Dear Readers,

We are honoured to present you another issue of our new Newsletter. Once again we are presenting content related to the four areas of our operation, i.e. Law, Taxes and Accounting, Corporate Finance and Direct Investments.

In this edition, we write about issues including the expenses of granting surety and what innovation is incorporated in the amendment to the Code of Civil Procedure of 3 May 2012. We also describe the planned changes to the operation of Poland’s special economic zones as well as we draw your attention to the significance of the control premium to transaction prices in the M&A process.

Thank you for your confidence in JP Weber.

We wish you a pleasant reading while remaining at your service as your trusted advisor.

Yours sincerely,
JP Weber team

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JP Weber Golf Challenge – the fourth edition of the tournament

JP Weber is already organizing the fourth edition of JP Weber Golf Challenge tournament. This year’s event will take place on 22 September at Toya Golf & Country Club course near Wroclaw. The rapidly growing event, held in collaboration with its sponsors, enjoys interest of golfers and golf fans from the world of business internationally. This year, JP Weber Golf Challenge is going to attract a hundred participants. The Golf Academy is part of the event which will cater for those new to this sport. You will be able to read an account of the tournament in the September issue of J Weber Inside. Those willing to take part in the event are requested to contact Ms Monika Kiljan at m.kiljan@jpweber.com

Photos from the 3rd edition of JP Weber Golf Challenge 2011 tournament; Toya Golf & CC; Fot.: M. Kromarek

Training for regional partners of the Polish Information and Foreign Investment Agency (PAIIIZ)

A training session for regional investor assistance centres was held between 20 and 21 May 2012 at the seat of the Polish Information and Foreign Investment Agency. JP Weber Investments limited liability company was the subject matter partner for the event.

The scope of the first day of the training session entailed activities in the area of partnership cooperation in 2012. PAIIIZ representatives presented the latest tendencies in the influx of direct foreign investments, investments in the Business Process Offshoring sector and experiences of assisting industrial projects as well as Chinese delegations and investments.

JP Weber Investments organized a seminar, serving training and informative purposes, in which the speakers – Jędrzej Piechowiak and Łukasz Czajkowski, shared their knowledge and experience in providing assistance to investors. They spoke of cultural differences in business and ways to prepare a presentation for an investor as well as they discussed post-investment service issues, emphasizing stimulating and supporting reinvestment activities.
Law
Amendments to the Code of Civil Procedure from the entrepreneur’s viewpoint

The amendment to the Code of Civil Procedure, enacted with the law of 16 September 2011, came into force on 3 May 2012. The scope of the changes entails substantial modifications of the rules governing the Code of Civil Procedure. Below, a summary is given of the most important issues concerning the newest amendment.

Generally, the new regulations apply to proceedings commenced after 3 May 2012. It means that until cases commenced before that date are closed, with exclusion of very few regulations applying straightforwardly to all proceedings, two versions of the Code will be in force parallely: the “old” version for proceedings from before 3 May and the “new” one for those commenced after the amendment becoming effective.

Separate proceedings for commercial cases have been done away with by the amendment, however specialized commercial courts have remained. As a result, commercial cases will be settled in accordance with the general lawsuit rules. The change poses fear of proceedings becoming lengthy – after all, the previous separation was also intended to facilitate commercial proceedings’ efficiency. Abandoning the restrictive rules governing separate commercial proceedings, the evidence preclusion system in particular (phasing out the possibility of invoking new facts and evidence in further stages of procedure), may “block” proceedings if the judge accepts new evidence at each stage of proceedings.

An additional factor which could make the wait for verdicts longer is the increase in the number of property rights cases heard by regional courts – from 3 May regional courts will arbitrate at first instance every commercial case where the matter in dispute amounts to more than PLN 75,000 instead of the previous PLN 100,000.

In order to prevent lengthiness of proceedings, the legislator has strengthened the role of the so-called informational questioning of the sides. The amended art. 212 has given to judges a possibility of posing questions during trial with a view to specifying the factual grounds of demands and claims as well as facts and evidence produced by the sides.

Another innovation is curtailment of the possibility of filing preparatory documents beyond a response to the suit. The regulation is intended to curb the practice of filing by proxies lengthy documents which do not contribute much substantial content but block the course of proceedings instead. Thus, from 3 May 2012 sides will be able to express their stance during trial only in an oral form, unless the court demands filing a document. It will probably result in sides’ filing annexes to the protocol, which by definition are supposed to be limited to a summary of what was said at the trial. This regulation, along with the amended art. 217 § 2 (making it possible for the court to disregard late statements and evidence), makes trials more rigorous and has functions similar to preclusion in the former commercial proceeding.

In the enforcement proceedings, bailiffs’ possibilities of imposing fines as well as their liberty to set amounts of fees have been strengthened – an entity refusing to provide a bailiff with information will pay up to PLN 2,000 instead of the previous PLN 500 (art. 762 § 1), while a person hindering a bailiff’s proceedings will part with up to PLN 1,000 zł (art. 764, the Code of Civil Procedure). Lessees and tenants of property subject to enforcement proceedings should be cautious too – thanks to the new art. 929 § 11 a tenant or lessee who paid their rent in advance for a period longer than 3 months (rental)/6 months (lease) for property subsequently distrained due to the owner’s debts will have to pay it again to the bailiff.
Moreover, a new section has been added to art. 930, which makes loaning, lease and renting distrainted property ineffective with respect to the buyer of property under execution.

The solution oriented towards increasing judges’ discretionary power deserves to be appreciated. However, it must be stressed that attaining the set goal of the amended regulations will only be possible if judges rationally take advantage of their additional authority. A too arbitrary approach to application of the new instruments may even lead to infringement of a side’s the right to trial, thus depriving them of a possibility of defending their rights, whereas a failure to apply the regulations where it would streamline proceedings will prevent their very aim from being achieved.

Employers should remember that employees using their cars (both company and private) for business purposes should, pursuant to the directive on medical examinations for drivers and persons applying for driving licenses, changed in June 2011, be submitted to additional examinations – ophthalmological checks as well as examinations assessing dusk vision and the eye’s reaction to illumination. Additionally, as far as the mandatory psychotechnical tests for employees using company cars are concerned – the obligation definitely applies to employees whose work involves driving vehicles (e.g. sales representatives, medical representatives). As for other office workers – referral to additional examinations may be issued by the doctor carrying out preventive screening, who must be informed by the employer of the employee’s need for using a company car. The doctor, even if the employee drives occasionally (e.g. on business trips), should refer them to examination, in accordance with the directives of 2008 issued by the Occupational Health Institute in Łódź and the National Consultant for Occupational Health.

Worth remembering

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In the practice of business trading, particularly among international capital groups, it happens fairly often that entities grant sureties to their affiliated units. Until recently, it was not clear what are the tax consequences of granting a surety if it is free of charge. In practice, there were tax authorities’ interpretations assuming that the provision of art. 12 section 1 clause 2 of CIT Law may be applied only at the moment of exercising the surety granted (e.g. when a taxpayer’s loan is actually repaid). However, the very granting of surety free of charge does not constitute a free of charge service – excluding situations where the guarantor is an entity operating professionally in this line of business. This opinion was shared by administrative courts until recently.

On 27 April 2012 the Minister of Finance, by executing a general interpretation of the tax law, took a different stance. Contrary to the previous interpretation applied by courts and tax authorities, he deemed that granting surety free of charge is not an economic event – both for the entity granting the surety and the one whose liability is secured by it. The Minister pointed out that granting surety results in acceptance on the part of the guarantor of a financial risk related to the debtor’s nonfulfilment of their commitment to the creditor. This risk has a certain economic value, reflected by the price which the entity obtaining surety would pay to the guarantor in normal market conditions. The material profit on the part of the entity being granted surety may manifest itself in an improvement in their creditworthiness, for instance, or a lower interest on their loan being offered to them. The Minister emphasized that the fact of the guarantor’s non-operating as a professional financial service provider is irrelevant.

The Minister’s general interpretation is binding for all tax offices and tax inspection bodies. Therefore, to abide by it is a safe thing to do in terms of tax risk assessment.

Nevertheless, the interpretation has not dissipated all doubts about the practicalities which can be linked with classifying free of charge surety as a free of charge service on the grounds of CIT law. The Minister of Finance did not indicate how the value of such a service should be determined, only limiting himself to a laconic reference to the provisions of CIT law, according to which while establishing the value of such a service, one must refer to the prices which the guarantor offers to other entities or to prices applied by entities professionally providing surety and guarantee services.

Should you have additional questions related to tax consequences of free of charge services, particularly those provided by affiliated entities, we will be happy to assist you.
Corporate Finance
Estimation of control premium

The value of a company’s shares being taken over is not usually a fraction of the very company’s value but it also entails the strength of the stake being acquired and the ability to control the business entity.

The value created through a merger is most often seen on the part of the acquired company, not the acquiring entity. It is most frequently the buying companies that pay the seller the so-called control premium. The amount of the control premium ranges from 10 to 40 per cent, often leading to overestimation of the company’s value and detaching the price paid from market realities.

The reasons for overpayment in transactions include most notably a misunderstanding of the very point of how control premiums work in terms of managing the value of the merged companies and a failure to fulfil the basic premise according to which the increase in the value of the entity acquired must be higher than the control premium paid. In other words, the expected synergy must be worth more than the control premium paid. Unfortunately, this condition does not solve another problem – the one of excessive optimism in estimating the synergy’s outcome or even incompetent execution of the two entities’ integration process.

What is more, bearing in mind frequent and too optimistic assumptions of the acquired company’s growth, even a small control premium may be too high for the investor to achieve an extra value from the investment.

The following so-called optimal premium levels are considered theoretically:

- minimum premium, amounting to 15 per cent – desired while making a transaction, however relatively low as against the market levels;
- moderate premium, amounting to 15 to 40 per cent – commonly accepted in M&A transactions;
- risky premium, amounting to more than 40 per cent – this premium level may lead to destruction of the acquirer’s company value and is encumbered with a high investment risk.

In practice, one may find examples of transactions with recorded control premiums ranging from 15 to 30 per cent. According to research into 100 transactions conducted by Bank Zachodni WBK’s Capital Market Area, in Poland acquisition premiums usually tend to be slightly lower than in developed markets, amounting to 10 to 20 per cent.

Premiums paid by investors are not always linked with their transactions’ success. Based on negative examples of mergers, it may be proven that many transactions have not resulted in the synergies planned, and if synergies are attained, they are not revolutionary. Frequently, they even require incurring additional investment costs and have a long-term character.

What I consider to be most justified is using the control premium in the case of strongly undervalued entities. In transactions on the capital market it is relatively easy to determine a premium while what seems problematic is estimation of optimal prices for companies on the private market, where such analyses are not often conducted. However, in both cases the control premium concerns mainly the fact of owning the company being sold untapped and valuable assets, which must be attractive to a potential investor. The above is also relevant in the case of unskilful management or high agency costs being generated.

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Direct Investments
Changes planned to the operation of Poland’s special economic zones

Special economic zones, allowing investors operating within their boundaries to benefit from substantial income tax reliefs, have been for many years Poland’s considerable asset facilitating new foreign investments. Moreover, they have allowed Polish entrepreneurs to carry out their projects on more advantageous terms. Unfortunately, according to the provisions of law in force, the time limit for Special Economic Zones’ operation is the end of 2020, which over the recent years has more and more strongly contributed to the decline of the zones’ importance in the eyes of potential investors.

Special economic zones usually offer properties which are well communicated, fitted out and better prepared than the majority of the land intended for development purposes, however it must be stressed that the only additional tax benefit guaranteed in the zones is exemption from income tax, where the amount of the attainable relief is calculated on the basis of the amount of investment-related expenses or expenses borne by the investor in relation with the cost of labour. Assuming that execution of a development project takes about two years and the profit made in the first years of its operation are encumbered with considerable costs related to depreciation and the facility’s initiation, an entrepreneur considering an investment in the zone may expect to benefit from substantial tax reliefs only for two to four years before the zone ceases to exist. It is a fairly modest advantage, as against the tax reliefs and other incentives offered by other countries in the region and in other parts of the world.

That is why for a few years the authorities of special economic zones, local governments and experts have been calling for introduction of provisions prolonging the zones’ lifespan or regulating their operation as permanent. Only last year it seemed that the latter, a much more advantageous option, would be put into practice. The Ministry of Economy prepared then a preliminary project of a law doing away with time limits for special economic zones, according to which permits for business operation within them with tax reliefs secured, would be granted, depending on voivodship, for a period of 15 to 20 years from issue date.

Unfortunately, reservations voiced by the Minister of Finance and the Supreme Chamber of Control concerning the lack of data necessary to assess the zones’ operational effectiveness, which would justify the change to the law, resulted in the Ministry’s only undertaking action orientated towards prolonging the zones’ lifespan till the end of 2026. The change is to be introduced through an amendment to 14 directives on each of the zones in operation, with only the sections specifying the time frame of the zone’s operation being altered. Currently, the projects are being discussed and no planned date of their acceptance by the government has been announced, however it is likely to become reality still before the end of 2012.

The above solution is not unprecedented as it was once put into practice in the previous decade, when the zones’ life span was prolonged from 2017 to 2020. It must be also emphasized that it is of a fragmentary character as well as it completely neglects the second of the most significant demands of the zones and investors, concerning a possibility of a drop in employment by 20% in relation with the terms specified in the permit, even if it also entailed a decrease in the available pool of tax reliefs. The change could be only introduced through an amendment to the law.

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