approval of the draft terms of conversion
- The proposed wording of the articles of association.

Adoption of such a resolution takes the place of adoption of articles of association of the converted company and appointment of its corporate authorities.

A resolution in the form of a notarial deed can be adopted at either an extraordinary general meeting or an ordinary (annual) general meeting. The latter solution saves time and costs associated with convening an additional meeting. Another argument in favour of the second option is the statutory requirement that a company must have approved financial statements for at least the last two financial years before conversion of the joint-stock company to a limited-liability company. The financial statements for the most recent financial year may be approved at the same meeting where the resolution to convert the company is adopted. Thus at one meeting, both obligations required for conversion can be fulfilled.

Conversion date and post-conversion activities

Once the shareholders have passed a resolution on conversion and all the necessary corporate documents have been assembled, all the members of the management board of the converted company (i.e. the limited-liability company, not the joint-stock company) should apply for entry of the company in the register. If the application is submitted by an attorney, the power of attorney must be signed by all members of the management board.

The conversion date is the date when the registry court enters the converted company in the register. At that moment, the company being converted (SA) becomes the converted company (sp. z o.o.). Therefore, it is not possible to firmly indicate a specific conversion date in the application, as this will depend on the action of the court. However, the practice shows that the courts will grant a request in the cover letter attached to the application for registration indicating the conversion date desired by the applicant, and that is when the court actually enters the new company in the register. At that time, the company being converted is also deleted by the court *ex officio*. In practice, the deletion often occurs a few days after the conversion itself.

GO TO THE TABLE OF CONTENTS →

After conversion from a joint-stock company to a limited-liability company, the company should remember to terminate the contract for maintaining the register of shareholders. This is because in its new legal form, the company will no longer have dematerialised shares in an SA (*akcje*), but shares in a sp. z o.o. (*udziały*). Therefore, the company will no longer have to bear the costs of maintaining the shareholder register. The details of the termination should be verified in the contract with the operator of the register. Most often, it is sufficient to submit a request for termination of the contract, along with a copy of the resolution on conversion and an excerpt from the National Court Register.

The next step is the issue of announcement on the conversion. The provisions do not specify whether announcement of entry of the converted company in the register is sufficient, or another, separate announcement of completion of the conversion process is necessary. The lack of an obligation to proceed with an additional announcement would allow the company to avoid the additional cost of placing an announcement in *Monitor Sądowy i Gospodarczy*. However, some commentators take the view that these two announcements are not equivalent, and as the obligation to announce the conversion is indicated in a separate provision of the Commercial Companies Code, it is necessary to publish a separate notice on completion of the registration process (M. Tofel in *Commercial Companies Code: Commentary* (8th ed. 2022), Art. 570)). Because there is no settled position on this matter, submitting an additional application is the safer and suggested solution. However, the code does not indicate the deadline for submitting such an application.

Conclusion

Conversion of a joint-stock company into a limited-liability company in Poland is a formal process, consisting of the steps outlined above, most of which are regulated by the Commercial Companies Code. However, practical legal issues arise in the course of the conversion procedure, which must be dealt with in a timely manner so that the whole activity is completed as smoothly as possible and ends in entry of the converted company in the register by the deadline indicated in the application.

GO TO THE TABLE OF CONTENTS →

The impact of a conversion in corporate form on companies' financial reporting

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This issue continues to raise numerous doubts under Polish law. The doubts surround the number of financial statements required by law to be prepared in relation to the conversion, the reporting period covered by each financial statement, and the obligation for the financial statement to be examined by an auditor and approved by the competent body. Of particular importance is the correct determination of the period for which the first annual financial statement of the company post-transformation (the "new" company) must be prepared, which directly affects the method for distribution of profit from the company prior to transformation (the "old" company) and the limitations on distributions.

In response to doubts raised by the Polish Chamber of Statutory Auditors (PIBR), the Ministry of Finance has issued guidance in this regard (in particular, letters from the ministry's Department of Public Expenditure Effectiveness and Accounting of 29 June 2020 (DR1.5101.11.2.2020, responding to PIBR letter of 19 December 2019) and 9 July 2021 (DWR5.5101.82.2021, responding to PIBR letter of 18 March 2021). Nonetheless, the reporting practice of units that have undergone a corporate conversion is still not uniform.

Classification of financial statements

First some points of order on the classification of financial statements under Poland's Accounting Act. The act distinguishes between "annual financial statements" and "other financial statements," depending on the time the statement is prepared and reason it is prepared.

The Accounting Act ties the obligation to prepare financial statements to closing of the unit's accounting books, which is mandatory in the cases indicated in Art. 12(2) of the act—among other things:

- Periodically, as of the end of the unit's financial year (Art. 12(2)(1))
- On the date of a merger in which the unit is taken over by another unit (for the unit being acquired, Art. 12(2)(4))
- As of the day before the unit is placed in liquidation or is declared bankrupt (Art. 12(2)(6))
- As of the day before a change in the unit's legal form (Art. 12(2)(2)).

GO TO THE TABLE OF CONTENTS →

Thus, under the Accounting Act, annual financial statements are financial statements prepared as of the end of the financial year (Art. 45(1) in conjunction with Art. 12(2)(1)), where the financial year or a change in the financial year is determined by the articles of association under which the unit was established (Art. 3(1)(9)).

Any financial statement prepared as of a balance sheet date other than the end of the financial year is a financial statement other than an "annual financial statement" (Art. 45(1) in conjunction with Art. 12(2)(2)–(7)).

The Accounting Act distinguishes between two categories of financial statements:

- "Annual financial statements" (prepared as of the end of the financial year)
- "Other financial statements" (prepared as of another balance sheet date).

Financial statements prepared in connection with conversion

Two types of financial statement are required for the immediate needs of the conversion of corporate form of a company (or partnership) governed by the Commercial Companies Code:

1. **Financial statement prepared for purposes of conversion** (Commercial Companies Code Art. 558 §2(4)). This statement should be prepared as of the same date as of which the balance sheet value of the property of the company being converted is determined, i.e. as of a specific date in the month preceding submission of the draft terms of conversion to shareholders of the company being converted (using the same methods and in the same layout as the last annual financial statement of the company).
2. **Financial statement as of the day before the change in legal form of the unit** (Accounting Act Art. 45(1) in conjunction with Art. 12(2)(3))—pursuant to Commercial Companies Code Art. 552, the date of the change of legal form of the company is the date of entry of the "new" company in the commercial register.

Closing of the accounting books on the day preceding the conversion, and subsequently opening the accounting books of the "new" unit on the date of conversion, has the effect of cutting short the last financial year of the "old" company and starting the first financial year of the "new" company. This has significant implications for the distribution of profit from the "old" company, which in principle is frozen until the first annual financial statement of the "new" company is approved.

GO TO THE TABLE OF CONTENTS →

The Accounting Act also provides for certain simplifications allowing the company to skip the closing and reopening of the unit's accounting books despite the company's conversion. This may be applied in the case of conversion of a partnership under the Commercial Companies Code or a partnership under the Civil Code (*spółka cywilna*) into another partnership, as well as conversion of one type of company into another type of company (Accounting Act Art. 12(3)(1)). Thus, this exemption will also apply to conversion of a limited-liability company (sp. z o.o.) into a joint-stock company (SA) and vice versa.

The following reports may also be directly related to the conversion:

3 **Separate financial statement as of another balance sheet date** (Accounting Act Art. 45(1) in conjunction with Art. 12(2)(7)), if provided for by separate regulations, in particular when the reorganisation is due to tax considerations. In recent years, a large share of corporate conversions have been driven by the desire to take advantage of a form of deferred taxation referred to as "Estonian CIT." In particular, the choice of this form of taxation is possible even before the end of the unit's adopted financial year, provided that on the last day of the month preceding the first month of lump-sum taxation the unit closes its accounting books and prepares its financial statement in accordance with accounting regulations (Corporate Income Tax Act Art. 28j(5)).

4 **First annual financial statement of the newly converted company** (Accounting Act Art. 45(1) in conjunction with Art. 12(2)(1)).

Under the foregoing systematic scheme, the statement indicated in point 4 is an "annual financial statement" of the "new" company, while the financial statements in points 1 through 3 are "other financial statements" of the "old" company.

Requirement for audit and approval of financial statements prepared in connection with a conversion

Accounting Act Art. 64 requires auditing of the annual consolidated financial statements of capital groups and the annual financial statements of continuing units indicated in the act. As a result, under the act, of the aforementioned financial statements, the following will not have to be audited:

- Financial statements prepared for purposes of conversion
- Financial statements prepared in connection with closing of the unit's accounting books as of the day before the change of legal form
- Statements prepared as of another balance sheet date (if the obligation to prepare them arises).

GO TO THE TABLE OF CONTENTS →

The Polish Accounting Act imposes an obligation for financial statements to be examined by a statutory auditor and approved by the competent body only in relation to annual financial statements.

As with the requirement for auditing of financial statements, the requirement for approval of financial statements is specified by the Accounting Act only in relation to annual financial statements (Art. 53). Hence, under the act, the following do not require adoption of a resolution by the competent body approving the statement:

- Financial statements prepared for purposes of conversion
- Financial statements prepared in connection with closing of the unit's accounting books as of the day before the change of legal form
- Statements prepared as of another balance sheet date.

The foregoing principles for auditing and approval of financial statements have been confirmed in letters issued by the Ministry of Finance.

However, the requirements arising from other regulations must also be taken into account.

First, after the amendments introduced in 2020, the draft terms of conversion of a company (or partnership) must be audited if the company is being converted into a joint-stock company (Commercial Companies Code Art. 559). That audit concerns the correctness and reliability of the draft terms of conversion, as well as whether the valuation of the property (assets and liabilities) of the company being converted is reliable. Since the financial statement prepared for the purpose of conversion is an appendix to the draft terms of conversion, it will have to be audited in that case.

Second, the provisions of the Commercial Companies Code on approval of financial statements by the competent body refer literally not to approval of "annual financial statements," but approval of "financial statements for the previous financial year" (e.g. Art. 146 §1(1), 231 §2(1) or 395 §2(1)). Since the closing of the accounting books of the "old" company as of the date of the conversion results in cutting short the financial year, it is functionally reasonable to take the approach that the shareholders of the "old" company should vote on a resolution to approve the financial statement for the period of the last financial year. This solution is justified even though opening of the "new" company's accounting books as of the date of the unit's change in legal form (Accounting Act Art. 12(1)(3)) formally begins the running of the first financial year of the "new" company. Application of this approach is also justified with respect to other interim financial statements of the unit that

GO TO THE TABLE OF CONTENTS →

do not constitute an "annual financial statement" of the unit for purposes of the Accounting Act. This will guarantee the unit's shareholders direct control over each period of the unit's operations in a given calendar year for which a financial statement must be prepared pursuant to the Accounting Act.

First annual financial statement of the "new" company

In practice, the doubts regarding the reporting period for which the first annual financial statement of a newly converted company must be prepared have led to creation of two competing models.

First option

In the first option, the annual financial statement of the "new" company is prepared for the period from the date of the last opening of the accounting books in the first financial year of the newly converted company through the date ending the company's first financial year. This approach is consistent with the systematic classification of financial statements adopted in the Accounting Act.

EXAMPLE 1

On 1 July 2022, a general partnership (s.j.) whose financial year is equivalent to the calendar year was converted into a joint-stock company whose financial year is also equivalent to the calendar year. For the general partnership, the prerequisites giving rise to the obligation to have its annual financial statement examined by a statutory auditor (Accounting Act Art. 64(1)(4)) have been met.

In this case, the following statements will have to be prepared:

- Financial statement for the period 1 January – 30 June 2022
- Financial statement for 1 July – 31 December 2022.

Under the Accounting Act, the only annual financial statement requiring examination by a statutory auditor and approval by the general meeting of the joint-stock company (the competent body) is the company's financial statement for 1 July – 31 December 2022.

The financial statement for 1 January – 30 June 2022 will be a financial statement other than an annual financial statement. Thus, under accounting provisions, it will not require a separate audit, nor approval by the competent body. Nonetheless, functionally, it would be reasonable for them to be approved by the competent body pursuant to the Commercial Companies Code.

GO TO THE TABLE OF CONTENTS →

EXAMPLE 2

On 1 March 2022, a limited partnership (sp. k.) whose financial year is equivalent to the calendar year was converted into a limited-liability company (sp. z o.o.) whose financial year is also equivalent to the calendar year. Subsequently, on 31 August 2022, the limited-liability company closed its accounting books, which was required to change its form of taxation and take advantage of lump-sum "Estonian CIT." Here, both the limited partnership (before conversion) and the limited-liability company (after conversion) met the prerequisites giving rise to the obligation to have their annual financial statements examined by a statutory auditor (Accounting Act Art. 64(1)(4)).

In this case, the following financial statements will have to be prepared:

- Financial statement for the period 1 January – 28 February 2022
- Financial statement for 1 March – 31 August 2022
- Financial statement for 1 September – 31 December 2022.

Under the Accounting Act, the only annual financial statement requiring examination by a statutory auditor and approval by the shareholders' meeting of the limited-liability company (the competent body) is the financial statement for 1 September – 31 December 2022.

The financial statement for 1 January – 28 February 2022, as well as the financial statement for 1 March – 31 August 2022, will be financial statements other than annual financial statements. Thus, under accounting provisions, they will not require a separate audit, nor approval by the competent body. Nonetheless, functionally, it would be reasonable for them to be approved by the competent body pursuant to the Commercial Companies Code.

Second option

In the second option, the annual financial statement of the "new" company is prepared for the period from the beginning of the financial year of the "old" company through the end of the first financial year of the "new" company. If the financial years of the "old" and "new" companies are equivalent to the calendar year, and the conversion occurred on 1 March 2022, then under this model the first annual financial statement of the "new" company would be prepared for the period 1 January – 31 December 2022. Some auditors prefer this approach, pointing out that in choosing the first model, the period from the beginning of the financial year of the "old" company through the closing of its accounting books the day before the change in legal form would never be audited.

However, it should be pointed out that each time, information on the unit's conversion and preparation of financial statements other than annual financial statements should be included in the notes, which form part of the annual financial statement. As a result, the financial statement with the data of the "old" company for the financial year in which the conversion occurred

GO TO THE TABLE OF CONTENTS →

are subject to both audit and approval indirectly—at the stage of audit and approval of the first annual financial statement of the "new" company.

Nor is there a risk that the shareholders will be deprived of the right to dispose of the profit earned during this time. Any profit (or loss) generated during the period from the opening of the accounting books of the "old" company through the closing of its accounting books which occurs for a reason other than reaching the closing date of the financial year should be posted as retained earnings (or loss) from prior periods, and left to the disposal of the competent body considering the first annual financial statement of the "new" company and adopting a resolution approving the first annual financial statement.

Conclusion

The practice in determining the reporting period that should be covered by the first annual financial statement of a newly converted company or partnership in Poland continues to vary. This impacts the number and scope of the financial statements prepared, and also results in the lack of a uniform approach to auditing of financial statements and approval by the competent bodies.

On one hand, the Accounting Act distinguishes between "annual financial statements" and "other financial statements," imposing an obligation for audit and approval only of annual financial statements. This approach is confirmed by guidance issued by the Ministry of Finance. But on the other hand, some auditors take the position that the audit should cover the entire period of operation of both the "old" company and the "new" company, or otherwise the shareholders would be deprived of full knowledge and control of the company's operations during the interim period, which is not audited.

Thus, despite the wording of the Accounting Act and guidance from the Ministry of Finance, in practice, the recommended solution is to first consult with the statutory auditor on the model to be adopted for preparing the first annual financial statement of the "new" unit. Functionally, it is also reasonable for the competent body to pass a resolution in each case approving not only the annual financial statement (within the meaning of the Accounting Act), but also the interim financial statements relating to a reporting period for the unit that is not covered by the annual financial statement.

GO TO THE TABLE OF CONTENTS →

Administrative permits and corporate reorganisations: How to ensure business continuity?

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For companies participating in a reorganisation to continue pursuing their owners' objectives, permits, licences or other administrative decisions necessary for operation must be secured. Proper preparation for this process requires not only knowledge of the regulations under which the administrative decisions are issued, but also the agencies' procedural practice.

In the Polish legal system, permits issued under administrative law are wide-ranging, and cases involving them are decided by different levels of administration. Sometimes rulings are delegated to field offices, whose practice and interpretation of the regulations may be inconsistent. And administrative officials are not always comfortable navigating the corporate reorganisation provisions, which are outside their daily routine.

The general rule governing processes of merger or demerger is legal succession. But in Polish administrative law, universal succession is subject to limitations, under the Commercial Companies Code and special laws (e.g. environmental). A general principle of administrative law is that rights and obligations of an administrative nature are closely linked to the entity for which they were established.

As a rule, rights arising from administrative-law relations are non-transferable and non-hereditable, as the administrative-law relationship is specific. On one hand, it binds the individually designated addressee and, on the other, the public administrative body. Thus, in substantive administrative law, the rule is the impermissibility of legal succession, unless the transferability of rights arising from the administrative-law relationship is grounded in a specific provision of substantive law or in the administrative act issued pursuant to that provision.

Exceptions to this rule are provided for in the Commercial Companies Code, but they do not apply to all situations where a corporate merger or demerger takes place. Meanwhile, the rights arising from "non-transferable" administrative decisions may be crucial for the acquiring or newly formed company to be able to conduct its business. Awareness of these limitations allows the parties to plan the reorganisation and take steps to ensure that the activity

GO TO THE TABLE OF CONTENTS →

can be continued. Taking into consideration the inconsistent approach of administrative bodies to transfer of such decisions, these steps need to be arranged accordingly (often down to the specific day).

Art. 494 of the Commercial Companies Code provides for universal succession in a merger, unless a decision or specific law provides otherwise. Analogous effects are provided for in the case of a demerger, where the rights and obligations under administrative acts connected with the assets of the demerged company allocated in the draft terms of demerger are transferred to the acquiring or newly formed company. In contrast, the Accounting Act provides for accounting for the effects of reorganisation and use of financial data of the acquired or divided company so they are properly reflected in the books of the surviving company.

Based on our experience, in light of the regulations governing decisions issued to an entity undergoing reorganisation, we can formulate conclusions helping identify the issues to be analysed in the initial phase of the reorganisation:

- Administrative-law succession applies only to permits, licences or exemptions granted after the effective date of the Commercial Companies Code (1 January 2001).
- There is no need for a specific provision allowing a decision or exemption to be transferred to the acquiring company. On the contrary, the code itself provides a basis for the acquiring or newly formed company to step into the shoes of the company being acquired or divided. In a specific case, it is the act or decision that must exclude application of the code.
- After the date of the merger or demerger, the acquiring or newly formed company must continue to meet the criteria for obtaining a given right, whether involving the entity (e.g. having a clean criminal record or existing in a certain legal form) or the subject matter (e.g. having appropriate assets or qualified personnel).
- The succession rules in the Commercial Companies Code cannot provide a basis for the allocation of rights and duties under administrative decisions among the companies involved in the split, in the event that both the company being split and another company participating in the split were to exercise them as a result of the split. Appropriate actions to obtain a new decision or other act for the company being acquired or the newly formed company, or to amend a decision or act issued in favour of the company being split, must be taken before the relevant administrative body. This makes it necessary to coordinate the date of the merger or demerger with the date on which the competent body grants or modifies the rights or duties in question.

GO TO THE TABLE OF CONTENTS →

Reorganisation and transfer of a decision on environmental conditions

With regard to the transfer of rights under a decision on environmental conditions, Art. 72a of the Polish Environmental Impact Assessment Act constitutes a specific law (*lex specialis*). Pursuant to this provision, the authority competent to issue a decision on environmental conditions is obliged, with the consent of the party to whom the decision was issued, to transfer the decision to another entity if it accepts the conditions stated in the decision.

The possibility of transferring a decision on environmental conditions (which has a preliminary character) is certainly an important response to market changes and the need to reorganise business entities. In the procedure for transferring a decision on environmental conditions, only two parties are involved, i.e. the rightholder under the decision and the party interested in assuming the rights. The entity seeking to assume the rights under an administrative ruling should submit a transfer request to the administrative authority issuing the substantive decision. The rights arising from a decision on environmental conditions are transferable, but only under the conditions stipulated by the act. This means that transfer of a decision on environmental conditions can only take place by way of an administrative decision. The holder must agree to transfer of the decision to another entity, and the entity to which the decision is to be transferred must absolutely accept all the terms and conditions arising from the decision.

However, practice shows that the transfer procedure is not as simple as a reading of the regulations might suggest. Administrative authorities interpret Art. 494 of the Commercial Companies Code in conjunction with Art. 72a of the Environmental Impact Assessment Act inconsistently. Moreover, a statement from the existing holder may not be sufficient, and sometimes is impossible to obtain, since the entity has already been "absorbed" by the newly formed or acquiring company, i.e. formally it no longer exists.

This lack of consistent treatment of the procedure for transferring environmental decisions can disrupt reorganisations, especially if multiple decisions are being transferred, issued by different authorities in different parts of the country—a dilemma we have faced more than once.

Transfer of a non-final decision, or a partial transfer, i.e. of only some conditions of the environmental decision, is also problematic. Most commentators seem to reject this possibility. To avoid complications and ensure business continuity, this issue should be examined in advance and planned for in the draft terms of reorganisation.

GO TO THE TABLE OF CONTENTS →

The foregoing problems also occur in the case of companies' mergers and demergers, as the Commercial Companies Code and specific laws in relation to the code often prove inadequate.

Reorganisations of energy companies and industrial customers

It should come as no surprise that the Energy Law contains provisions requiring interpretation when juxtaposed with the rules for companies' mergers and demergers. Indeed, due to its importance to state security and ensuring the supply of utilities and fuel to consumers, energy is one of the most regulated areas of the economy.

The Energy Law provides for expiration of the licence due to deletion of the company holding the licence from the register. A literal interpretation of the law would result in expiration of the licence even upon conversion, as any reorganisation (with the exception of a demerger by split-up and spin-off) results in deletion of the company being taken over or converted from the register. However, a position has developed in the legal literature that excludes the application of this provision when the licensed activity is continued through succession (or in accordance with the principle of continuation under transformation).

But this does not mean that the issue of guaranteeing the continuity of licensed activities can be treated lightly. The Energy Law contains a whole catalogue of requirements necessary to obtain a licence, and the president of the Energy Regulatory Office has issued guidance in the form of "information packs" whose volume exceeds the length of this article many times over. This guidance is intended to help applicants submit the correct set of documents when applying for a licence. These requirements include:

- No criminal record for offences related to the business in question (harder than it might seem to demonstrate in the case of foreign entities)
- Possessing the necessary infrastructure (technical capabilities)
- Access to financial resources ensuring proper operations
- Guarantee of proper performance of the licensed activity.

The regulator may request clarifications to verify whether the acquiring or newly formed company meets the requirements for holding a particular licence. If this cannot be confirmed, the regulator may amend or revoke the licence.

GO TO THE TABLE OF CONTENTS →

On the other hand, with a demerger, the parties need to remember to contact the market regulator to determine the procedure for obtaining a new licence and amending the existing one, if after reorganisation the licensed business is to be continued by more than one company. While an existing licence may be amended sometime after the merger or demerger, a new licence should be issued on or immediately after that date. This means that it is necessary to prepare the application and collect the required documentation well in advance, so that the regulator can examine them and issue a licence in due time to guarantee the continuity of the licensed activity.

For obtaining and enjoying relief for industrial customers, the regulator has confirmed that in performing its obligations as an industrial customer and applying for industrial customer status in the following year, the acquiring company may use the financial data of the acquired company which had this status on the date of the merger. The application for relief for the following year may include the aggregated financial data of both companies for the purpose of demonstrating that the acquiring company meets the requirements for obtaining relief.

Reorganisations of food and healthcare entities

Entities operating in areas affecting consumers' life and health are subject to particularly strict legal regulation. This is manifest in the need to obtain various types of permits, approvals and/or entries in registers maintained by regulators, and to maintain the validity of these administrative instruments for conducting uninterrupted operations in a given area. These are requirements arising from extensive sectoral regulations such as the Pharmaceutical Law, the Medical Devices Act, the Food and Nutrition Safety Act, as well as, for example, the Act on Prevention of Alcoholism. Fulfilment of these requirements is overseen by authorities such as the Office for Registration of Medicinal Products, Medical Devices and Biocidal Products, the Minister of Agriculture, the Minister of Environment, pharmaceutical and sanitary inspectorates, local offices of the state administration, and local government bodies.

Reorganisations have different models, and it is critical to tailor the reorganisation model not only to the tax environment (which is a common motivation for introducing changes in a group structure), but also to the regulatory environment of the specific industry. For example, in a merger, acquisition or reorganisation involving a supermarket chain, in the food industry it is important to remember that each store has a separate sanitary approval, and

GO TO THE TABLE OF CONTENTS →

if the store sells alcoholic beverages, it must have three retail licences (depending on the strength of the products) to offer the full range of such products.

When it comes to demerging or merging companies, the following issues should be taken into account:

- Some permits are treated as inextricably linked to the holder and therefore are treated as non-transferable under law and practice. Examples include alcohol permits, as well as pharmacy permits (especially after this year's "Pharmacies for Pharmacists" amendment, which is highly controversial and has been appealed to the European Commission).
- Even when dealing with permits that in principle are not non-transferable, in practice administrative bodies are reluctant to amend an administrative decision (the form in which all types of permits are issued) to designate a different holder.

Thus if as a result of the companies' reorganisation, a regulated activity carried out by company X is taken over from a given date by company Y, the administrative bodies usually take the position that it is necessary to issue a new administrative decision to the new entity. Formally, this will involve revocation of the permit for X and issuance of a new permit to Y. Then it will be necessary to coordinate the reorganisation process so that all new permits are issued on the pre-scheduled date of implementation of the companies' reorganisation.

So, when preparing a reorganisation process, it should be checked in advance whether and under what conditions given permits are transferable. If necessary, it is worth consulting the proposed approach to this process with the authority or authorities who issued the permits and oversee the regulated activities, and to allow a realistic amount of time for transferring the legally required permits or obtaining new ones (optimally at the preplanned implementation date of the companies' reorganisation).

Conclusion

Only an extensive analysis of the factual and legal status of the planned reorganisation will allow it to be properly prepared, maintaining business continuity and minimising the costs. Involving specialists in various fields of law in the reorganisation process will ensure that the entire process runs smoothly, while reducing the risks associated with transfer of rights under administrative law.

GO TO THE TABLE OF CONTENTS →

Debt-to-equity conversions in practice

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Converting a company's liability into capital can be a way to "heal" its balance sheet. This can increase the company's credibility with counterparties and reduce the risk of insolvency. Conversion can also generate tax benefits, for example by reducing interest expense to below the deductible limit.

The benefits of debt-to-equity conversion are not affected by the manner in which it is carried out, i.e. in-kind contribution or an increase in the company's share capital through a cash contribution.

Legal and practical issues

Under the currently prevailing position in the case law and legal literature in Poland, in both an in-kind and a cash contribution, conversion of a liability into share capital can be carried out without amending the articles of association. In such a situation, the current articles must allow for capital increases without amending the articles, by indicating the maximum amount of such an increase (by how much) or the maximum amount of capital (up to what amount), and the deadline for making such an increase.

When the capital is raised in this way through a non-cash (in-kind) contribution, it cannot be described in the articles of association (which, after all, are not being amended). Instead, the obligation to describe the contribution can be fulfilled in the resolution on the capital increase, also identifying the shareholder making the in-kind contribution as well as the number and nominal value of shares taken up in exchange. This resolution (like the articles of association) is a publicly available document in the National Court Register. The description of the contribution and revision of the amount of share capital after the increase without amending the articles of association may then be explicitly reflected in the wording of the articles of association in the future, at the same time when other amendments need to be made.

However, due to the evolving interpretation of the provisions in this regard and previous divergent positions, we suggest a cover letter with the application to the registry court pointing out the current position in the doctrine. This should avoid delays in registering the increase.

GO TO THE TABLE OF CONTENTS →

Dispensing with the need to visit a notary to amend the company's articles of association or perform any other acts saves both time and money. The only stage of a capital increase that may take longer is entry of the capital increase in the National Court Register, required for it to be effective. But the contribution itself is effective as soon as the relevant agreement is signed (assignment or setoff). Thus, the debt is expunged earlier than entry of the capital increase in the National Court Register.

Potential problems when increasing share capital under the existing articles of association may arise with a larger number of shareholders. In such a situation, the shareholders should be entitled to new shares pro rata to their existing shares. Thus, if the capital is increased without amending the articles of association, the parity of shares between the shareholders must be maintained. On the other hand, rare situations occur where the value of the converted debt corresponds ideally to the shareholders' stakes, and in such case converting them in full would mean increasing the value of all shares at the expense of the shareholder whose debt was worth more.

On the other hand, a change in parity implies the need for the involvement of a notary and the standard procedure for increasing capital by amending the articles of association (i.e. by a notarial deed). Here, in turn, the shareholders who do not want to convert their claims, do not hold claims, or whose converted claims are of lesser value, face potential dilution of their stake in the company.

Tax issues

Another extremely important aspect of the conversion is its proper accounting for tax purposes.

Income on the part of the shareholder

In light of the well-established practice and case law of the Supreme Administrative Court of Poland, regardless of the conversion model adopted (in-kind contribution of the claim or setoff of the debt against the cash contribution), conversion of debt to equity will be considered a non-cash contribution for tax purposes. The practical consequence of this is that a shareholder must recognise revenue in an amount equal to the value of the contribution as specified in the articles of association or equivalent document. In doing so, the revenue cannot be less than the market value of the contribution.

GO TO THE TABLE OF CONTENTS →

At the same time, a shareholder may recognise a corresponding deductible expense, provided that the principal of the loan was transferred to the company's account. In practice, this will mean no additional tax to be paid on the conversion (i.e. tax neutrality). However, a condition defined for recognising a deductible expense may lead to a lack of neutrality of the conversion when the loan was paid out other than in cash to the borrower, for example through a remittance to another creditor of the borrower (*przekaz*). In the case of conversion of non-loan liabilities, the expense will be the value of the debt previously included in taxable income. Importantly, a conversion performed by one shareholder does not affect the tax liability on the part of the remaining shareholders; any potential increase in the value of their shares resulting from the conversion will be taxed only when they sell their shares.

Under Polish regulations, if a shareholder is a foreign entity, revenue does not necessarily arise.

Withholding tax

If the conversion includes an interest portion payable to a foreign shareholder, it is also necessary to examine the company's potential withholding obligations. In particular, this includes collecting documents necessary for application of a preferential rate or exemption from withholding tax, exercising due diligence in verifying the rationale for such a rate or exemption (including determining whether the recipient is the beneficial owner of the payment), or applying the pay-and-refund mechanism.

A tax liability arises on the payment of interest in any form, including, for example, by setoff. In the case of conversion, unlike cash interest payments, the economic burden of withholding tax will most often lie with the debtor, as there is no payment on which tax can be deducted, leading to the effective grossing up of interest. Such a configuration may mean that in the withholding (pay and refund) procedure, the entity entitled to claim a tax refund will be the company repaying the loan. However, this does not exclude contractual arrangements effectively shifting the cost of the tax to the lender.

Civil transaction tax

A share capital increase is subject to the tax on civil-law transactions (0.5% of the value of the increase). The amounts transferred to the capital reserve (*agio*) are not taxable. Since the Commercial Companies Code give leeway in determining the proportion of share capital and *agio*, the question arises whether the tax authorities can challenge such an allocation as aiming to

GO TO THE TABLE OF CONTENTS →

understate the tax base. In principle, the answer to this question seems to be affirmative. But in assessing such risks, it should be borne in mind that the allocation of even a large portion of the increase to the capital reserve may have a legitimate economic justification.

For example, when a conversion is dictated by the need to improve the company's financial indicators (e.g. eliminating negative equity), it is reasonable to increase the share capital to a minimal extent. In such a situation, the purpose of the conversion is not to increase the share capital, and the process itself is driven by external factors (e.g. to meet covenants imposed by banks lending to the company). Also, the allocation of the increase may be justified by the existing equity structure. On the other hand, in the case of a joint-stock company, the argument for allocating the increase to the capital reserve may be that an increase in the share capital results in the need to increase the value of the capital reserve. Therefore, an excessive increase in share capital may adversely affect the company's ability to pay dividends.

Consequently, the existence of a business case for the allocation should be assessed in each instance, including for the purpose of properly fulfilling potential obligations to report on tax schemes. Indeed, to determine the reporting obligation, it may be necessary to assess whether the "main benefit" criterion is met, i.e. in simple terms, to determine whether the tax benefit is the main benefit or one of the main benefits that the participant expects to achieve in relation to carrying out the conversion.

Notary fee vs. transaction tax

The notary fee payable on capital increases with an amendment to the company's articles of association reduces the base for calculating the tax on civil-law transactions. Therefore, the best tax solution is usually for the company itself to pay the notary fee, which will be subject to VAT in Poland.

This may not be possible if the notary's fee is paid by a foreign shareholder. If the shareholder is from outside the EU, then the notary fee is not subject to VAT. If the foreign shareholder is based in the EU, two cases are possible:

- When the shareholder is an active VAT payer and does not hold an EU VAT number, then Polish VAT will be added to the notary fee
- When the shareholder is an active VAT taxpayer and holds an EU VAT number, then the notary fee will be exempt from Polish VAT (under the reverse-charge mechanism).

GO TO THE TABLE OF CONTENTS →

Not charging VAT on the fee means no reduction in the company's cost associated with the need to pay the transaction tax.

Information regarding the payer of the notary fee should be provided to the notary in advance so that they can make the appropriate calculations. In doing so, it should be borne in mind that the notary, as the remitter of the transaction tax, must receive from the company the amount of tax for subsequent payment.

Converting a company's liability into its share capital can serve a variety of purposes, ranging from tax benefits to improving credibility in the market due to reduced debt levels, or reducing the risk of insolvency. In this process, we have advised entities from many different industries and fields, such as SPVs investing in and implementing renewable energy projects or managing real estate. We have also applied similar mechanisms in M&A, real estate and financing transactions, when a party to the transaction or the provider of the financing for whatever reason does not wish for the continued existence of the converted liability.

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GO TO THE TABLE OF CONTENTS →