REPUBLIC OF POLAND

CONVERGENCE PROGRAMME

2019 UPDATE

Warsaw, April 2019

Contents

Figures

Tables

Boxes

Foreword

The European Union Member States submit annually the updates of stability or convergence programmes to the European Commission and the Ecofin Council. Based on the analysis of these documents, the Ecofin Council subsequently issues recommendations for the economic policies of the Member States, which shall be taken into account when designing budgets for the next year. In the opinion of 13 July 2018 on the last year's update of the *Convergence Programme*, the Ecofin Council recommended that Poland shall:

- ensure that, in 2019 the nominal growth rate of net primary expenditure of the general government does not exceed 4.2%, which would correspond to an annual improvement in the structural balance by 0.6% of GDP,
- take measures to improve the effectiveness of public spending, including by improving the budgetary process.

This *Convergence Programme* (hereinafter referred to as the *Programme*) presents the medium-term forecast of Poland's economic situation and its public finances up to 2022. At the same time, it is a part of the *Multiannual Financial Plan of the State (MFPS*) adopted by the Council of Ministers and developed on the basis of *the Public Finance Act of 27 August 2009* (hereinafter referred to as *the Public Finance Act*). The MFPS shall provide the basis for the preparation of the draft Budget Act for 2020.

The document was prepared in compliance with *Council Regulation No 1466/97/EC of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies* and the guidelines concerning the stability and convergence programmes of the EU Member States adopted by the Ecofin Council in June 2017. The macro-fiscal scenario presented in the *Programme* is based on the data available as of 1 April 2019.

The *Programme* was prepared simultaneously with this year's edition of the *National Reform Programme* (NRP), which contains, inter alia, an overview of structural reforms aimed at Poland meeting the objectives of the *Europe 2020* strategy and implementing the Council policy guidance formulated based on an analysis of the 2018 NRP.[1] Information on the *Programme* and the NRP were discussed at a joint meeting of parliamentary committees for EU affairs, public finances and the economy and development on 11 April this year. As in previous years, the opinion of the Council on this *Programme* and the Council recommendations concerning the 2019 NRP will be also the subject of discussion of the Polish Parliament.

[1] *Council Recommendation of 13 July 2018 on the National Reform Programme of Poland for 2018 and delivering a Council opinion on the Convergence Programme of Poland for 2018*, available at https://eur-lex.europa.eu/legal-content/PL/TXT/HTML/?uri=CELEX:32018H0910(20)&from=EN

Summary

In 2018, the GDP growth accelerated to 5.1% and was the highest since 2007. Poland was one of the fastest developing EU countries and in the following years it will remain at the forefront of the EU in this respect, especially against the background of the largest economies. In 2019, a relatively mild slowdown in the economic growth to 4% is expected. In 2020, the GDP will grow by 3.7% in real terms, and in 2021 and 2022 by 3.4% and 3.3%, respectively.

The general government deficit decreased to 0.4% of GDP in 2018, which is the best result since Poland's accession to the European Union. The deficit reduction was fostered by measures aimed at tightening of the tax system as well as by good macroeconomic conditions. It is estimated that the structural deficit amounted to 1.2% of GDP, i.e. it was by 0.6 percentage points lower than in the previous year. This means the structural balance was in line with the medium-term budgetary objective (MTO) within a tolerance band considered by the European Commission. The general government debt-to-GDP ratio fell to 48.9%.

In order to prepare Poland for the effects of potential external shocks (Brexit) and the expected slowdown in the global economy, ensuring the fiscal space is crucial. This, while maintaining the long-term sustainability of public finances, will allow for stabilisation of the economic growth at a safe level. Achieving this objective will be possible thanks to the compliance with fiscal rules, such as in particular the (stabilising) expenditure rule which, pursuant to the *Public Finance Act*, sets the maximum level of state budget expenditure that can be planned in the Budget Act.

Implementation of significant measures in the area of social and economic policy is envisaged in the *Programme* horizon. They cover in particular ►the extension of the *Family 500 plus* programme to each child, ►the continued lowering of the tax wedge and ►reconstruction of bus connections. Those actions are contained in the macro-fiscal scenario of the *Programme*. Continued tightening of the tax system and new solutions on the revenue and expenditure side will enable the implementation of those measures while respecting the expenditure rule. Those measures shall include, in particular ►tightening of the tax system and increased collection of taxes, social security and health insurance contributions and environmental taxes, ►broadening of the tax and contribution bases, ►improvement of the macroeconomic efficiency of the tax wedge, ►systemic changes in taxes, contributions and the pension system as well as ►changes in cash benefits from social security in case of sickness and maternity, and ►prioritisation and rationalisation of expenditure within the fixed expenditure limit resulting from the stabilising expenditure rule.

Poland will continue to participate in the process of deepening the Economic and Monetary Union, in particular in the institutional reform in order to ensure stability in the euro area. The scale and strength of political and economic ties between Poland and the countries of the common currency area mean that the condition of the euro area significantly affects the processes taking place in Poland. In view of the current level of similarities between the economy of Poland and the euro area - in particular in terms of the economic development measured as e.g. GDP *per capita* - Poland's membership in the euro area could constitute a source of turbulences in the economy. Implementation of structural reforms strengthening the potential and efficiency of the Polish economy will contribute to increasing the degree of economic convergence with the euro area.

I. Economic outlook

I.1. Current prospects

In 2018, GDP growth accelerated to 5.1%, which means that it was the highest rate since 2007. Domestic demand remained the main growth factor and its dynamics was clearly higher than in the previous year. Net exports had a slightly negative contribution to the GDP growth. The average quarterly GDP growth rate in 2018 amounted to approx. 1.1% (sa), which is the same as in 2017 and slightly more than the long-term average. However, the economy performance in Q4 shows a slowdown in the growth rate of economic activity at the end of 2018 (qoq, sa) compared to the pace observed in Q3 and H1 2018.

In 2018, the economic situation in the European economy deteriorated markedly. Economic growth in the EU amounted to 1.9% and was much lower than a year ago (2.4%). The slowdown in the activity was particularly visible in the second half of the year, when the average quarterly GDP growth rate fell to 0.3% qoq, sa). Domestic demand, mainly private consumption, remained the major source of economic growth. The rate of growth in the volume of EU imports, the main indicator of demand for Polish goods and services, decreased significantly (to 3.0% from 4.3% in 2017). On the supply side, the downturn in the EU was mainly related to manufacturing and originated in the temporary problems of some industries, but also in increased uncertainty related to global trade tensions and Brexit. As a result, the growth rate of the volume of Polish exports of goods and services also slowed down.

The improvement in the dynamics of economic activity in Poland in 2018 translated into further improvement of the situation on the labour market.[2] The number of employed increased by 0.4%, i.e. less than a year ago (1.4%). This increase was largely due to an increase in the number of permanent employees, with a slight increase in the number of employers and self-employed and a marked decrease in the number of temporary workers. The increase in the number of employed - similarly to the previous year - resulted mainly from the increase in the number of employed in the service sector, and to a lesser extent in the industry sector (including industry and construction), with a decrease in the agricultural sector. The increase in the labour demand has contributed to a continued decline in unemployment. The unemployment rate decreased to 3.9% from 4.9% a year earlier and for the seventh consecutive year it was lower than the EU average (by about 3 percentage points). The participation rate - after rising to a record high last year - slightly decreased by 0.1 percentage points to 56.3% (compared to the EU average of 58.0%).

The improvement in the labour market situation combined with very good consumer sentiment were reflected in a high private consumption growth, although slightly lower than in the previous year. Real growth of investments was the fastest since 2014 and contribution of investments demand to the economic growth was clearly higher than in the previous year. The improvement in the dynamics of investment outlays resulted from the high dynamics of the general government investments. The investments rate (i.e. investments to GDP ratio) was about 0.5 percentage points higher than in the previous year but remained below the long-term average and the EU average (20.5%).

Estimates of the potential growth rate of the Polish economy, prepared in accordance with the methodology of the European Commission, indicate that 2018 was the second consecutive year in which the Polish economy recorded a significantly positive product gap. With a strong downward trend in the non-accelerating wage rate of unemployment (NAWRU) continuously since 2002 and the strong demand for labour persisting in the following year, a gradual increase in total factor productivity is observed. Consequently, it is estimated that in 2018, the potential growth rate in Poland increased by approx. 0.3 percentage point to approx. 4.0% y/y. The growing dynamics of the Polish economy potential in 2018 was, however, much lower than the real GDP growth rate (5.1% y/y), which resulted in a positive output gap at the level of ca. 1.6% above the potential, compared to an EU average of 0.5% of potential GDP. It seems that in terms of the growth cycle, the upper turning point has been reached, which means the beginning of the cyclical slowdown phase.

Despite the favourable situation on the labour market and the high growth rate of private consumption, inflationary pressure in the Polish economy in 2018 remained at a low level. The average prices of

[2] Information on the labour market is based on LFS data (15 years and more).

consumer goods and services in 2018 were 1.6% higher than in the previous year (and 1.2% higher, according to the HICP). For the past six years, inflation in Poland has remained below the inflation target of the National Bank of Poland (NBP). The level of prices of consumer goods and services in the country is significantly affected by the price situation in the global commodity markets (especially energy and agricultural commodities). A sharp decline in oil prices in the last months of 2018 contributed to a fall in inflation at the end of the year below the lower deviation from the inflation target (1.1% at the end of the year). The core inflation (i.e. the change in prices of consumer goods and services excluding food and energy prices) in 2018 remained at a low level and amounted to 0.7% on average. Fluctuations in commodity prices also affected the rate of growth in the producer price index (PPI) which grew in the first three quarters (to 3.2% in Q3), and decreased to 2.1% at the end of the year. On average, industrial prices increased by 2.1% throughout the year.

In 2018, the MPC did not make any changes in the NBP interest rates due to the lack of signs of increasing inflationary pressure in the Polish economy and the prospect of inflation running close to the target, in the monetary policy transmission horizon . The main interest rate - the reference rate remained at a level of 1.50%.

In 2018, the current account balance amounted to -0.7% of GDP, compared to a surplus of 0.2% in the previous year. This was mainly caused by a deterioration in the balance of trade in goods. However, the primary income deficit as a consequence of a high negative net international investment position continued to have the greatest negative impact on the external balance of the economy. This balance was also negatively affected by a growth in transfers associated with seasonal labour immigration of non-residents, mainly citizens of Ukraine. On the other hand, the surplus of services reached another record level which was caused, among others, by the development of the business services sector. The current account deficit was financed with a large surplus by the inflow of long-term capital, i.e. direct investment of non-residents and European structural funds classified in the capital account.

In 2018, the average EUR/PLN exchange rate amounted to 4.26 while the USD/PLN exchange rate was at 3.61 and it was higher by 0.1% and 4.4%, respectively, than a year before. Global factors had a major impact on the exchange rate of the Polish currency. After a relative stabilisation in the first two months of the year, the zloty depreciated against the euro as a result of a deterioration in global sentiment related to fears of a stronger monetary policy tightening in the USA in 2018. The improvement in sentiment in the global financial markets, followed by S&P's decision in April to raise Poland's rating outlook, helped the zloty return to stronger levels. However, since mid-April, the zloty had depreciated again under the pressure of a strong increase in risk aversion in global financial markets and capital outflow from emerging markets. In August, the EUR/PLN volatility clearly decreased and till the end of the year the exchange rate was following a sideways trend.

I.2. Medium-term scenario

Winter forecasts of the European Commission concerning the growth of aggregate economic activity of Poland's main trade partner, i.e. the European Union, indicate a slowdown in the GDP dynamics in this region over the next two years. The European Commission reduced the GDP growth path for EU economies in 2018 to 1.9% y/y and in 2019-20 to 1.5% and 1.7% y/y, respectively. For the euro area, the economic growth forecast has been reduced to 1.3% and 1.6% in 2019-20 respectively. For the macroeconomic scenario it has been assumed that the real GDP growth rate of the EU in the following years will gradually converge with potential EU GDP (1.4%).

Polish society, as in other EU countries, is gradually ageing. After a minimal decrease in the population in 2017, a further decrease in the total population is expected within the forecast horizon, on average by 0.06% y/y. At the same time, the number of population aged 15-74 in the projection horizon will also decrease. On the other hand, it is assumed that factors delaying exit from the labour market: low replacement rate, growing share of services in the economy or growing share of the workforce of people with higher education will positively influence the labour force participation rate, which in 2019-20 will remain at a level similar to 2018. Support for the labour market participation of young people and low income earners will be provided by the continuation of measures to reduce the tax wedge started in 2017 with the introduction of a degressive amount of personal income tax reduction (cf. chapter II.3).

It is expected that in 2019 the number of people working in the Polish economy will slightly increase, while in the following years the growth rate of employment will approach zero. The changes in the total number of employed take into account the assumption of stabilisation in the number of employed in the general government until 2022 adopted in the *Programme*. Considering the expectations related to the developments in the participation rate in the horizon of the *Programme*, a further systematic reduction in the harmonized unemployment rate is expected. It is estimated that in 2019 the unemployment rate will fall to 3.6% from 3.9% recorded in the previous year while in 2020 it will reach the level of 3.3%. It is assumed that if the adopted trends in the labour market are maintained, the unemployment rate may slightly decrease within the forecast horizon.

The continuation of the improvement in labour market conditions will foster the growth of wages. It is estimated that in 2019 the nominal growth rate of average wages in the national economy will amount to 7.6%, and in 2020-22 it will reach, respectively, 6%, 5.8% and 5.7% in 2022. The real wage growth will accelerate to 5.7% y/y in 2019 and gradually decrease in the horizon of the forecast.

Real revenues are expected to continue to grow faster than in 2010-15 due to a very good labour market situation and only slightly dampening inflation. The ease of finding a job and a low probability of losing a job translate into record-breaking consumer sentiment. As a result, private consumption will remain the main driver of economic growth and will increase by 4.0% y/y in real terms in 2019. In the following years of the forecast horizon, the real growth rate of consumption will amount to 3.5% on average.

The real growth in public consumption shall be determined by the actions of the government focusing on the adherence to the fiscal rules. It is estimated that the real growth rate in this economic category shall amount to 5.3% in 2019, to stabilise at a level of approximately 2.1% in the years 2020-22.

The factors supporting the growth in the investment demand of the private sector in the forecast horizon will include: the cost of capital remaining on a relatively low level in connection with low interest rates and the effective implementation of the government’s measures aimed at increasing the investment rate, growth in innovation and productivity of the economy. In accordance with the foregoing, it is expected that the share of investment in GDP will grow in the period of the forecast. It is foreseen that in 2019 the share of gross expenditures on fixed assets of the private sector in GDP will amount to 13.9%, to increase by nearly 2 percentage points within the horizon of *the Programme* . Thus, the contribution of private investment to GDP growth will reach even 1.4 percentage points in the forecast horizon, and the total gross fixed capital expenditure in the whole economy will increase from 18.6% of GDP in 2019 to 19.8% of GDP in the last year of the forecast. The balance of working capital is linked to the level of demand on the domestic market and foreign markets. Over the *Programme* period, the contribution of stock changes to the GDP growth is estimated as neutral.

Since Poland's accession to the EU, the Polish economy has been systematically opening up to foreign markets. As a result, the share of exports in GDP is growing rapidly and in 2018 it reached a record level of around 55%. One of the factors explaining such a dynamic change in the structure of the Polish GDP is the persistently high competitiveness of Polish enterprises. Moreover, periods of relatively weak domestic demand, especially in 2012-13, forced domestic entrepreneurs to look for new markets. Despite a weaker economic climate, Poland's main trade partners expect exports to grow at a rate of 5.3% y/y in 2019 and 4.8% y/y on average within the forecast horizon.

On the other hand, the growth rate of imports will be a consequence of final demand development. The estimated real growth in imports in exports in the horizon of the *Programme* in the years 2019-22 it will reach 6.0%, 5.1%, 5.1% and 5.0%, respectively. Consequently, the contribution of net exports to the GDP growth will amount to -0.1 percentage points in 2019 and will be neutral in the forecast horizon.

The development of net exports is, in turn, reflected in the balance of trade in goods and is an important factor affecting the current account balance of payments. In 2019, the current account deficit will remain negative, exceeding 1% of GDP. The main source of external imbalances will continue to be the primary income deficit, which reflects the negative net international investment position of the Polish economy.

The overall conclusion is that real GDP growth is expected to reach 4% y/y in 2019. In 2020, it will slightly decrease, reaching 3.7% y/y. Within the forecast horizon, an increase in the share of investments in GDP is expected, inter alia, in connection with the use of funds from the EU financial perspective for 2014-20. Nevertheless, private consumption, supported by optimistic expectations of Polish consumers and a favourable situation on the labour market, will remain the most important component of economic growth. In 2021-22, the real GDP growth will reach 3.4% and 3.3% y/y, respectively.

The growth rate of potential output within the forecast horizon will gradually decrease after reaching the peak of 4.0% y/y in 2019. The main factors influencing the dynamics of the economy potential will include the accumulation of production capital and the increase in the efficiency of production factors. A significant increase in public investment supported by EU funds and private investment supported by programmes aimed at innovation growth translates into a faster accumulation of capital in the economy. The steadily declining non-accelerating wage rate of unemployment (NAWRU), reflecting positive structural changes in the Polish labour market, has less positive impact on the potential of the Polish economy. The output gap will remain open at around 1.6% of GDP in 2019. In the following years, negative trends in the size of the working-age population will result in a lower dynamics of potential GDP. In parallel, a lower real GDP growth will gradually reduce the output gap.

Due to the sustainable balance of risk factors in the external environment of the Polish economy (see Chapter III.1), for the needs of the macroeconomic scenario it was assumed that throughout the entire forecast period, the exchange rate of the zloty will remain at a level of 10 business days until 1 April 2019 (i.e. 4.3 EUR/PLN and 3.8 USD/PLN). This is a technical assumption, and the date is related to the beginning of the forecasting work on the *Programme*. In view of the costs of servicing foreign debt and its level as a share of GDP in the medium term, the assumption of exchange rate stability seems relatively conservative. In the case of lack of external shocks, strengthening of the Polish currency in the coming years should be fostered by the fundamentals of the Polish economy.

The beginning of 2019 brought a decline in the annual growth rate of consumer prices to 0.7% in January, followed by an increase to 1.2% in February. Inflation is expected to reach the average level of 1.8% throughout 2019, and in the following years, the forecast will be close to the inflation target of 2.5% y/y. In 2019, energy prices will remain stable. However, energy prices, similar to food prices, will rise moderately in the horizon of the forecast. In addition, core inflation is expected to increase, driven mainly by strong wage growth, outpacing productivity growth. As a result, core inflation is expected to reach 1.6% in 2019 and slowly approach the inflation target.

II. General government balance and debt

II.1. Policy strategy and medium-term objectives

The priority objective of the government is to support inclusive economic growth. A growth-friendly fiscal policy that supports economic recovery but does not put at risk the sustainability of public finances is recommended by the European Council. In order to maintain the sustainability of public finances and sustainable economic growth, solutions in the area of social-economic policy should be implemented in compliance with legal provisions, in particular with regard to the stabilising expenditure rule that sets the limit for the majority of general government expenditure (cf. Chapter II.4).

II.2. Actual balances

In 2018, the major goal of fiscal policy was accomplished, i.e. maintaining the sustainability of public finances taking into account the limitations contained in the provisions of the national and EU law. The general government deficit (according to the ESA2010 methodology) in 2018, according to preliminary estimates, amounted to 0.4% of GDP, which is a significant improvement, i.e. by about 1.1 percentage points compared to 2017. The lower headline deficit was mainly the result of an increase in the general government revenues by 1.5 percentage points of GDP (including tax revenues by 0.8 percentage points) with a simultaneous increase in expenditure by only 0.3 percentage points. The level of general government revenues and expenditures in 2018 and their detailed structure in relation to GDP are presented in Table 13.

General government revenue

Taxes

In 2018, tax revenues amounted to 21.9% of GDP, which means a growth by approx. 0.8 percentage point as compared to 2017, including a 0.3 percentage point growth in revenue from taxes related to production and imports and 0.5 percentage point rise in income taxes. A strong increase in tax revenues has been observed since 2016, when a number of tax system reforms were introduced and the National Revenue Administration was established (since March 2017).

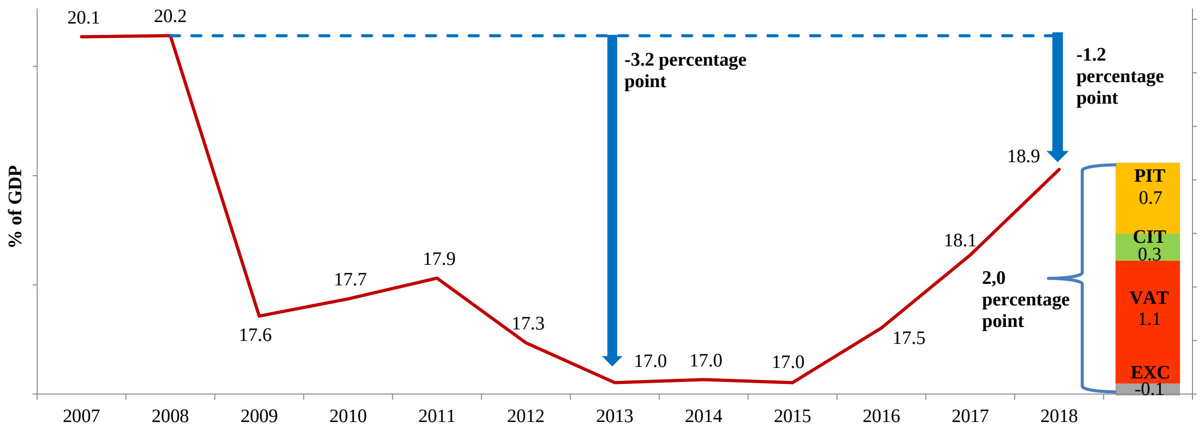
VAT revenues improved significantly, which contributed to a very good implementation of the state budget in 2018. Thanks to the actions undertaken to tighten the tax system in 2018, in cash terms, the budget collected PLN 18.1 billion more from VAT than in 2017. In the period of last three years, the total increase in VAT revenues amounted to PLN 51.8 billion in cash terms.

In addition to the positive effect on VAT receipts in 2018 (an increase by 11.6% y/y, i.e. by PLN 18.1 bn), higher revenues from excise tax on engine fuels were recorded. In cash terms, they increased by 6.8%, i.e. by PLN 2.1 billion as compared to 2017. Based on the analysis of the developments in official sales of excise goods, in particular motor fuels, it can be assessed that the high increases in 2018, apart from positive market trends, resulted also from measures improving tax compliance described above.

In 2018, the highest growth rate in tax revenues was achieved from CIT. It was well above the nominal economic growth rate. The 16.2% increase in CIT revenues (the state budget including shares of local government units) compared to 2017 meant an increase in receipts by PLN 6.2 bn. In total, in 2016-18, CIT receipts increased by PLN 11.4 billion, i.e. by 34.8%, and significantly exceeded the effects expected from the introduction of the General Anti-Avoidance Rule (GAAR).

The rapid growth of tax revenues in 2018 is a result of numerous measures taken in 2016-18 to tighten the tax system. However, despite a significant improvement in the last three years (2.1 percentage points of GDP), the tax revenue-to-GDP ratio is still lower compared to the pre-crisis situation.

Figure 1. The ratio of revenues from main taxes (State Budget revenues and local government units shares) to GDP (in %) and the structure of the loss divided into individual taxes

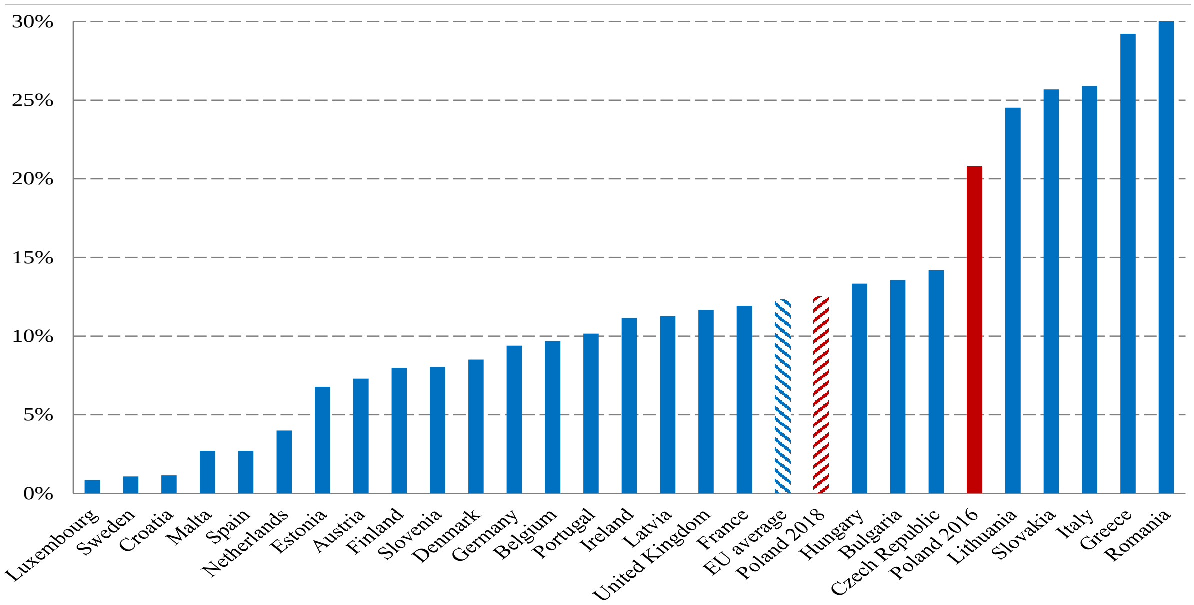


Source: Ministry of Finance

In 2018, the level of revenues from four basic central taxes (i.e. taxes being the revenue of the state budget, including shares of local government units in PIT and CIT) remained 1.2 percentage point of GDP lower on an accrual basis. as compared to 2008.

Analyses show a particularly strong improvement in VAT collection rates. According to CASE estimates for the European Commission, in 2016[3] Poland was one of the EU countries with the largest VAT gaps. Only 5 countries recorded a higher gap: Romania, Greece, Italy, Slovakia and Lithuania.

Figure 2. VAT gap (% of theoretical revenues) in the EU member states in 2016



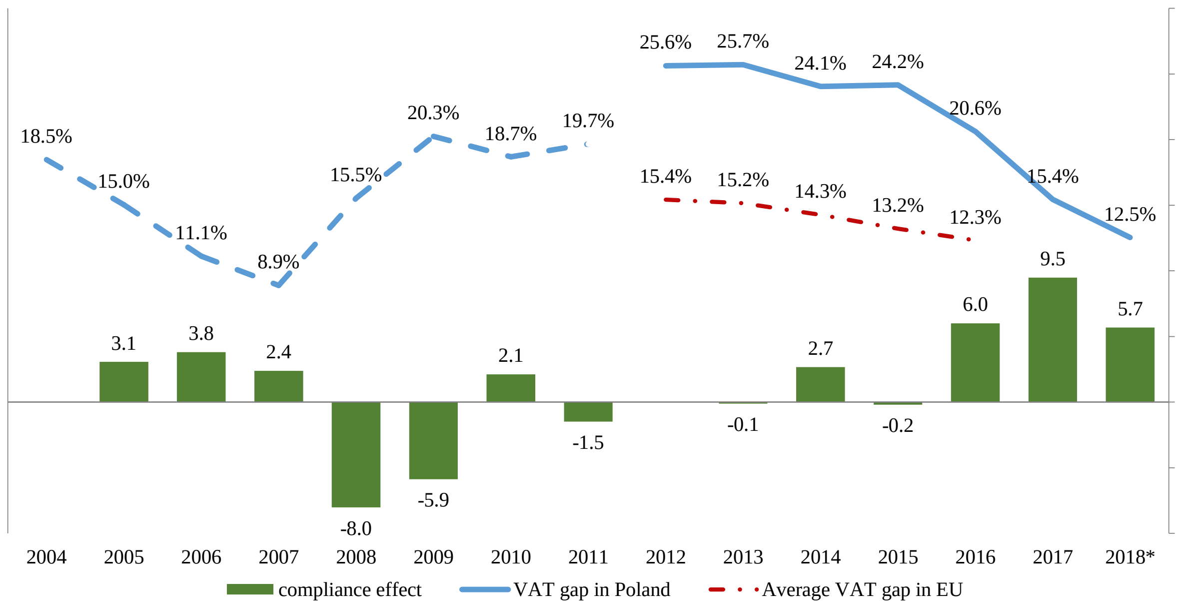
Source: CASE Report for the European Commission, *Study and Reports on the VAT Gap in the EU-28 Member States: 2018 Final Report*; for 2018, estimates of the Ministry of Finance.

[3] The comparison was based on estimates from the CASE report for the European Commission (September 2018) concerning the VAT gap in EU countries. For comparison purposes, an indicator is used which compares actual VAT receipts with theoretical *VAT Total Tax Liability*(VTTL) receipts. Cf. *Study and Reports on the VAT Gap in the EU-28 Member States: 2018 Final Report*, TAXUD/2015/CC/131, https://ec.europa.eu/taxation_customs/sites/taxation/files/2018_vat_gap_report_en.pdf

According to preliminary estimates of the Ministry of Finance[4], in 2018, a noticeable reduction of the tax gap was recorded (by 2.9 percentage points) although it still amounted to approx. PLN 25 billion, i.e. approx. 12.5% of potential revenues (VTTL) (cf. Figure 3). In 2018, for the purpose of estimating the VAT gap, the top-down method was applied, as in the previous *Programme* update, which uses macroeconomic data on VAT base (private consumption, net purchases and investments of general government). The results of estimating the VAT gap for the years 2012-16 obtained using the method applied by the Ministry of Finance[5] are very similar to the estimates presented in the CASE reports for the European Commission.

Based on the European Commission's methodology related to estimation of the VAT gap, it can be assessed that in 2018, the improvement in VAT revenues due to better tax payers' compliance with the regulations in force (the so-called *compliance effect*) amounted to PLN 5.7 bn (and in 2016-18 - PLN 21.1 bn). This confirms that the instruments introduced to combat criminal practices in VAT and other measures aimed at tightening up the tax system have produced measurable effects.

Figure 3. VAT gap (in %) and compliance effect (in PLN billion)



Source: CASE Report for the European Commission, *Study and Reports on the VAT Gap in the EU-28 Member States: 2018 Final Report*; for 2018, estimates of the Ministry of Finance.
Note: data before and after 2012 are not comparable due to a change in ESA national accounts methodology.

The implemented and planned measures tightening the tax system are discussed in Annex 1. Comparison of the 2008 and 2018 tax revenue-to-GDP ratios and the level of the VAT gap show there is still room for improvement in tax collection, but it is significantly lower, in particular with respect to VAT revenue. Measures tightening the tax system will therefore be directed at income taxes and other public levies, such as social and health insurance contributions and environmental fees and contributions.

In 2018, the regulations separating the capital result from the non-capital result came into force, eliminating the possibility of past overstatement of capital losses in order to reduce the overall profit and, as a result, the due income tax. Based on the preliminary data from the 2018 annual returns

[4] For 2016-18 the data is of preliminary nature due to the lack of sufficiently detailed statistical data to carry out complete estimates.
[5] See also: "Report on the size of the tax gap in VAT in Poland in the years 2004-2017" available at https://www.gov.pl/web/finanse/no-3-2019

(sample), it can be estimated that the introduction of this solution resulted in a positive effect in the form of an increase in CIT revenues in the range from PLN 1.0 bn to PLN 3.0 bn.

Box 1. Reducing the income tax gap

The measures described in the previous *Programmes* and in Annex 1 aimed at tightening the tax system in the area of VAT had a positive impact on reducing tax avoidance not only in the area of VAT, but also CIT and PIT on economic activity.

In relation to CIT, it was estimated that the improvement in CIT revenue due to better tax payers' compliance with the applicable regulations (the so-called *compliance effect*) amounted to PLN 3.0 bn in 2017 and PLN 4.2 bn in 2018. The estimation methodology is analogous to the VAT gap and uses data on the execution of CIT revenue and macroeconomic indicators of the taxable amount. The positive effects of introduction of the General Anti-Avoidance Rule are also demonstrated by the econometric analysis carried out using a variable model during co-integration using cyclically adjusted flexibilities. First of all, it indicates Q4 2015 as the date of structural change, which coincides with the launch of legislative work on the implementation of the clause. Secondly, the effect of the change in long-term parameters estimated based on the ARDL model in 2017 is PLN 0.7 bn and in 2018 - PLN 1.2 bn.

The analysis of the effect of systemic changes, in particular the introduction of the General Anti-Avoidance Rule and JPK (standard audit file) on business tax revenues (CIT and the flat PIT rate) was also based on the panel model including the data for EU countries (except for Luxembourg, Malta, Cyprus and Croatia). It shows that after eliminating cyclical effects, the impact of tightening activities amounted to PLN 1.8 bn in 2017 and PLN 2.9 bn in 2018, respectively.

The effect of introducing JPK for small business activity (flat PIT rate) was separated by means of two methods. The first method, the econometric analysis based on the VECM model, indicates a result in the amount of PLN 1.1 bn in 2018. On the other hand, the microeconomic analysis based on tax returns indicates the effect at a level of PLN 1.2 billion in 2018.

Social security contributions

Besides the growth of tax revenues, an increase in general government revenues due to social security contributions registered in the social security subsector by 0.3 percentage points of GDP (8.8% y/y in nominal terms) contributed to the improvement of the general government balance in 2018. This increase was mainly a result of a good situation on the labour market (a strong increase in employment combined with an increase in wages), as a result of which the growth of the wage fund in the national economy in 2018 amounted to 9.8% y/y and was the highest since 2008.

The level of inflows from contributions was also positively influenced by the measures implemented by ZUS (Social Security Institution) to seal the contributions system, such as the introduction of the so-called *e-Contribution (e-Składka)*, electronic sick leave and the increase in the effectiveness of enforcement of receivables (more details: Annex 2). The total effect of actions undertaken by ZUS is estimated at PLN 0.4 bn.

General government expenditures

The ratio of general government expenditure to GDP in 2018 increased to 41.5% (by 0.3 percentage points), mainly as a result of acceleration in the use of EU funds from the 2014-20 financial perspective (an element neutral for the general government balance).

The main factor behind the increase in expenditure in 2018 was a significant acceleration in public investment and a related increase in the use of EU funds. The nominal growth of the general government investment remained at a double-digit level (31.5% y/y) and was significantly higher than in 2017 (23% y/y). In relation to GDP, public investment increased by 0.9 percentage points to 4.7%. The local government subsector recorded a particularly strong growth in investment expenditures (an increase by 54.2% y/y), which resulted from high absorption of EU funds from the 2014-20 financial perspective and investments launched before the local government elections (autumn 2018). Two-digit nominal increase in investment expenditure was recorded in the government subsector reaching 12.9% y/y (after an increase of 14.3% y/y in 2017), and the main contributor was the investment in railway infrastructure implemented by the company PKP Polskie Linie Kolejowe S.A.

Expenditures on social benefits in 2018 constituted a continuation of programmes implemented in previous years. The main components of this group include expenditures on pensions, expenditures related to the *Family 500 plus* programme, family benefits, social pensions and benefits financed from the state budget and commissioned for payment by ZUS and KRUS. The *Good Start* programme has become a new programme within the framework of the pro-family policy introduced in 2018 and will be continued. It envisages supporting families with school-age children thanks to a one-off benefit of PLN 300 paid at the beginning of the school year, and its annual cost amounts to about PLN 1.3 bn. Total social benefits increased by 5.6% y/y in nominal terms and amounted to 16.8% in relation to GDP.

In 2018, a nominal increase in public consumption by 6.5% y/y was recorded, which means that in relation to GDP it remained at the level of 17.7%. The stabilisation of public consumption as a ratio to GDP was influenced by a decrease in labour costs by 0.1 percentage points and an increase by 0.1 percentage points in indirect consumption, i.e. purchases of goods and services. Over the last 10 years, the labour costs to GDP ratio has been reduced by about 1 percentage point of GDP, including in the last 3 years - by 0.3 percentage points.

The government's aid programme for farmers and agricultural producers in the context of an exceptionally severe drought contributed to a slight increase in the general government expenditure in relation to GDP. Expenditures on mitigation of drought-caused damages amounted to PLN 1,405.503 million, i.e. approx. 0.1% of GDP (cf. Box 2).

II.3. Medium-term budgetary outlook

In the baseline scenario of *the Programme*, apart from the changes resulting from *the Act of 6 December 2018 amending the Act on Special Measures to Implement the Budget Act for 2018* and the *Budget Act for 2019 of 16 January 2019*, a package of measures announced in February 2019 has been included. This covers in particular the extension of the *Family 500 Plus* Programme, changes in income taxes and a one-off additional benefit for pensioners paid in 2019. Continued tightening of the tax system and new solutions on the income and expenditure side should enable the implementation of these measures while respecting the stabilising expenditure rule.

The revenue measures are presented in Annexes 1 to 3.

Annex 1 presents the measures in general within the competence of the Minister of Finance. They include, among others, measures aimed at tightening of the tax revenue system, broadening the tax base, reducing and increasing the macroeconomic effectiveness of the tax wedge. Annex 1 also presents planned systemic changes in taxes (e.g. in the context of pro-health policy) and actions aimed at tightening and equivalence of environmental taxes.

Annex 2 presents measures within the competences of the minister responsible for social security. They are related to the pension system, its cohesion and aim at tightening the system of collection the social and health contributions and increasing the base of payers. .

The level of general government expenditure presented in the macro-fiscal scenario is determined by the stabilising expenditure rule, which limits the growth of the majority of public expenditure. The levels of general government revenues and expenditures and their detailed structure in relation to GDP in the forecast horizon are presented in Table 15.

In the macro-fiscal scenario, a structural deficit is forecast, after its temporary increase in 2019 (inter alia, due to measures aimed at compensating for energy prices, support for agricultural and fisheries farms which suffered from drought in 2018, commitments in the area of demographic policy) to gradually decrease towards the medium-term budgetary objective. The general government debt -to-GDP ratio will remain well below 60%. The achievement of the MTO shall ensure the sustainability of public finances and means that public finances are prepared for the risk of an economic downturn. At the same time, it allows for the implementation of measures related to inclusive economic growth.

In addition, responsible fiscal policy-making leading to the reduction of public debt to a level, which will disable the correction mechanism in the stabilising expenditure rule (cf. Chapter II.4), in line with the *Act* of *22 November 2018 amending the Law on Value Added Tax* (Journal of Laws, item 2392) allows for a reduction in VAT rates in 2022. Budgetary policy must therefore also take account of this commitment.

Table 1. General government - key elements of the forecast

% of GDP	2018	2019	2020	2021	2022
Revenue*	41.2	41.7	42.0	41.6	40.6
Expenditure	41.5	43.3	42.8	42.1	41.3
General government balance*	-0.4	-1.7	-0.9	-0.5	-0.7
Structural balance	-1.2	-2.5	-1.6	-1.0	-1.0

*For the years 2019-22 forecast of the general government balance and revenue excludes one-off measures.

Factors determining the general government revenues

Taxes

Proceeds from taxes are determined by the development of their base, thus, mainly the private consumption, level of public investment, revenues from work, retirement and disability pension benefits and profits of enterprises. In the horizon of the current tax revenue forecast, further tightening of the tax system will also play an important role, comprising, inter alia:

- the introduction of a split payment mechanism, including on a mandatory basis in certain sectors,
- implementation of the ITC System of the Clearing House (STIR),
- modification of provisions regarding the General Anti-Avoidance Rule,
- introducing the obligation to provide tax authorities with information on tax schemes (MDR).

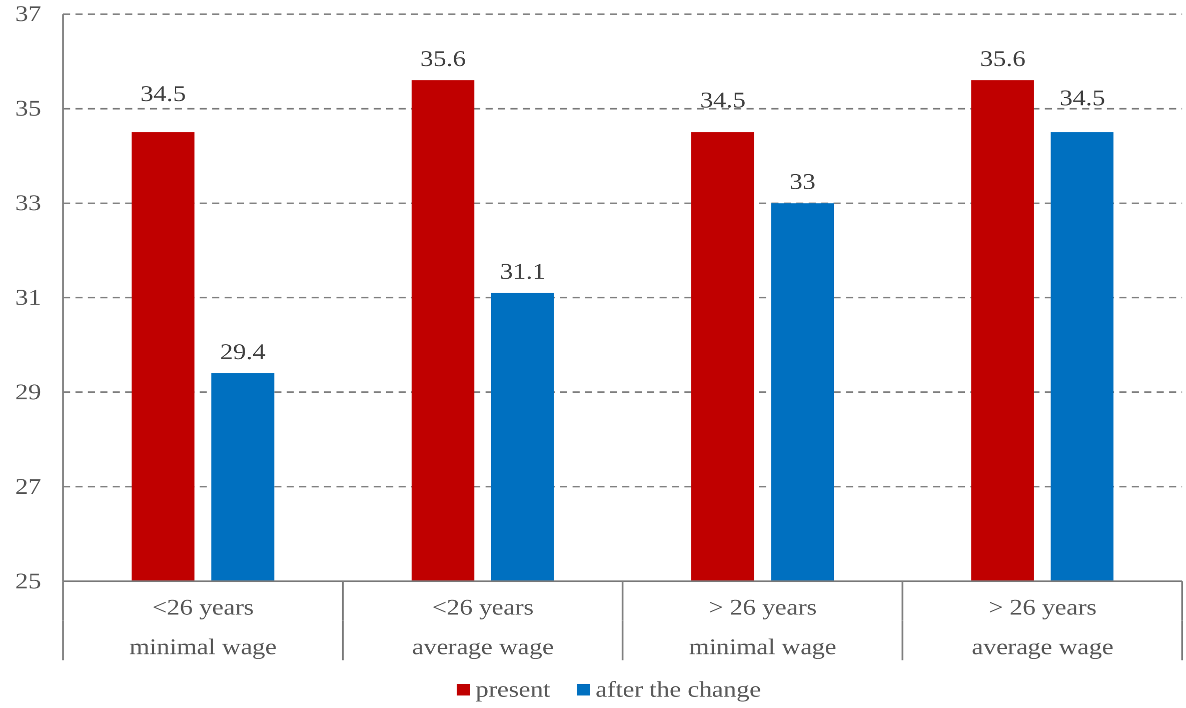
The **financial consequences of the implemented and planned actions tightening** the system of value added tax, income tax and excise tax **are estimated at PLN 7.4 bn in 2019 and an additional PLN 9.7 bn in 2020.**

The revenue forecast also takes into account the expected reduction in personal income tax revenue - by PLN 10.4 bn in 2020 - as a result of a **further reduction in the tax wedge** . It will consist in:

- reduction of the PIT rate from 18% to 17% for income not exceeding PLN 42,764 per year,
- increase in lump-sum tax deductible costs for employees,
- introduction of PIT exemption for employees aged up to 26 years to the income not exceeding PLN 42,764 in a fiscal year.

As a result of the above changes in PIT, the tax wedge for persons over 26 years of age receiving the minimum wage will be reduced by 1.5 percentage points. For the same age group, assuming average salary, the wedge will decrease by 1 percentage point. In the case of persons aged under 26, the reduction of the tax wedge for persons with minimum and average wages is greater and amounts to 5 percentage points and 4.5 percentage points respectively. These changes will contribute to an increase in the progressivity of the tax wedge.

Figure 4. **Reduction of the tax wedge**



Source: Ministry of Finance.

The financial effects of all key measures in the tax area is estimated at PLN 7.5 bn in 2019 and additional PLN 3.3 bn in 2020. They are presented in Annex 1.

Moreover, in the forecast horizon, PIT income will be affected by planned systemic measures increasing social insurance contributions (cf. below). The level of tax revenues in the coming years will also be determined by:

- reduction of VAT rates (from 23% to 22% and from 8% to 7%) as of January 2022 (PLN -10.1 bn), which results from the projected reduction of the "net" public debt to GDP ratio below 43% in 2020. (cf. Chapter II.4). In accordance with *the Act of 22 November 2018 amending the Act on Value Added Tax*, this entails an automatic reduction of VAT rates from 2022 onwards,
- so-called solidarity levy paid from 2019 by individuals in the amount of 4% of the income exceeding 1 million PLN. The new levy constitutes the income of the Solidarity Fund for the Support of the Disabled (PLN 1.2 bn),
- introduction as of 2019 of 9% CIT rate for small taxpayers (-0.4 bn PLN),
- the effects of *the Act of 28 December 2018 amending the Excise Duty Act and certain other acts*, which introduced as of 1 January 2019 a reduction in the excise duty rate on electricity, a reduction in the so-called transitional fee rates (tax according to the ESA2010 methodology) and other mechanisms to stabilise electricity prices (PLN -1.9 bn).

Social security contributions

The second important source of revenue of the general government in terms of value are the inflows from social insurance contributions. Their level depends on the developments in the base for their calculation, the main component being the wage fund in the national economy as well as on systemic solutions. The nominal growth rate of the wage fund, after a record high increase in 2018 and the expected continuation of this trend in 2019 (forecast growth at a level of approx. 10% y/y), will amount to 6.5%, 5.8% and 5.7%, respectively in the following years.

Within the forecast horizon, the level of income from social insurance contributions will be positively influenced, apart from macroeconomic factors, by ZUS measures aimed at tightening the system of contributions and additional systemic measures increasing the receipts from contributions. **The financial effects of implemented and planned measures in strengthening the system of social security contributions is estimated at 721 million in 2019 and additional PLN 15 billion in 2020**, including the l PLN 3.5 bn of pension contribution which is currently transferred to the accounts of OFE (open pension fund) members. These measures are presented in Annex 2.

On the other hand, the decrease in the level of income is affected by the introduction on 1 January 2019 the option to benef from reduced social security contributions by persons starting their own businesses (the so-called small ZUS).

One-off revenue

A significant revenue of the social insurance subsector will be the so-called transformation fee resulting from the planned **reshaping of the Open Pension Funds model**. The fee will be a one-off payment and it will credit the Social Insurance Fund (see Annex 2).

Annex 3 presents other one-off revenue measures which, within the forecast horizon, will significantly affect the headline balance: sale of greenhouse gas emission allowances and allocation of frequency resources in the 3.7 GHz, 26 GHz and 800 MHz bands.

The financial effects of all one-off measures is estimated on a cash basis at PLN 5.7 bn in 2019, PLN 17.8 bn in 2020 and additional PLN 12.0 bn in 2021.

Factors determining the general government expenditure

The level of general government expenditure is determined by the stabilising expenditure rule laid down in *the Public Finance Act* (cf. Chapter II.4). This rule covers most of the expenditures of the general government The algorithm of setting the maximum limit of expenditures for the state budget, which is determined by the expenditures of other entities included in the rule, indicates the maximum binding level of expenditures which can be planned in the budget act.

In this scenario, expenditure level was adopted in compliance with the binding limit resulting from the stabilising expenditure rule, taking into account effects of one-off measures mentioned in Annex 3. Bearing in mind the model of functioning of the stabilising expenditure rule and in view of the long-term nature of new measures announced and planned for implementation by the government as early as 2019, the aggregate of legally determined expenditures in the state budget will increase. This will have an impact on the path to reaching the expenditure limits for the state budget set by the rule. As a result, an increase in the residual expenditures of the state budget will be possible at a level of 1-3% y/y. This means that the expenditure paths determined in certain sectoral acts (rigidly linked to macroeconomic parameters) must be postponed over time, and expenditure must be prioritised taking into account effectiveness in the area of spending.

Social transfers

The level of social transfers in 2019 and subsequent years of the forecast will be determined by changes in the existing programmes and the introduction of new social policy instruments:

- modification of the *Family 500 plus* programme, consisting in abolishing the income criterion as of July 2019. The cost of extending the *Family 500 Plus* Scheme in 2019 amounts to PLN 9.6 bn and in subsequent years to approximately PLN 20 bn annually,
- the *pension plus* scheme, from which a one-off cash benefit of PLN 1100 will be paid in May 2019 to pensioners and disability pensioners. The cost of benefits for pensioners and disability pensioners will amount to PLN 10.8 bn. The increase in expenditure on pensions will also result from the change in the rules of their indexation (from 1 March 2019 the amount of the lowest pension was

increased to PLN 1100 and the guaranteed minimum indexation increase amounts to PLN 70). Cost of these changes in 2019, amounts to PLN 7.6 bn,

- the *Mama 4 plus* scheme (effective from 1 March 2019) introducing a supplementary parental benefit for mothers (and fathers) who have brought up at least four children. The estimated cost of the scheme in 2019 amounts to PLN 0.8 bn,
- increase in care benefits and income criterion for persons applying for benefits from the Maintenance Fund (increase in expenditure on family benefits by PLN 0.6 bn in 2019),
- expenditures on social, professional and health support for the disabled implemented from the resources of the Solidarity Fund for the Support of the Disabled established last year (PLN 0.5 billion in 2019 and PLN 1.4 billion annually in subsequent years).

On the other hand, the reduction of expenditure in the existing social transfers should be affected by ►systemic changes consisting in rationalisation of the rules for obtaining rights to sickness, care and maternity benefits and their granting (the estimated effect is about PLN 1.6-2.2 billion annually) and ►measures leading to limitation of abuses related to their payment, such as the introduction of electronic sick leave and increase in the frequency of control (the estimated effect is about PLN 0.8 billion in 2019).

Public investments

After two years of strong growth, general government investment is projected to weaken in 2019-22 due to the absorption path of EU funds. Despite this, the ratio of investment expenditures to GDP will remain within the forecast horizon at the average level of 4.5%. General government investments will be determined by multiannual governmental programmes, particularly in the area of infrastructure and by the implementation of the EU financial perspective for 2014-20. Investment projects in the central subsector will be carried out, inter alia, within the framework of :

- *National Road Construction Programme for 2014-2023 (with perspective until 2025),*
- *National Railway Programme until 2023 (KPK),* covering investment expenditure on the construction and modernisation of railway lines carried out by the company PKP Polskie Linie Kolejowe S.A.

In the longer term, the implementation of *the Act of 10 May 2018 on the Central Communication Port* will be important.

It is forecast that after record-high increases in 2017-18, local government investments will cease to be the main driver of general government investments and their dynamics will slow down, which will result from a weaker absorption of EU funds. Due to limited financial possibilities of local government units, the support for investments in the development of local road infrastructure will be provided by a new mechanism in the form of the Local Government Roads Fund. Its task will be to co-finance the construction and reconstruction of public roads managed by districts and municipalities since 2019.

Other expenditures

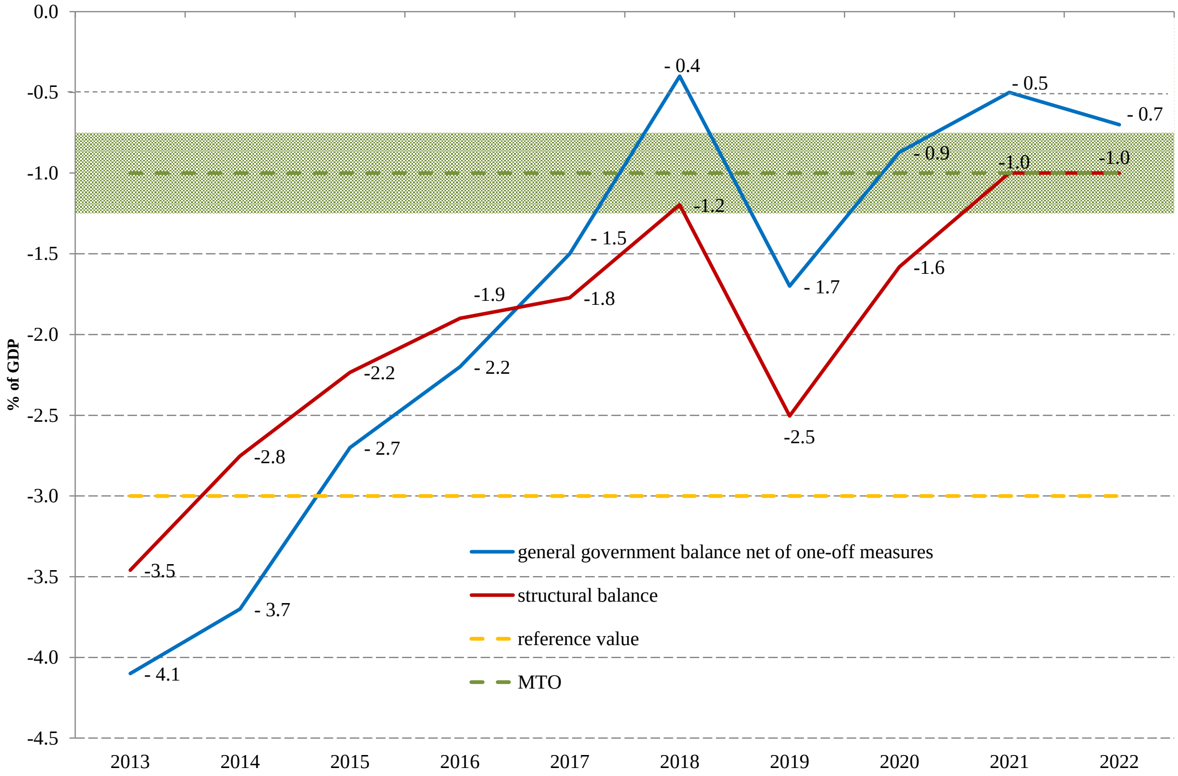
The baseline scenario of *the Programme* also includes a new programme aimed at the restoring local bus connections. The total annual cost of the programme, including the share of the state budget and local governments, is about PLN 1 billion.

In addition, the forecast for 2019 comprises one-off expenses planned from the Price Difference Payment Fund to cover the difference between the purchase price of energy from producers and the selling price to end customers, as part of the set of solutions adopted to stabilise electricity prices. The expected financial impact on the expenditure side on an accrual basis is about PLN 4.5 billion in 2019.

The general government expenditures within the forecast horizon will also be affected by the introduction from mid-2019 of the Employee Capital Plans - PPK (cf. Chapter IV.1), through introducing the incentive mechanism in the form of a welcome bonus and an yearly bonus both paid from the Labour Fund to the PPK participants. The cost for the general government will result from financing incentives and contributions of employees of public institutions and, after the programme will be extended to include general government employees and in the horizon covered by the *Programme* it will amount to PLN 0.7 billion in 2019, PLN 3.8 billion in 2021 and PLN 3.6 billion in subsequent years.

On the other hand, in 2020-22, there will be a reduction in the general government expenditures related to one-off transfers, including those resulting from the aid scheme for farmers affected by drought. Additional savings should also appear as a result of measures tightening the expenses of the social insurance subsector.

Figure 5. General government balance



Source: Ministry of Finance

II.4. Structural balance

Poland is subject to the requirements of the preventive part of *the Stability and Growth Pact* which requires EU Member States to formulate and achieve the so-called medium-term budgetary objective (MTO) within a specified time frame. The compliance with the MTO is essential to minimise the risk of the nominal general government deficit exceeding 3% of GDP.

According to the estimates of the Ministry of Finance, in 2018 the structural balance amounted to -1.2% of GDP (improvement by 0.6 percentage point). This means achieving the MTO within a deviation band acceptable to the European Commission[6]. Within the horizon of *the Programme*, after a temporary increase in 2019, the improvement of the structural balance to the level of -1% of GDP is envisaged. The structural balance forecast takes into account the one-off measures described in Annex 3.

[6] The European Commission recognizes a structural result at a level consistent with the MTO if it is contained within the range of 0.25 percentage point of GDP from MTO. Cf. *Vade Mecum on the Stability & Growth Pact 2019 Edition*, p. 15, https://ec.europa.eu/info/publications/vade-mecum-stability-and-growth-pact-2019-edition_en

Table 2. General government structural balance

	% of GDP	2018	2019	2020	2021	2022
1.	**Real GDP growth (%)**	5.1	4.0	3.7	3.4	3.3
2.	**Net lending of general government***	-0.4	-1.7	-0.9	-0.5	-0.7
3.	**Interest expenditure**	1.4	1.4	1.4	1.3	1.2
4.	**One-offs and temporary measures**	0.0	0.0	1.1	0.2	0.1
4.1	One-offs on the revenue side: general government	0.0	0.0	1.1	0.2	0.1
4.2	One-offs on the expenditure side: general government	0.0	0.0	0.0	0.0	0.0
5.	Potential GDP growth (%)	4.0	4.0	3.9	3.8	3.7
6.	Output gap	1.6	1.6	1.4	1.0	0.6
7.	Cyclical budgetary component	0.8	0.8	0.7	0.5	0.3
8.	Cyclically-adjusted balance	-1.2	-2.5	-0.5	-0.8	-0.9
9.	Cyclically-adjusted primary balance	0.2	-1.1	0.8	0.5	0.4
10.	**Structural balance**	-1.2	-2.5	-1.6	-1.0	-1.0

Source: Ministry of Finance.
* Net lending of general government does not include one-offs and temporary measures from fourth row.

Since 2017, the leading tool for assessing progress towards the MTO, i.e. the implementation of the required adjustment, has been the expenditure benchmark. It represents the annual growth rate of general government expenditure that ensures compliance with the *Stability and Growth Pact* requirements.

The nominal growth rate of general government expenditure in 2018 amounted to 3.8%, which was lower than the expenditure benchmark by 0.1 percentage points and led to an improvement in the structural balance by 0.5 percentage point of GDP. The analysis of compliance with the *Stability and Growth Pact* requirements should take into account the exceptional nature of drought-related expenditure in 2018. (see Box 2).

Box 2. Exceptional drought-related expenditure in 2018

The vegetation period in Poland in 2018 was exceptionally warm against the background of decades and the last decade. According to data of the Institute of Meteorology and Water Management, the average temperature between April and September was about 2°C higher than in 2008-17 and even higher compared to the norm of 1966-2015[7]. High air temperatures were accompanied by intensive sunshine and about 25% lower precipitation than the average for the vegetation period of the previous decade. As a result of the specific meteorological conditions, the Institute for Fertilisation and Soil Science recorded a drought between April and September that threatened agricultural crops throughout the country. Between May-July drought occurred in all 14 monitored crops[8].

As a result, the government adopted an aid programme for farmers and agricultural producers who suffered damage as a result of the exceptionally severe drought observed at that time *(Resolution No. 107/2018 of the Council of Ministers of 31 July 2018 on establishing an aid programme for agricultural and fisheries farms in which damage caused by drought or flooding[9]occurred in 2018*). The support covered mainly subsidies for 1 ha of agricultural area, for 1 ha of area under fishponds and subsidies for interest rates on loans for the resumption of production. Sureties and loan guarantees, assistance with the payment and settlement of social security contributions, deferral of payments under sale and lease agreements and agricultural tax credits were also provided for by that programme .

The Agency for Restructuring and Modernisation of Agriculture has been appointed to provide assistance to agricultural holdings. Ultimately, the amount of budgetary resources allocated for the implementation of the programme amounted to PLN 2215 million. Until the end of 2018, the amount of aid granted exclusively in connection with drought amounted to PLN 1405,533 million. Expenditure incurred in order to mitigate the damage caused by drought was directly linked to an extraordinary event outside the control of the government, and was temporary in the meaning of the *Stability and Growth Pact*.

Table 3. Expenditure from the government's aid programme for agricultural and fisheries farms where damages caused by drought occurred in 2018

	PLN million	ESA Code	2018
1.	subsidies to 1 ha. of agricultural area	D.99	1394.176
2.	subsidies to 1 ha. of an area under fishpond	D.99	11.130
3.	subsidies to credit interests, which were taken to resume production	D.99	0.227

Source: The Agency for Restructuring and Modernisation of Agriculture.

Some funds of the aid programme in the amount of PLN 734.950 million were classified as not expiring after 2018. This allowed for continuation of the aid until 31 March 2019. As at 19 March this year, PLN 590,237 million was paid out of funds not expiring.

[7] http://www.imgw.pl/2018/10/11/susza-2018-podsumowanie-okresu-wegetacyjnego/
[8] See Agricultural Drought Monitoring System on the website http://www.susza.iung.pulawy.pl
[9] https://www.gov.pl/documents/912055/913531/uchw_nr_107_RM_2018.pdf/29494101-a271-ba00-87c6-6eb94cca3d18 and https://www.gov.pl/documents/912055/913531/Uchwała_nr_124_RM_2018_zm_program_pomoc_dry_2018.pdf/9d59dee9-b015-6b0c-d2eb-db88f5f0a13f

The stabilising expenditure rule provides a similar concept to the expenditure benchmark[10]. The adjustment by 0.5% of GDP required by the benchmark is embedded in the mechanism correcting the rules, which requires a reduction in the dynamics of expenditure resulting from the rule of 1.5-2 percentage points in the situation of public finance imbalances specified in *the Public Finance Act*.

The **initial amount of expenditure for 2020**, consistent with the stabilising expenditure rule, was estimated based on the amount of expenditure for 2019 specified in Article 1(3) of *the Budget Act for 2019 of 16 January 2019* at PLN[11] 847,773,421 thousand. Discretionary measures on the income side in the amount of PLN 13,598 million, included in the initial amount of expenditures for 2020 are, in principle, neutral for the general government balance. These include in particular the impact of the tax and social security arrangements as described in Annex 1 and Annex 2 respectively (cf. Table 4). As a result, the preliminary estimated amount of expenditure for 2018 is equal to PLN 901,068 million (38.0% of GDP).

Pursuant to Article 112aa of *the Public Finance Act* and taking into account the discretionary effects presented in Table 4, it is estimated that the expenditure in 2021 will amount to PLN 948,445 million (37.7% of GDP). At the same time, as a result of the projected reduction of the net public debt in 2020, i.e. calculated in accordance with Article 38a(4) of *the Public Finance Act*, below 43% of GDP in 2022, the correction for public finance imbalances, specified in Article 112aa(4) of *the Public Finance Act*, will amount to 0 percentage points. As a result, the expenditure for 2022, taking into account the exclusion of the correction mechanism of the rule and the reduction of VAT rates to 7% and 22%, will amount to PLN 1,000,673 million (37.6% of GDP).

[10] The differences between the national and the EU rule refer to: ►use in the stabilising expenditure rule the 8-year average real GDP growth rate (instead of the 10-year average potential GDP growth rate in the benchmark), ► the inflation target (instead of the GDP deflator forecast), ►the discretionary measures on the revenue side as well as ►the non-adjustment of the amount resulting from the stabilising expenditure rule. For the purpose of assessing the compliance with *the Pact* , the general government expenditure adjusted by: ►debt servicing costs, ►expenditure fully financed by the EU funds, ►national investment expenditure (in year t) less the 4-year average of such expenditure (t-3; t), ►cyclical expenditure on unemployment benefits.

[11] Detailed calculation of the level of expenditure for 2019 was included in the explanatory memorandum to the draft Budget Act for 2019.

Table 4. Expenditure's amount calculations in accordance with the stabilising expenditure rule

	PLN million	2020	2021	2022
1.	initial point (Budget Act for the previous year)	847 518*	901 068	948 445
2.	8-year GDP growth indicator**	1.0366	1.0389	1.0389
3.	NBP inflation target	1.025	1.025	1.025
4.	correction due to the public finance imbalance	-1.5%	-1.5%	0.0%
5.	discretionary measures	13 598	2 776	-9 300
	Level of expenditure	901 068	948 445	1 000 673
	Discretionary measures (taxes and contributions)			
1.	reducing VAT rates to 7% and 22%			-9 300
2.	reducing the VAT gap	7 944	1 000	
3.	updated effects of the *Act of 10 May 2018 on supporting new investment* (economic zones)	1 079		
4	withholding tax (WHT), Mandatory Disclosure Rules (MDR) and changes in the General Anti-Avoidance Rule (GAAR)	1 679		
5.	withdrawal of the effects of the previous recycling fee	-1 207		
6.	tightening the recycling fee from 09.2019 on	1 419		
7.	solidarity tribute	1 150		
8.	indexing the excise duty rate on alcoholic beverages and tobacco	1 146		
9.	reduction of the excise duty rate for electricity	-1 940		
10.	reduction of the transitory fee	-2 346		
11.	reduction of the tax wedge	-10 429		
12.	tightening the qualification of revenues to the source of "non-agricultural economic activity", digital tax	1 465		
13.	additional revenue in Social Security Fund due to transformation of Open Pension Funds	3 469		
14.	mitigating the effects of mismatches in qualification of hybrid and reverse hybrid structures, automatic exchange of information on cross-border tax arrangements	736		
15.	abolition of the limitation of the annual base for the assessment of pension and disability benefit contributions, tightening art. 19 of the Act of 13 October 1998 on social contribution system (net effect)	5 175	1 776	
16.	reduction of avoidance in paying social contributions (net effect)	2 542		
17	Social Insurance Institution measures improving compliance in the system of social contributions	1 717		
	Total	**13 598**	**2 776**	**-9 300**

Source: Ministry of Finance

* The original amount of expenditure for 2020, derived from the 2019 Budget Act, has been adjusted in Table 4 for the expenditure of the Office of the Polish Financial Supervision Authority (UKNF) in connection with the transformation of UKNF from 1 January 2019 in a state legal entity.

** The indicated values take into account the information contained in the notice of the President of the Central Statistical Office of 16 April 2019 on the total dynamics of gross domestic product in fixed prices for 2013-2018.

II.5. General government debt

In the period covered by the *Convergence Programme*, debt management will, as in previous years, focus on the achievement of the objective set out in the *Public Finance Sector Debt Management Strategy*, i.e. on the minimisation of long-term debt servicing costs subject to constraints on the level of risk. Debt management will take place in a context of primary general government surplus. On the other hand, uncertainty in financial markets can be expected to arise from the monetary policy of the major central banks, including the ECB and the Fed, the process of UK exit from the EU and the trade policy of the major world economies.

The changes in the debt to GDP ratio in 2019-22 will mainly result from the state budget borrowing requirements (the State Treasury debt constitutes over 85% of the general government debt) and the GDP growth rate. Changes in the debt of other entities of the general government will result mainly from an increase in the debt of local governments and the National Road Fund (the increase in debt will be related to incurring liabilities for the implementation of road projects).

It is expected that within the horizon of *the Programme* , the debt to GDP ratio according to the EU definition will gradually decrease from 48.9% at the end of 2018 to 40.6% at the end of 2022. The development of the average interest rate on the debt of the general government and the debt service costs will result primarily from the expectations as to the increase of interest rates within the horizon of *the Programme*.

Table 5. General government debt (end of the year)

	% of GDP	ESA Code	2018	2019	2020	2021	2022
1.	**Gross debt**		48.9	47.9	46.0	42.9	40.6
2.	**Change in the gross debt ratio**		-1.7	-1.0	-2.0	-3.1	-2.2
	Contributions to changes in gross debt						
3.	**Primary balance***		-1.1	0.3	-1.5	-1.0	-0.6
4.	**Interest expenditure**	EDP D.41	1.4	1.4	1.4	1.3	1.2
5.	**Stock-flow adjustment**		-2.0	-2.6	-1.9	-3.4	-2.8
	of which: difference between cash and accruals		0.1	0.2	1.2	0.5	0.6
	net accumulation of financial assets		0.3	-0.2	-0.3	-1.3	-1.0
	effect of change in GDP		-3.0	-2.6	-2.8	-2.6	-2.4
	valuation effects and others		0.6	0.0	0.0	0.0	0.0
	p.m. implicit interest rate on debt (%)		3.0	3.0	3.3	3.5	3.7
	Other relevant variables						
6.	Liquid financial assets		4.7	4.3	4.0	3.8	3.6
7.	Net financial debt (=1-6)		44.2	43.7	41.9	39.1	37.0
8.	Debt amortisation (existing bonds) from the end of the previous year**		5.5	3.7	4.4	4.9	3.8
9.	Percentage of debt denominated in foreign currency (%)		31.0	28.5	26.7	25.2	24.8
10.	Average maturity***		5.1	4.9-5.0	4.8-5.1	4.7-5.1	4.7-5.2

Source: Ministry of Finance.
* Impact of primary balance on debt: (-) means primary surplus.
** In the case of public finance units' debt other than the State Treasury – estimate based on available reports.
*** Interval forecast for State Treasury debt.

III. Sensitivity analysis and comparison with the previous update

III.1. Risk factors

The forecast presented in this update of the *Programme* assumes that the economic growth in the EU, which is the largest trade partner of Poland, will be consistent with the scenario presented by the European Commission in the edition of forecasts published in February 2019. According to the Commission experts, the balance of risk factors for this forecast remains negative. The main reasons why the euro-area economic growth may turn out slower include the uncertainty about the potential negative effects on international trade due to increased protectionism in US trade policy and the expected slower growth rates in China and the US. It overlaps with the risk of adjustments in asset price increases to date, which was fostered by a low interest rate environment and the uncertainty about the outcome of the Brexit negotiations. On the other hand, good labour market conditions and optimistic expectations may lead to an increased investment, especially in net beneficiary countries of EU funds.

The macro-fiscal scenario assumes a lower dynamics of public investment than in 2018-19, with the approaching end of the inflow of EU funds under the 2014-20 financial perspective. The actual scenario in this area may turn out other than assumed, which would be significant for the adopted investment path and, as a consequence, the GDP growth.

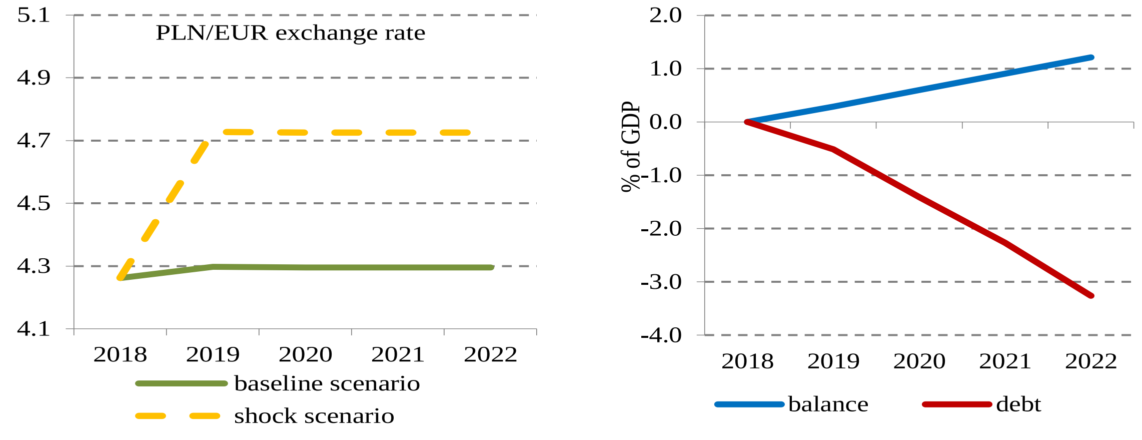
A particular risk factor related to structural changes in the labour market in Poland is the size of labour supply in the forecast horizon. High demand for labour, including the less qualified and less well paid, supported by low replacement rates, translates into postponing retirement and keeps labour force participation stable. In addition, incoming workers from Ukraine significantly increase the supply of labour in the country and help to meet the growing demand for labour. However, labour supply resources are not unlimited and the so-called flexibility of the labour market is difficult to estimate. In case of shortages on the supply side, it can be expected that the space for increasing production and expansion of enterprises will be limited and competition for employees through higher wages will translate into an increase in core inflation. As a result, it is possible to slow down the GDP growth rate and increase prices faster than in the *Programme* scenario.

Risk factors for the fulfilment of the inflation forecast also include a possibility of other developments in prices in world markets of commodities and food than assumed, which will directly translate into the path of price changes in Poland. This is particularly true for oil prices, which have a significant impact on fuel prices in Poland and consequently on transport costs.

III.2. Sensitivity analysis

The sensitivity of the general government balance and debt in the years 2018-22 to a depreciation of the zloty exchange rate and the increase in the domestic interest rate is presented below. The analysis was performed on the basis of the econometric Model of Public Finance (eMPF) developed by the Ministry of Finance. Simulation results should be interpreted with caution, as they are based on historical elasticities estimated for the assumed forms of behavioural equations.

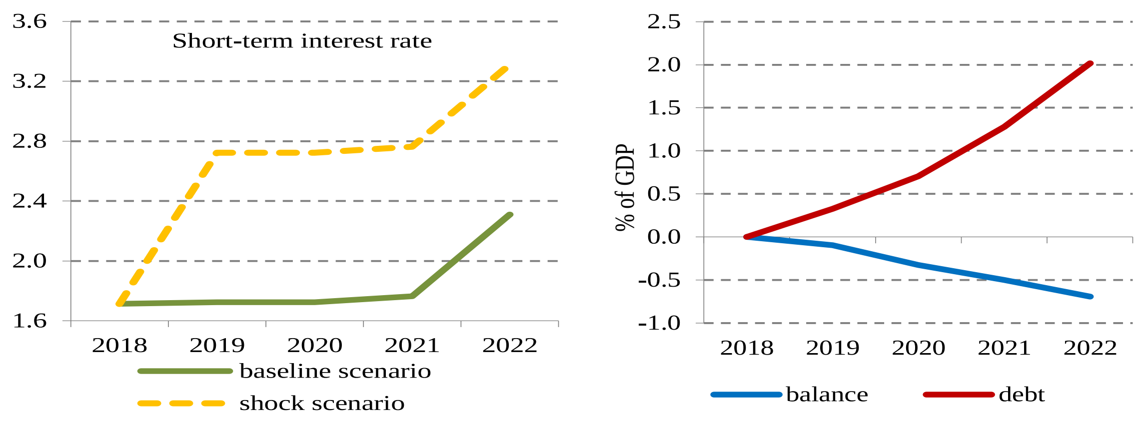
Figure 6. EUR/PLN exchange rate (left chart) and its impact on the general government balance and gross debt (right chart)



Source: Ministry of Finance

The exchange rate impulse was introduced as a permanent 10% depreciation of the PLN/EUR exchange rate. The weakening of the zloty improves the competitiveness of domestic products, which directly results in an increase in the volume of exports. The increase in exports due to its high import-intensiveness is accompanied by an increase in imports. An increase in demand for Polish goods fosters the improvement of labour market conditions and an acceleration of investment activity, which supports the GDP growth in the horizon of the forecast. Higher economic growth leads to an increase in government revenue which exceeds the increase in expenditure on debt servicing denominated in foreign currency, ultimately leading to an improvement in the government balance. As a consequence, in the shock scenario, the general government debt in 2022 is lower in relation to GDP than in the baseline scenario.

Figure 7. Short-term interest rate (left chart) and its impact on the general government balance and gross debt (right chart)



Source: Ministry of Finance

The interest rate impulse has been defined as an increase in the nominal short-term interest rate of 1 percentage point for the entire horizon covered by the analysis. A rise in short-term interest rates results in an increase in long-term interest rates and leads to a higher cost of capital acquisition, which causes limiting of the investment level against the baseline scenario and higher debt financing costs. As a result of a shift in consumption over time due to inter-temporal substitution and tightened conditions for granting loans, the level of private consumption is also decreasing. As a consequence, the impulse triggering the enhancement of monetary policy restrictiveness leads to a decrease in GDP volume in the forecast horizon. Parallel to the growing debt servicing costs and a relatively lower GDP level, the general government balance to GDP ratio deteriorates and the share of the general government debt in GDP grows against the relation in the baseline scenario.

III.3. Comparison with previous update

Real GDP growth in 2018 turned out 1.3 percentage points higher than assumed in the last year's update of *the Programme* due to a faster increase in accumulation, private consumption and a more favourable contribution of net exports to GDP growth. Compared to the previous update of *the Programme*, the assumed average annual real GDP growth rate in 2019-21 did not change, while the real growth rate was slightly increased in 2019 and adjusted downwards for 2021.

The general government deficit in 2018 amounted to 0.4% of GDP and turned out 1.7 percentage point lower than anticipated. The lower general government deficit was the result of expenditure control based on a stabilising expenditure rule and a stronger growth in the general government revenue than in expenditure, which mainly affected a very good state budget balance. The correction of the deficit path in 2019 and the subsequent years of the forecast is mainly the result of taking into account new instruments in social policy, which will be implemented within the framework of a stabilising expenditure rule, thanks to the implementation of additional measures in the area of revenues.

A lower general government debt to GDP ratio in 2018 against the forecast from the previous *Programme* resulted mainly from significantly lower borrowing needs in relation to planned levels and a faster nominal GDP growth. The lower forecast for 2019-21 results from lower borrowing needs of the state budget and faster nominal GDP growth in 2019-20 compared to the assumptions of the previous *Programme*.

Table 6. Difference from the previous update

	ESA Code	2018	2019	2020	2021	2022
Real GDP growth (%)						
Previous update		3.8	3.8	3.7	3.6	
Current update		5.1	4.0	3.7	3.4	3.3
Difference		1.3	0.2	0.0	-0.2	
General government net lending (% of GDP)	EDP B.9					
Previous update		-2.1	-1.5	-1.1	-0.7	-
Current update		-0.4	-1.7	0.2	-0.3	-0.6
Difference		1.7	-0.2	1.3	0.4	
General government gross debt (% of GDP)						
Previous update		50.4	50.4	48.7	46.0	-
Current update		48.9	47.9	46.0	42.9	40.6
Difference		1.5	2.5	2.8	3.1	-

Source: Ministry of Finance, Central Statistical Office

IV. Sustainability of public finances

IV.1. Long-term budgetary prospects, including the implications of ageing population

Sustainable public finance supports long-term economic growth and constitute a critical element of the macroeconomic stability. In this context, it is crucial for the sustainability of public finance to have well-grounded fiscal framework.

One of the elements of the Polish fiscal framework are fiscal rules, including public debt rules, stabilising expenditure rule, which has a stabilising effect on public finance in the medium and long term and corrects potential imbalances, minimising the risk of over-tightening of fiscal policy, and rules limiting the growth in debt of local government units. The above-mentioned set of fiscal rules reduces the risk of high deficits and excessive debt growth, and thus the risk to the sustainability of Polish public finance.

The European Commission regularly assesses the situation in Member States in terms of public finance sustainability, based on fiscal gap ratios in the medium (S1 indicator), and long, infinite horizon (S2 indicator). The fiscal gap reflects the scale of the necessary adjustments to the primary structural balance, so that the public debt reaches the level of 60% of GDP (S1 indicator), or so that the solvency condition is satisfied in the infinite horizon (S2). The indicators are derived assuming the no-policy change scenario. Fiscal gap indicators therefore illustrate whether current policies are sufficient to maintain fiscal sustainability and do not aim to show the most likely scenario. The increase of an indicator means that a greater improvement of the primary structural result adjusted by a cycle is required.

Table 7. Fiscal sustainability indicators in the subsequent periods

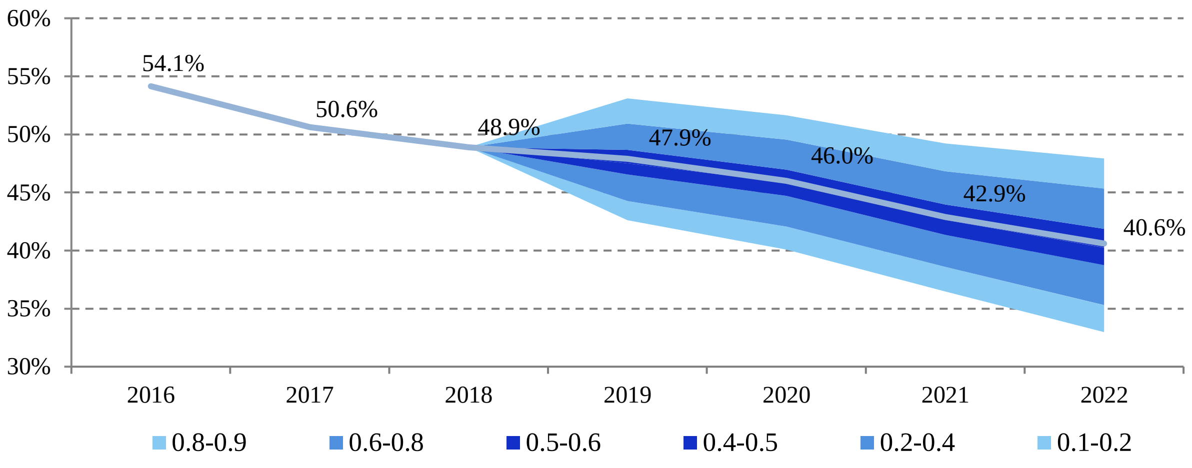
% of GDP	***Fiscal Sustainability Report 2018***	**Current update base year: 2022**
S1	-0.7 low risk	-1.9 low risk
S2	2.2 medium risk	1.3 low risk

Source: European Commission, Ministry of Finance.

Table 7 presents the S1 and S2 indices estimated by the Ministry of Finance against the background of the European Commission's assessment in the *Fiscal Sustainability Report* of January 2019. (base year: 2020, macro-fiscal assumptions derived from the European Commission forecasts of November 2018). The Ministry of Finance estimate is based on the macro-fiscal projections presented in the Programme and the age-related cost projections prepared in the framework of the work of the Ageing Working Group (AWG) of the EU Economic Policy Committee and presented later in this chapter. The indicators were estimated assuming 2022 as the base year.

Assuming that the consolidation is carried out consistently with the forecast presented in this *Programme*, it can be expected that S1 and S2 indicators for Poland will improve in the coming years. Indicators will be decreased by the decline in public debt projected in 2019-22 and the expected cyclically adjusted primary surplus.

Figure 8. Stochastic debt projections from 2019



Source: Ministry of Finance

A similarly low level of risk to the sustainability of public finances is indicated by stochastic simulations of the debt (development) based on the approach adopted by the European Commission and the International Monetary Fund[12]. The projections were derived based on the baseline scenario presented in the *Programme* and using the annual shocks obtained for the following variables: real GDP growth, real effective yield rate of general government debt, the primary balance and the exchange rate. The analysis shows that even with a considerable combination of adverse shocks, the general government debt over the forecast horizon shall not exceed the reference value of 60% GDP. In the chart above, 80% of possible paths of the debt derived with the use of the aforementioned approach are presented (the paths below 10 and above 90 percentile, representing the scenarios associated with the most extreme set of shocks in the economy, were excluded). Based on the methodology used, the general government debt in 2022 is projected to be lower than 50% GDP.

Table 8. Long-term sustainability of public finances

% of GDP	2016	2030	2040	2050	2060	2070
Total expenditure						
Of which **age-related expenditure**	20.3	20.4	20.6	21.4	22.1	21.4
Pension expenditure	11.2	11.0	10.8	11.2	11.1	10.2
Social security pension	11.2	11.0	10.8	11.2	11.1	10.2
Old-age and early pensions	9.9	10.2	10.0	10.4	10.4	9.5
Other pensions (disability, survivors)	1.3	0.8	0.8	0.8	0.7	0.7
Health care	4.3	4.5	4.8	5.0	5.2	5.2
Long-term care (previously as a component of health care)	0.5	0.7	0.9	1.0	1.2	1.3
Education expenditure	4.3	4.2	4.1	4.2	4.6	4.7
Other age-related expenditure						
Interest expenditure	0.0	0.0	0.0	0.0	0.0	0.0
Total revenue						
Of which: from pension contributions	7.9	8.3	8.4	8.3	8.3	8.3

[12] Stochastic projections are developed using the Monte Carlo simulation based on 1000 draws.

% of GDP	2016	2030	2040	2050	2060	2070
Assumptions						
Labour productivity growth	2.1	2.7	2.2	1.9	1.7	1.5
Potential GDP growth	2.7	1.9	1.2	0.7	1.0	1.0
Participation rate males (aged 20-64)	73.9	72.9	71.7	68.2	68.7	71.0
Participation rate females (aged 20-64)	58.0	57.4	55.7	52.6	54.4	56.4
Total participation rate (aged 20-64)	65.8	65.1	63.7	60.4	61.6	63.8
Unemployment rate (aged 20-64)	6.0	5.5	5.5	5.4	5.4	5.4
Population aged 65+ over total population	16.3	23.3	26.1	30.9	34.1	33.3

Source: European Commission and Ageing Working Group (AWG) of the Economic Policy Committee (EPC).

The long-term scenario of public expenditure presented in Table 8 was prepared within the framework of the work of the Ageing Working Group (AWG) of the Economic Policy Committee (EPC). It was published by the European Commission in 2018 in the *Ageing Report 2018* on ageing effects foreseen up to 2070. The scenario was based on demographic assumptions developed by Eurostat and relatively conservative technical assumptions regarding the basic factors of economic growth, i.e. labour, capital and labour productivity. These assumptions basically mean that economic activity in the period covered by the scenario of individual age cohorts will remain at historical average levels, that the share of capital in GDP will stabilise in the medium and long term (it should be remembered that in Poland this share is still relatively low) and that the TFP growth rate will converge in the long term to lower levels observed in developed countries. It should be noted that the *Act of 24 November 2017 amending the Act on health care services financed from public funds*, which provides for a gradual increase in health care expenditure by 2025 to 6% of GDP, entered into force after the completion of the AWG on health care projections. The amending act of 5 July 2018 shortened the increase in expenditure on health care by 1 year, i.e. until 2024.

According to AWG projections, pension expenditure shall remain stable over the long term and will fall from 11.2% GDP in 2016 to 10.2% GDP in 2070. Fluctuations in expenditure result mainly from changes in the demographic structure of the population. Compared to the previous forecasts, expenditure is slightly higher, as a result of the reduction in the retirement age for women (60) and men (65) from 1 October 2017 on. The forecast was also affected by the change in macroeconomic assumptions. However, demographic change continues to have the greatest impact on the level of expenditure. The forecast of AWG is based on the assumption that the key factor for a decision to exit the labour market is the statutory retirement age. In the context of trends in effective retirement ages observed since 1999, this assumption can be considered as conservative. The Polish pension system defines only the minimum retirement age and it is possible to continue the professional activity, which is rewarded by a significant increase in future benefits.

The total age-related expenditure also increases slightly, from 20.3% GDP to 21.4% GDP. The main determinant of the increase in this type of expenditure is health and long-term care expenditure. Demographic changes constitute one of the major challenges for the long-term stability of public finance in most European countries. Against their background, the current situation in Poland appears to be favourable. It should be expected however that the ageing population phenomenon observed in recent years will continue, caused by the extension of life expectancy, low fertility and the current age structure of population. As a result, the demographic burden ratio shall deteriorate, i.e. the relationship between the number of population at post-productive age (65 and more) against the number of population at productive age (i.e. aged 15-64), expressed as percentage. According to the AWG forecast, this ratio will increase from 23.7% in 2016 to 62.2% in 2070.

As of 1 January 2019, Employee Capital Plans (PPK) were introduced as an instrument aimed at increasing the level of long-term savings and growth of future pensioners' assets. Ultimately, the programme will cover all employees paying pension insurance contributions, including employees of the general government. The PPK will make a system of voluntary savings consisting of contributions paid by the employee and the employer supported by financial incentives from the State. The funds accumulated in the PPK will be invested in the financial market and paid out when the PPK participant reaches the age of 60. The PPK is an element of the *Capital Building Programme*. One of the basic effects of the proposed solution should be an increase in the long-term savings rate of Poles, which will serve to limit the effect of a decrease in replacement rates for pensions received under the participation in the first pillar of the pension system (pension savings under the PPK will, in fact, transfer consumption to future periods). To a certain extent, the PPK may contribute to the improvement of Poland's net international investment position, as well as to an increase in the investment rate and acceleration of the potential GDP growth rate. Another element of the *Capital Building Programme* will be the reconstruction of the functioning model of Open Pension Funds (cf. Chapter II.3 and Annex 2). The change of the nature of funds accumulated in open pension funds into private pension funds (IKE) will be another impulse to build pension savings in the third pillar.

IV.2. Contingent liabilities

Potential contingent liabilities on account of sureties and guarantees granted by the general government in Poland reached 5.3% of GDP at the end of 2018, against 6.0% of GDP at the end of 2017 (in accordance with the updated GDP for 2017 and the preliminary GDP estimate in the fourth quarter of 2018). Sureties and guarantees provided by the State Treasury had the major share in this category - at the end of 2018 they accounted for 5.1% of GDP as compared to 5.9% of GDP at the end of 2017.

The State Treasury activity with regard to sureties and guarantees does not pose any significant risk to public finances. At the end of 2018, approximately 98% of non-current contingent liabilities on account of sureties and guarantees granted by the State Treasury were classified as a low-risk group. The long-term risk ratio for the State Treasury sureties and guarantees portfolio remained at a low level. Parallel to the growth in potential contingent liabilities on account of sureties and guarantees granted by the State Treasury, their decline in relation to GDP occurred. In particular, it resulted from a slower than expected increase in the volume of guarantees in 2018, as well as from repayments of liabilities significant in terms of amounts.

As part of the surety and guarantee portfolio, the State Treasury guarantees granted for the liabilities of the financial sector (excluding guarantees granted to support the National Road Fund by Bank Gospodarstwa Krajowego) amounted to only approx. 0.1% of GDP as of the end of 2018, and did not relate to any anti-crisis measures.

Table 9. Contingent liabilities

% of GDP	**2018**
Public guarantees	**5.3**
Of which: linked to the financial sector*	0.1

Source: Ministry of Finance.
* Data on potential liabilities of other public finance sector entities on account of sureties and guarantees for the financial sector are not subject to reporting (only total potential liabilities are available). Therefore, the presented value of guarantees granted for financial sector liabilities refers to the State Treasury sureties and guarantees portfolio (excluding guarantees granted for supporting the KFD at BGK).

In subsequent years, potential contingent liabilities on account of sureties and guarantees granted by the State Treasury may increase, which could translate into a slight increase in the ratio of those liabilities to GDP. Granting Treasury sureties and guarantees in order to support investments fostering development in the area of road and rail infrastructure will continue . In addition, it is possible to grant sureties and guarantees for other purposes permitted by the Act, in particular as regards support for: exports, environmental protection, job creation, innovation, corporate restructuring, regional development, entrepreneurship, and programmes or projects under the EU assistance programmes.

Sureties and guarantees will be mainly granted for investments co-financed by EU funds (loans and bonds underwritten or guaranteed by the State Treasury should enable the acquisition of EU funds), as well as for other investment tasks arising from potential new support programmes stipulating granting sureties and guarantees. At the same time, maintaining of the long-term risk factor for the portfolio of sureties and guarantees granted by the State Treasury at a level of up to 10% is anticipated.

The value of new sureties and guarantees granted by the State Treasury in a given year is limited by the Budget Act. The 2019 limit in the Budget Act was determined at PLN 200 bn and, apart from supporting the above-mentioned projects, it may be used, if necessary, to react in the event of a deterioration in the conditions of functioning of the Polish financial system in the face of a global financial and economic crisis.

V. Institutional features of public finances

In the period since the previous update of the *Programme*, changes were introduced in the national budgetary frameworks, which modified, among other things, the scope of some annual budgetary documents and the course of the budgetary process. In accordance with the provisions of *the Act of 24 July 2015 on the Social Dialogue Council and other social dialogue institutions*, amended in 2018, the governmental side shall submit the Multi-year Financial Plan of the State) containing the *Convergence Programme* to the Council by 10 May each year. Previously, the preliminary forecast of basic macroeconomic data constituting the basis for work on the draft budget law for the following year was submitted to the Council separately, and the Multi-year Financial Plan of the State itself was not subject to any opinion.

On the other hand, in order to supplement the implementation of *Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, the Public Finance Act* was amended. The amending Act (i.e. *the Act of 6 June 2018 amending the Public Finance Act*) introduced a definition of a macroeconomic scenario and an obligation to include in the justification attached to the draft Budget Act the information on:

- the macroeconomic scenario and its comparison with the most recent forecasts of the European Commission and other independent institutions,
- measures taken in the case of significant deviations affecting the macroeconomic projections in the four consecutive fiscal years preceding the development of the macroeconomic scenario,
- a sensitivity analysis related to general government deficit and debt, public debt and the level of expenditure referred to in Article 112aa(1) of *the Public Finance Act*, with different assumptions concerning the economic growth and interest rates.

The provisions of the amending Act entered into force on 31 July 2018 and were applied to the draft Budget Act for 2019.

Moreover, the works were continued with the aim - in accordance with the "Assumptions of the budget system reform" adopted by the Council of Ministers on 26 July 2016 - to link and ultimately integrate multiannual and annual planning processes and to strengthen the top-down character of budgetary planning. *The Regulation of the Minister of Finance of 28 January 2019 on the detailed manner, procedure and deadlines related to preparing materials for the draft Budget Act* was amended in order to integrate the process of preparing the draft Budget Act with works on the Multi-year Financial Plan of the State and *Programme* update and to focus budget planning on a long-term perspective.

In the period covered by the *Programme*, changes in fiscal rules applicable to local government units will gradually come into force. The *Act of 14 December 2018 amending the Public Finance Act and certain other acts* modified individual debt ratios of local government units and the rules of incurring and rolling over debt.

Work on the public accounting reform is continued. The objective is to develop legal and institutional solutions enabling the preparation of consolidated financial statements of the state and streamlining data collection systems (budgetary reporting and financial reporting). This work will be carried out with the use of experience resulting from already implemented solutions. Moreover, owing to the financial support of the European Commission from the Programme for Supporting Structural Reforms, in cooperation with the International Monetary Fund, work on a uniform chart of accounts and budget classification will be carried out.

In 2018, expenditure reviews concerning 1) the prison system, 2) physical culture and sport, 3) support for maritime economy, inland navigation and fisheries, 4) expenditure of entities specified in Article 139(2) of the *Public Finance Act*, as well as 5) wage development for employees of the state budget sphere were continued. The horizontal expenditure review was initiated, concerning purchases and use of ICT and IT resources in ministries and subordinate and supervised government administration units. Moreover, in the context of the aforementioned reform of the budgetary system, the analysis of expenditure under heading 758 'Miscellaneous accounts' was carried out and analytical works related to expenditure under heading 750 'Public administration' and heading 751 'Offices of the chief bodies of state authority, control and protection of law and the judiciary' were launched. In 2019, the public expenditure reviews are expected to cover the following areas.

Table annex

Table 10. Macroeconomic prospects

	ESA Code	2018 Level	2018 Rate of change	2019 Rate of change	2020 Rate of change	2021 Rate of change	2022 Rate of change
1. Real GDP (PLN billion)	B1*g		5.1	4.0	3.7	3.4	3.3
2. Nominal GDP (PLN billion)	B1*g			5.7	6.1	6.0	5.9
Components of real GDP							
3. Private consumption expenditure	P.3			4.0	3.8	3.4	3.2
4. Government consumption expenditure	P.3			5.3	2.3	1.9	2.1
5. Gross fixed capital formation	P.51			5.7	5.6	5.5	5.4
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53			2.5	2.3	2.2	2.1
7. Exports of goods and services	P.6			5.3	4.8	4.8	4.8
8. Import of goods and services	P.7			6.0	5.1	5.1	5.0
Contributions to real GDP growth							
9. Final domestic demand				4.3	3.6	3.4	3.3
10. Changes in inventories and net acquisition of valuables	P.52 + P.53			-0.2	0	0	0
11. External balance of goods and services	B.11			-0.1	0	0	0

The levels of real volumes are expressed in constant prices of 2017.

Table 11. Price developments

	ESA Code	2018 Level	2018 Rate of change	2019 Rate of change	2020 Rate of change	2021 Rate of change	2022 Rate of change
1. GDP deflator				1.7	2.4	2.5	2.5
2. Private consumption deflator				1.8	2.5	2.5	2.5
3. HICP			1.2	1.8	2.5	2.5	2.5
3a. CPI			1.6	1.8	2.5	2.5	2.5
4. Public consumption deflator				1.7	2.5	2.4	2.4
5. Investment deflator				2.2	2.7	2.5	2.5
6. Export price deflator (goods and services)				1.9	2.0	2.0	2.0
7. Import price deflator (goods and services)				2.2	2.2	2.0	2.0

Table 12. Labour market developments

	ESA Code	2018 Level	2018 Rate of change	2019 Rate of change	2020 Rate of change	2021 Rate of change	2022 Rate of change
1. Employment (thousands of persons)*		16484	0.4	0.2	0.0	0.0	0.0
2. Employment (hours worked)**		-	-	-	-	-	-
3. Unemployment rate (%)***		3.9	3.9	3.6	3.3	2.8	2.3
4. Labour productivity (PLN thousand)****		127.7	4.5	3.8	3.7	3.4	3.3
5. Labour productivity (PLN thousand)*****		-	-	-	-	-	-
6. Compensation of employees (PLN billion)	D.1	817.0	6.5	7.1	6.0	5.8	5.7
7. Compensation per employee (PLN thousand)		62.5	5.7	6.9	6.0	5.8	5.7

* Average employment based on LFS (aged 15 and older).
** National accounts definition.
*** Harmonised unemployment rate, Eurostat definition, levels.
**** Real GDP per person employed.
***** Real GDP per hour worked.

Table 13. Sectoral balances

% of GDP	**ESA Code**	**2018**	**2019**	**2020**	**2021**	**2022**
1. Net lending / borrowing vis-à-vis the rest of the world*	B.9	1.3	0.6	0.6	0.5	0.1
of which: - balance on goods and services		3.4	3.0	2.7	2.6	2.5
- balance of primary incomes and transfers		-4.1	-4.1	-4.1	-4.0	-4.0
- capital account		2.0	1.8	2.0	1.9	1.5
2. Net lending/borrowing of the private sector	B.9	1.7	2.3	0.4	0.8	0.7
3. Net lending/borrowing of general government	EDP B.9	-0.4	-1.7	0.2	-0.3	-0.6
4. Statistical discrepancies		-	-	-	-	-

* Balances level in line with the balance of payments statistics. Net lending/borrowing vis-a-vis the rest of the world is equal to sum of capital and current account.

Table 14. Basic assumptions

	2018	2019	2020	2021	2022
Short-term interest rate (annual average)	1.7	1.7	1.7	1.8	2.3
Long-term interest rate (annual average)	3.2	2.9	3.0	3.2	3.3
Nominal effective exchange rate	-	-	-	-	-
Exchange rate vis-à-vis the EUR (annual average)	4.26	4.3	4.3	4.3	4.3
World excluding EU, GDP growth*	3.9	3.8	3.8	-	-
EU GDP growth*	1.9	1.5	1.7	1.7	1.7
Growth of relevant foreign export markets**	3.0	3.0	3.0	3.4	3.6
World import volumes *	4.8	3.9	3.6	-	-
Oil prices (Brent, USD/barrel) *	71.1	61.2	61.2	61.2	61.2

* Source: *European Commission, European Economic Forecast. Winter* 2019, February 2019. (years 2019-20).
** EU import as an indicator of the foreign export markets.

Table 15. General government budgetary prospects

	ESA Code	2018 PLN million	2018 % of GDP	2019 % of GDP	2020 % of GDP	2021 % of GDP	2022 % of GDP
			Net lending (EDP B9) by sub-sector				
1. General government	S.13	-7 687	-0.4	-1,7	0,2	-0.3	-0.6
1a. General government excluding one-offs		*-7 687*	*-0.4*	*-1,7*	*-0,9*	*-0.5*	*-0.7*
2. Central government	S.1311	-13 094	-0.6	-1,3	-0,2	0.1	-0.7
3. State government	S.1312						
4. Local government	S.1313	-7 369	-0.3	-0,4	-0,1	-0.2	-0.1
5. Social security funds	S.1314	12 776	0.6	-0,1	0,4	-0.2	0.2
			General government				
6. Total revenue	TR	871 043	41.2	41.7	43.0	41.8	40.7
6a. Total revenue excluding one-offs		*871 043*	*41.2*	*41.7*	*42.0*	*41.6*	*40.6*
7. Total expenditure	TE	878 730	41.5	43.3	42.8	42.1	41.3
8. Net lending/borrowing	EDPB.9	-7 687	-0.4	-1.7	0.2	-0.3	-0.6
9. Interest expenditure	EDPD.41	30 328	1.4	1.4	1.4	1.3	1.2
10. Primary balance		22 641	1.1	-0.3	1.6	1.0	0.6
11. One-off and other temporary measures*		0,0	0.0	0.0	1.1	0.2	0.1
			Selected components of revenue				
12. Total taxes (=12a+12b+12c)		463 503	21.9	22.5	22.5	22.7	22.0
12a. Taxes on production and imports	D.2	297 485	14.1	14.2	14.5	14.6	13.8
12b. Current taxes on income, wealth, etc	D.5	165 720	7.8	8.3	8.0	8.1	8.2
12c. Capital taxes	D.91	298	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	298 642	14.1	14.5	15.0	15.1	15.0

	ESA Code	2018 PLN million	2018 % of GDP	2019 % of GDP	2020 % of GDP	2021 % of GDP	2022 % of GDP
14. Property income	D.4	12 606	0.6	0.6	0.6	0.6	0.7
15. Other		96 292	4.6	4.0	4.9	3.5	3.0
16. Total revenue	TR	871 043	41.2	41.7	43.0	41.8	40.7
Tax burden (D.2+D.5+D.61+D.91-D.995)		759 583	35.9	36.9	37.4	37.6	36.9
Selected components of expenditure							
17 Compensation of employees + intermediate consumption	D1+P2	331 443	15.7	15.9	15.6	15.4	15.2
17a. Compensation of employees	D.1	213 820	10.1	10.2	10.0	9.8	9.6
17b. Intermediate consumption	P.2	117 623	5.6	5.6	5.6	5.6	5.5
18. Social payments (18=18a+18b)		356 293	16.8	17.7	17.4	17.2	17.0
***of which* Unemployment benefits**		2 152	0.1	0.1	0.1	0.1	0.1
18a. Social transfers in kind supplied via market producers	D.6311 D.63121 D.63131	40 631	1.9	2.0	2.1	2.1	2.1
18b. Social transfers other than in kind	D.62	315 662	14.9	15.7	15.3	15.2	15.0
19. Interest expenditure	EDP D.41	30 328	1.4	1.4	1.4	1.3	1.2
20. Subsidies	D.3	9 040	0.4	0.6	0.4	0.5	0.4
21. Gross fixed capital formation	P.51	98 968	4.7	4.7	4.8	4.4	4.3
22. Capital transfers	D.9	9 548	0.5	0.6	0.6	0.9	0.7
23. Other		43 110	2.0	2.4	2.5	2.4	2.4
24. Total expenditure	TE	878 730	41.5	43.3	42.8	42.1	41.3
p.m.: Government consumption (nominal)	P.3	374 690	17.7	17.9	17.8	17.5	17.2

* For 2020, the impact of the transformation fee resulting from the planned reconstruction of the Open Pension Funds model in the amount of PLN 19.3 bn has been taken into account. In the years 2020-22, revenues from the sale of additional CO_2 emission rights in the amount of PLN 5.7 bn, PLN 4.7 bn and PLN 2.4 bn, respectively, has been taken into account.

Table 16. No-policy change projections

	2018 PLN million	2018 % of GDP	2019 % of GDP	2020 % of GDP	2021 % of GDP	2022 % of GDP
1. Total revenue at unchanged policies	860 925	40.7	41.5	42.8	41.6	40.6
2. Total expenditure at unchanged policies	-	-	-	-	-	-

Table 17. Amounts to be excluded from the expenditure benchmark

	2018 PLN million	2018 % of GDP	2019 % of GDP	2020 % of GDP	2021 % of GDP	2022 % of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	32 619	1.5	1.4	1.6	1.0	0.6
1a. of which investment fully matched by EU funds revenue	28 716	1.3	1.2	1.4	0.9	0.5
2. Cyclical unemployment benefit expenditure*	-1 799	-0.1	-0.1	0.0	0.0	0.0
3. Effect of discretionary revenue measures	10 118	0.5	0.2	0.2	0.2	0.1
4. Revenue increases mandated by law						

* Estimation of cyclical unemployment expenditure is based on expenditure code D.62 and code D.63 in COFOG function, code 10.5. They cover expenditure exclusively related to social protection in the form of a cash benefit and a benefit in kind paid to households.
The basis for calculating *cyclical unemployment expenditure* is the unemployment expenditure included in COFOG function, code 10.5. The European Commission has left it up to the Member States to exclude from this function expenditure which in their opinion does not reflect the unemployment expenditure resulting from the cycle. Such situation occurs in case of Poland. Labour Fund expenditure represents the vast majority of expenditure in the COFOG function, code 10.5. At the same time, due to the changing role and tasks of the Fund, there is no justification for using all expenditures included in the COFOG function, code 10.5 as a basis for estimating cyclical unemployment expenditure.

Table 18. General government expenditure by function

% of GDP	COFOG Code	2017	2022*
1. General public services	1	4.4	
2. Defence	2	1.7	
3. Public order and safety	3	2.1	
4. Economic affairs	4	4.7	
5. Environmental protection	5	0.4	
6. Housing and community amenities	6	0.6	
7. Health	7	4.7	
8. Recreation, culture and religion	8	1.2	
9. Education	9	4.9	
10. Social protection	10	16.4	
11. Total expenditure	TE	41.1	41.3

* expenditure's disaggregation by function is a part of the budgetary process.

Key actions in the tax area in 2019-20

SUMMARY

The document presents the most important implemented and planned measures in the area of taxation, the implementation of which lies mainly within the competence of the Minister of Finance. They include, among others, measures aimed at tightening the tax revenue system, broadening the tax base, reducing and increasing the macroeconomic efficiency of the tax wedge as well as planned systemic changes in taxes (among others, in the context of pro-health policy).

As of 1 January 2018, all entrepreneurs are obliged by law to send monthly information on the records of purchases and sales in the form of standard audit file for VAT - JPK_VAT. Thanks to an IT tool **JPK analyser**, used for automatic identification of discrepancies in VAT settlements between taxpayers and their contractors, the use of so-called empty invoices to deduct input tax from such documents becomes virtually impossible.

The **ICT System of the Clearing House (STIR)** has also been in operation since January 2018, limiting the possibility for organised crime groups to use the financial sector to commit tax fraud.

The **split payment mechanism (SPM)**, introduced on 1 July 2018, allows tax authorities to monitor funds on VAT bank accounts and supervise their release, eliminating the risk of disappearance of taxable persons with VAT paid to them by their contractors but not paid to the tax authority. At the same time, this mechanism ensures better transparency of VAT settlements and impedes transfer of untaxed money abroad.

The current special VAT clearing arrangements in the form of reverse charge as well as joint and several liability are to be replaced with **the mandatory split payment mechanism** to further seal the VAT system. Additionally, due to the irregularities diagnosed, the obligation to apply the split payment mechanism will cover transactions concerning: parts and accessories for motor vehicles; coal and coal products; electrical machines and equipment, their parts and accessories as well as electrical equipment and their parts and accessories.

The system planned to be implemented in 2019 to control the transfer of data concerning the records of sales maintained by means of ***online* cash registers**, transferring data to an ICT system via an ICT network, will constitute one of the key tools for combating the shadow economy and will contribute to strengthening fair competition.

The implementation of **virtual cash registers** will also improve the efficiency of the revenue administration in combating unregistered retail sales as well as VAT evasion and avoidance.

Moreover, the **development of a system for road and rail freight transport monitoring,** planned in 2019-2020, should have a positive impact on the revenue side of the state budget and reduce leakage, including in excise duty (LPG, heating oils).

New solutions aimed at **tightening the income tax system** have been in place since January 2019**.** They include, in particular: ►the obligation to submit to the tax authorities information on tax arrangements, ►changes to the rules for collecting withholding tax, ►modification of the anti-abuse rule provisions, ►taxation of unrealised capital gains in case of the transfer of assets, tax residence or permanent establishment to another country. These measures and ►the automatic exchange of information on cross-border tax arrangements to be implemented in 2020 will reduce the use of so-called aggressive tax planning mechanisms.

Measures will be taken to **improve the efficiency of administrative enforcement**. Furthermore, the envisaged modernisation of the functioning of the so-called specialized tax offices servicing entities whose business activity is characterized by a high level of complexity of economic transactions, implementation of the Cooperation Programme, development of digitalization of financial statements and use of data contained in them for the needs of KAS units will enhance the effectiveness of the tax administration.

The above mentioned measures constitute the next stage of systemic approach to tightening the tax system. **On the other hand, from 2020 onwards, further significant systemic changes are foreseen**, including:

- tightening the qualification of revenues to the source of "non-agricultural economic activity",
- taxation of digital enterprises,
- tightening of the recycling fee,
- indexation of the excise duty rate for alcoholic beverages, tobacco products, raw tobacco, novel products,
- introduction of excise duty on liquid for electronic cigarettes and novel products,
- reduction of the tax wedge through changes in personal income tax consisting in: ►exemption from PIT for employees aged below 26, ►reduction of labour costs by at least doubling the tax deductible costs for employees, ►reduction of the PIT rate from 18% to 17%.

Additionally, tightening of environmental levies falling within the competence of the Minister of the Environment it foreseen from September 2019.

Table 19. Financial effects of implemented and planned measures in the tax area

Revenue (PLN million) yoy	2019	2020
expected outcome	7463.9	3312.9

Source: Ministry of Finance estimates.

Table of contents

1. Reducing the VAT gap

1.1. Analysis of the use of activities of banks and credit unions for purposes related to tax fraud (STIR)

Tools:

The Act of 24 November 2017 amending certain acts in order to counteract using the financial sector for tax fraud, which provides for:

- analysis by the Head of the National Revenue Administration (NRA) of the risk of using the activities of banks and cooperative credit unions (SKOK) for purposes related to tax fraud. This analysis is performed with the use of advanced analytical tools. In the analysis, the Head of the National Revenue Administration uses, in addition to data from tax databases, information received daily on accounts of qualified entities within the meaning of the Act (i.e. other than accounts of natural persons used for private purposes) and transactions between these entities, as well as the risk index determined by the clearing house in its ICT system (STIR). As a result, the analyses carried out by the Head of the National Revenue Administration take into account both information from its own databases and bank data,
- automatic determining in the STIR, on the basis of information from banks and SKOK and publicly available data transferred from tax bases, of the risk index of using banks and SKOK to commit tax offences; the risk index is determined by the clearing house on the basis of experience gained by the banking sector in combating money laundering,
- the option for the Head of the National Revenue Administration and the heads of customs and tax offices to block the account of a qualified entity for 72 hours, based on the results of the risk analysis, with a possibility to extend the blockade for up to 3 months; the blockade is applied if the statutory requirements for the blockade are met,
- maintaining electronic lists of entities that have not been registered as VAT taxpayers, have been removed from the register ex officio without the need to notify this entity or have been restored as VAT taxpayers; lists are available in the Public Information Bulletin of the Ministry of Finance; this regulation constitutes a significant support for entrepreneurs in proper fulfilling of their tax obligations, inter alia, by enabling them to verify the reliability of contractors' operations.

Addressees:

domestic banks (including cooperative banks), branches of credit institutions, branches of foreign institutions, credit unions, Krajowa Izba Rozliczeniowa S.A.(National Clearing House), Krajowa Spółdzielcza Kasa Oszczędnościowo-Kredytowa, authorities of the National Revenue Administration

Responsible body:

Minister of Finance, Head of the National Revenue Administration.

Date:

The Act of 24 November 2017 was amended by the Act of 5 July *amending the Tax Ordinance Act and certain other acts*. Some of the provisions of the amendment, e.g. concerning reporting of term deposit accounts of a qualified entity and extending the scope of data transmitted shall come into force on 1 July 2019.

1.2. The introduction of a split payment mechanism (SPM), including mandatory SPM in certain sectors

Tools:

Act of 15 December 2017 amending the Act on Value Added Tax and certain other acts.

The main assumption of the split payment mechanism (SPM) is to divide the payment for goods supplied or services provided into the net amount which is paid by the purchaser to the account of the supplier or service provider and the amount of tax which is transferred directly to a separate VAT account. From this separate account the taxpayers can pay input VAT shown in invoices they receive from their suppliers and they can pay their tax liability due to this tax to the tax office. In addition, the taxable person may receive refund of input VAT surplus to a VAT account under an expedited procedure.

This model allows tax authorities to monitor funds on VAT bank accounts and supervise their release, eliminating the risk of disappearance of taxable persons with VAT paid to them by their contractors but not paid to the tax authorities. It also ensures better transparency of VAT settlements and impedes the transfer of untaxed money abroad.

For the purpose of further sealing of the VAT system, it is planned to replace the current special VAT clearing arrangements in the form of reverse charge and joint and several liability with **the mandatory split payment mechanism**. The mandatory SPM will be applied, as a rule, to supplies of goods and services which are currently subject to a reverse charge or joint and several liability regime. Moreover, due to the irregularities diagnosed, the mandatory split payment mechanism will also apply to transactions the subject of which comprises: ►parts and accessories for motor vehicles; ►coal and coal products; ► electrical machines and equipment, their parts and accessories and ► electrical equipment and parts and accessories thereof.

The decision to cease the application of the reverse charge was based on analyses of longer application of this solution. Although the reverse charge mechanism eliminates irregularities in the industry in which it is applied, it is observed that it transfers them directly to another industry in which standard VAT settlements are applied. The use of a selective anti-fraud mechanism is therefore not sufficient to resolve the problem of VAT fraud throughout the economy.

The SPM constitutes a systemic tool, free of defects characteristic of the reverse charge. The functioning of the SPM, i.e. the restriction of the freedom to dispose of the VAT collected from the contractor, eliminates the risk of disappearance of taxpayers together with the VAT paid but not paid to the tax authorities. This mechanism therefore makes it virtually impossible for abuse to occur already at the stage of the transaction itself. This solution, apart from being more effective in the fight against tax fraud, also ensures the protection for the buyer of goods or services, guaranteeing the tax security of transactions.

The mandatory SPM will be applied in B2B relations only for transactions with a value of over PLN 15 thousand, i.e. transactions that must be settled through a bank account. The element identifying the mandatory application of the MPP to a given transaction will be the relevant information on the invoice.

The mandatory SPM will be based on the same technological solutions as the currently functioning voluntary form of the mechanism. The changes will be introduced pursuant to the Council Implementing Decision (EU) 2019/310 of 18 February 2019 authorising Poland to introduce a special measure derogating from Article 226 of *Directive 2006/112/EC on the common system of value added tax*.

Addressees:

VAT taxpayers carrying out transactions covered by the mandatory SPM.

Responsible body:

Minister of Finance, Head of the National Revenue Administration.

Date:

the split payment mechanism was introduced from 1 July 2018 under the *Act of 15 December 2017 amending the Act on Value Added Tax and certain other acts*. The introduction of mandatory SPM in specific sectors is foreseen from 1 January 2020.

Estimated financial effect of measures described in sections 1.1-1.2:

The estimated financial effects stem from the expected result of implemented legal and IT tools contributing to reduction of the VAT gap through (1) preventing deduction of input tax from invoices documenting fictitious activities, (2) limiting the scale of tax fraud by criminal groups, and (3) eliminating the risk of tax payers' disappearance without settlement of tax liabilities to the state. Moreover, the tools implemented are of preventive and disciplinary nature.

It is projected that in 2020, due to:

- introduction of the mandatory n split payment mechanism mandatory in particular sectors,
- very good results of measures implemented so far to reduce the VAT gap,
- further development of automated verification tools and advanced analytical methods - increasing the effectiveness of tax audits,

the VAT gap will be reduced by PLN 6,840 million.

It is expected that as a result of the introduction of the mandatory split payment mechanism in certain sectors, the VAT gap will decrease by approx. 0.5 percentage points, which will result in an annual increase in VAT revenues by approx. PLN 958 million, and in the year of introduction of this solution (i.e. 2020) by approx. PLN 878 million. The total increase in budget revenues resulting from the split payment mechanism was estimated at PLN 5,540 million in 2020.

Furthermore, it is expected that due to the enhanced effectiveness of the risk analysis system, owing to the extension of the catalogue of information used for the calculation of risk factors and taking into account the projected increase in VAT revenues, the budget revenue resulting from STIR in 2020 is expected to increase by 13 percentage points. (PLN 1,300 million).

Revenue (PLN million) yoy	2019	2020
expected outcome	4336	6840

1.3. Introduction of online cash registers for registering sales to non-business private individuals and flat-rate farmers

Objective: combating shadow economy and strengthening fair competition among entrepreneurs.

Tools:

the introduction of a solution allowing the application to the records of sales and amounts of tax due on sales to non-business private individuals and flat-rate farmers, of cash registers (hereinafter referred to as: "online cash registers") transferring data to a central IT system (hereinafter referred to as the "Central Register Repository"), maintained by the Head of the National Revenue Administration. *Online* cash registers will send information on each transaction recorded in the register, with details allowing to determine the amount of sales and output tax, VAT rate, type of goods/services, as well as the place of installation of the register. Data transmission from *online* cash registers will be continuous and automated or at the request of the Head of the National Revenue Administration.

Data on sales wil be transmitted to the Central Register Repository practically in real time and will contain a time stamp, which will enable detailed analyses for determining the probability that a given taxpayer does not record its sales using the cash register or records only a part of sales. It is assumed that the proposed solutions will contribute not only to strengthening the control of the correctness of VAT settlements, but also to simplifying the very process of control of settlements at entrepreneurs due to the possibility of remote monitoring by the tax authorities of sales transactions recorded in cash registers. The proposed solutions will also contribute to an increase in state budget revenues as a result of the assumed increase in VAT collection at the final stage of trade in goods and services - retail sales.

At the same time, pursuant to *the Act of 15 March 2019 amending the Act on value added tax and the Act - Measurements Law*, it is possible to use the cash registers used so far by taxpayers, i.e. cash registers with a paper record of copies and cash registers with an electronic record of copies, to keep records of sales. Cash registers with paper copies and electronic copies will be phased out of the market as solutions that do not meet the requirements of the new cash register system.

The Act does not provide for an obligation to replace cash registers with *online* cash registers, except in case of certain industries. Considering that prevention of VAT fraud is the main objective, first of all, taxpayers conducting business activity in industries particularly exposed to irregularities in keeping sales records became subject to an unconditional obligation to apply new cash registers to record sales.

Addressees: VAT taxpayers, in particular those who keep records of sales using cash registers.

Responsible body:

Minister of Finance, Head of the National Revenue Administration.

Date: *The Act of 15 March 2019 amending the Act on value added tax and the Act - Measurements Law* will enter into force on 1 May 2019.

Estimated financial effect:

the financial impact was estimated on the basis of statistical data on final consumption of households, with the assumption of a 1.5% increase in due tax on the introduction of online cash registers.

Revenue (PLN million) yoy	2019	2020
expected outcome	180.3	169.0

1.4. Implementation of virtual cash registers transmitting data on recorded sales transactions electronically

Objectives:

- reduction of the costs of meeting the obligation to register sales using cash registers for selected groups of entrepreneurs and streamlining the processes of registration and control of retail sales in real time,
- encouraging entrepreneurs to leave the shadow economy through the easy availability and reduction of the total cost of holding cash registers, as well as the value of the mobility of virtual cash registers as an alternative to cash registers in use,
- increasing the efficiency of the revenue administration in combating undeclared retail sales and VAT evasion and avoidance through the introduction of real-time audits,
- increasing the participation of customers in the reduction of the shadow economy by enabling them to verify of fiscal receipts in the Repository.

Tools:

- purchase of licenses for standard application software (application servers, databases) and access software for users (e.g. CAL type),
- construction of a portal for entrepreneurs and customers for registration of cash registers and verification of receipts,
- preparation of API specifications for virtual cash registers,
- preparation of a dedicated module for handling virtual cash registers,
- preparation of a mobile application to verify receipts,
- training for the Ministry of Finance employees on the principles of building modern web services, including API design,
- information and promotional measures.

Addressees:

retail providers of services and goods; purchasers of services and goods; tax administration officials who carry out enterprise inspections and will be recipients of reports from virtual cash registers.

Responsible body:

Minister of Finance, Head of the National Revenue Administration.

Date: 2020.

Estimated financial effect:

Revenue (PLN million) yoy	2019	2020
expected outcome	0	200

1.5. Other measures to tighten the VAT system

Objective: tightening the value added tax system and to strengthening fair competition among entrepreneurs.

Tools:

a catalogue of products for which the taxpayer is obliged to pay VAT within 5 days will be included in the VAT Act. The aim is to prevent doubts as to the application of the provisions of *the Excise Duty Act* and the *VAT Act* to petroleum products that can be used to propel vehicles and constitute a raw material for the production of other products. The changes are also meant to correlate the scope of the application of the so-called accelerated VAT with the scope of concessions.

It is also planned to **exclude from the VAT exemption industries sensitive to fraudulent activities**:

- distance sales (Internet sales) of certain goods sensitive to fraud - i.e. goods classified according to the Polish Classification of Goods and Services in PKWiU 20.42.1, 26-28 groupings (e.g. cosmetic and toilet preparations, electronic and electrical equipment, home appliances and audio/video devices),
- wholesale and retail sale of parts for motor vehicles and motorcycles,
- provision debt collection services.

The rules of issuing invoices for taxpayers based on a fiscal receipt and using such invoices will be modified. Issuing an invoice based on a receipt will be possible only if the receipt contains the number identifying the buyer. Appropriate sanctions will be introduced to ensure that this condition is effective. As a result, an invoice issued to a taxpayer (and used by the taxpayer in the settlement) on the basis of a receipt will document the purchase made by that particular taxpayer. This will eliminate the practice of issuance of invoices on the basis of receipts left by other customers.

Addressee:

VAT taxpayers

Responsible body:

Minister of Finance.

Date:

1 July 2019

Estimated financial effect:

estimated financial results of excluding fraud-sensitive industries from the VAT exemption and modifying the rules for issuing invoices based on receipts are resented below. Effects of the exclusion of certain VAT taxable persons from the personal exemption[13] were estimated on the basis of data on revenues and costs of economic activity of income tax payers who are not VAT payers, who in 2016 reported revenues from PLN 0 to 200,000. Due to the fact that the activity of taxable persons selected according to the indicated PKD may also refer to goods other than those listed in the planned change, revenues and costs were reduced by 20%. The positive budgetary impact of this solution may therefore be higher.

The effects of the modification of the rules for invoicing based on receipts were estimated using statistical data on final consumption of households. From 2020, a 0.3% increase in output tax was assumed due to the introduction of changes in invoices issued to taxpayers on the basis of receipts.

Revenue (PLN million) yoy	2019	2020
expected outcome	68	475.3

Table 20. Financial effects of implemented and planned measures in the VAT area

Revenue (PLN million) yoy	2019	2020
expected outcome	4584.3	7684.3

Source: Ministry of Finance estimates.

2. Tightening of the income tax system

2.1. Modification of the General Anti-Avoidance Rule provisions

Objective: to eliminate tax fraud related to the use of artificial structures by:

- partial implementation of *Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market* (the ATAD Directive) as regards the anti-abuse rule (Article 6 of the ATAD Directive),
- streamlining anti-avoidance proceedings,
- clarifying the role of the Head of the National Revenue Administration as the tax authority in performing tasks related to counteracting tax evasion,
- the application of measures limiting the contractual benefits contained in ratified double taxation conventions.

Tools:

Act of 23 October 2018 amending the Act on Personal Income Tax, the Act on Corporate Income Tax, the Act - Tax Ordinance and certain other acts of law

Addressee:

taxpayers and tax authorities within the meaning of *the Tax Ordinance*.

Responsible body:

Minister of Finance, Head of the National Revenue Administration.

Date:

the Act amending the provisions on the general anti-abuse rule entered into force on 1 January 2019.

[13] The estimation was based on taxpayers who reported the PKD 2004 subclass as the basic type of business activity: 52.48.A, 52.45.Z, 52.32.Z, 52.48.C, 52.61.Z, 52.63.B, 74.87.B and PKD of 2007: 47.41.Z, 47.42.Z, 47.43.Z, 47.54.Z, 47.74.Z, 47.77.Z, 47.91.Z, 47.99.Z, 82.91.Z.

2.2. Introducing the obligation to report information on tax arrangements to tax authorities (MDR)

Objectives:

- ensuring that revenue administration authorities have fast access to information on tax arrangements, potentially aggressive planning or abusive tax planning, and are able to identify promoters and users of tax arrangements,
- discourage taxpayers and their advisers from aggressive tax planning practices using tax arrangements.

Tools:

Act of 23 October 2018 amending the Act on Personal Income Tax, the Act on Corporate Income Tax, the Act - Tax Ordinance and certain other acts of law. It partially transposed *Council Directive 2018/822/EU of 25 May 2018 amending Directive 2011/16/EU as regards the mandatory automatic exchange of information in the field of taxation, as regards reportable cross-border arrangements*.

The provisions on the mandatory filing of information on tax arrangements (*Mandatory Disclosure Rules*) introduced by the Act stipulate, among others, that:

- The Minister of Finance may issue official guidelines concerning the application of the anti-abuse rule or other provisions aimed at counteracting tax evasion in connection with the reported information on tax arrangements,
- information on tax arrangements is submitted through the ICT system operated by the Head of the National Revenue Administration by means of electronic communication in accordance with the provisions of *the Tax Ordinance*,
- The Head of the NRA is responsible for assigning individual Tax Arrangement Numbers (the so-called TAN) to tax arrangements acquired as a result of reporting,
- The Head of the NRA analyses submitted information on tax arrangements in order to identify emerging tax structures related to aggressive tax planning or other tax abuses,
- The Head of the NRA manages imposition of financial penalties referred to in Article 86m of *the Tax Ordinance Act* and cases of criminal liability for a fiscal crime or fiscal offence related to the obligation to provide information on tax arrangements.

Addressees:

the legal provisions have introduced the widest possible imposition of the obligation to report the tax arrangements. The obligation to file information on tax arrangements may apply to three categories of entities: a promoter, a beneficiary and a supporter.

The amended provisions of *the Tax Ordinance Act* mean that, as a rule, information on a tax arrangement is submitted to the Head of the NRA by a promoter. The beneficiary is obliged to provide information about the tax arrangement in specific situations (e.g. lack of promoter or failure to release the promoter from the obligation of professional secrecy). The obligation to file information on the tax arrangement may also be imposed on the supporter.

Responsible body:

Minister of Finance, Head of the National Revenue Administration.

Date:

the provisions on the mandatory filing of information on tax arrangements entered into force on 1 January 2019.

2.3. Introduction of changes concerning withholding tax on paid receivables exceeding PLN 2 million for non-residents (WHT)

Objectives:

— verification of the conditions (criteria) for non-residents to benefit from preferential taxation of interest, dividends, royalties or other receivables subject to preferential withholding tax in Poland on the basis of agreements on the avoidance of double taxation or exemptions resulting from the provisions implementing EU directives,

— preventing irregularities in withholding tax settlements, e.g. in the case of interest payments to taxpayers who do not meet the criterion of *beneficial owner*.

Tools:

— *Act of 23 October 2018 amending the Act on Personal Income Tax, the Act on Corporate Income Tax, the Act - Tax Ordinance and certain other acts of law*.

— *Regulation of the Minister of Finance of 31 December 2018 on exclusion or limitation of the application of Article 26(2e) of the Corporate Income Tax Act*,

— *Regulation of the Minister of Finance of 31 December 2018 on exclusion or limitation of the application of Article 41(12) of the Personal Income Tax Act*.

Addressees:

payers of corporate income tax and personal income tax, as well as taxpayers obtaining income subject to the so-called withholding tax in Poland (including interest, licence fees, dividends, receivables for certain intangible services rendered by foreign entities).

Responsible body:

Minister of Finance, Head of the National Revenue Administration.

Date:

The Act and the implementing acts entered into force on 1 January 2019.

Estimated financial effect of measures described in sections 2.1-2.3:

it is expected that the solutions discussed above, consisting in the modification of the anti-abuse rule provisions and the introduction of the obligation to submit information on tax arrangements (MDR), will contribute to an increase in the efficiency of risk analysis and, consequently, to a more accurate selection of entities for inspection. It was assumed that the detailed information gathered from reported arrangements would reduce the number of inspections and that more accurate selection of taxpayers for inspection would allow a better use of working time and control staff, which would result in an increase in tax revenues.

In addition, taxpayers are expected to reduce overstatement of tax deductible costs as a result of these measures and thus increase the value of the tax base, which should translate into higher revenues for the state budget from income taxes. In 2017, the total amount of CIT and PIT tax deductible expenses amounted to PLN 5,721.7 billion. Assuming an increase in budget revenues due to reduction of the amount of tax deductible costs in the first year of the regulation by approx. 0.25% in CIT and 0.02% in flat PIT, it one can expect that the tax leakage in 2019 should decrease by approx. PLN 2.3 bn. In subsequent years, the growth rate of the scale of tightening the income tax system resulting from the discussed solutions should reach the level of 0.0025 percentage points in CIT and 0.0005 percentage points in PIT per year, which should translate into an increase in tax revenues in 2020 by about PLN 27 million.

To estimate potential revenues resulting from the implementation of changes in the rules of withholding tax collection (WHT), data from the IFT-2R returns have been used. The average sum of payments of receivables (on account of dividends, interest, licences, intangible services, etc.) to EU and non-EU countries exceeding PLN 2 million amounted in 2013-2016 to approximately PLN 80 billion. It is assumed that a thorough verification of payments in the indicated scope may lead to finding irregularities in the application of preferences.

It is estimated that the additional amount of tax related to the introduction of new withholding tax rules will amount to approximately PLN 700 million in the first twelve months of applying the new rules. Due to exclusions and limitations on the application of new withholding tax collection rules to certain entities, introduced by the regulations of the Minister of Finance of 31 December 2018, these effects will occur in 2019-20. In each of these years, additional revenue from withholding tax may amount to approximately PLN 350 million.

The measure described above may also have a positive effect on the amount of budget revenues resulting from limiting payments to entities that do not meet the conditions for applying the right to collect withholding tax receivables. Limiting these payments may result in an indirect effect in the form of reducing the tax base erosion (by excluding the payments in question from the tax base of Polish entities' tax deductible costs), which may indirectly affect the increase in revenues from income taxes. For prudential reasons, this effect is not included in the calculation below.

Revenue (PLN million) yoy	2019	2020
expected outcome	2711	375

2.4. Mitigating the effects of mismatches in qualification of hybrid and reverse hybrid structures

Objective: to limit possibilities of taxpayers’ use of optimisation arrangements that exploit mismatches in the qualification of hybrid or reverse hybrid structures.

Tools:

amendment of *the Corporate Income Tax Act of 15 February 1992* introducing the provisions concerning the qualification of reversed hybrid structures into the Polish legal system. Legislative changes will mean the implementation of two acts: the ATAD and *Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries* (ATAD2). The most important changes include:

- a new definition of a related party, in order to examine the mismatches resulting from the hybrid nature of the entities,
- introduction of a definition of 'mismatches in the qualification of hybrid structures',
- identification of four categories of hybrid structures:
    - resulting from payments under a financial instrument,
    - resulting from differences in the allocation of payments made to a hybrid or permanent establishment, including payments to a disregarded permanent establishment,
    - resulting from payments made by a hybrid entity to its owner or hypothetical payments between its head office and a PE or between two or more PEs,
    - resulting from a double deduction arising from payments made by a hybrid or permanent establishment.

Addressees:

corporate taxpayers carrying out cross-border transactions which could lead to a double deduction or to a deduction without inclusion. With the implementation of Article 9a of the ATAD (on reverse hybrid mismatches and the introduction of Article 1 of ATAD2), the addressees will be extended to all entities which Member States consider transparent for tax purposes.

Responsible body:

Minister of Finance, Head of the National Revenue Administration.

Date:

The obligation to implement selected provisions of both directives, including Article 9a of the ATAD Directive - by 31 December 2019

2.5. Automatic exchange of information on cross-border tax arrangements

Objectives:

- Compliance with the obligations imposed by *Council Directive 2018/822/EU of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements*.
- informing tax administrations of possible aggressive tax planning.

Tools:

Amendment to the *Act of 9 March 2017 on the exchange of tax information with other countries*. Information on tax arrangements, obtained pursuant to the provisions of *the Tax Ordinance*, which have been qualified as cross-border tax arrangements in accordance with the provisions of *the Tax Ordinance*, will be systematically exchanged with other EU countries. Due to the earlier introduction of the national requirement to report tax arrangements, it will be necessary to adapt the national logical structures to those developed by the European Commission.

Addressees:

automatic exchange of information on cross-border tax arrangements will apply to those arrangements that, under the *Tax Ordinance*, have been submitted to the Head of the National Revenue Administration by the so-called promoters, as well as by any other natural person, legal entity or organisational unit without legal personality, which, among others, prepares and offers arrangements for the provision of tax-related services. In specific circumstances, the planned amendments provide for the obligation for beneficiaries (taxpayers) to provide information on tax arrangements. The implementation of automatic exchange of information on cross-border tax arrangements will not affect third parties/entities.

Responsible body:

Minister of Finance, Head of the National Revenue Administration.

Date:

31 October 2020 – deadline for the first automatic exchange of information on cross-border tax schemes (in accordance with Article 8ab of *Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC*).

Estimated financial effect for measures described in sections 2.4-2.5:

it was assumed that the information on cross-border tax schemes obtained by the NRA from foreign tax administrations will contribute to an increase in the efficiency of risk analysis and, consequently, to a more accurate selection of entities to be audited. Achieving the intended effect will be possible if the information on cross-border schemes reported retrospectively is received, i.e. in 2020 for the period from 25 June 2018.

The effectiveness of risk analysis is assumed to increase in the first year of application of the new regulations by 5% in CIT and 2% in PIT, which should translate into an increase in the control findings at the level of approx. PLN 61 million in CIT and PLN 5 million in PIT. The estimation is based on data on control findings in 2017.

The second effect of the implementation of this solution will be to discourage taxpayers from overestimation of their tax deductible costs, which should result in an increase in the value of the taxable amount. In 2017, the total amount of CIT and PIT tax deductible expenses amounted to PLN 5,721.7 billion. Assuming an increase in budget revenues from the reduction of the amount of tax deductible costs in the first year of the regulation by approx. 0.07% in CIT and 0.02% in flat PIT, the total tax leakage in 2019 are expected to decrease by approx. PLN 670 bn in the first year of effectiveness of new regulations.

Revenue (PLN million) yoy	2019	2020
expected outcome	0	736

Table 21. Financial effects of implemented and planned measures in the income tax area

Revenue (PLN million) yoy	2019	2020
expected outcome	2711	1111

Source: Ministry of Finance estimates.

3. Development of the monitoring system for road and rail freight transport

Objectives:

- tightening of the tax system through collection of data on carriage of selected "sensitive" goods in connection with their supply to the territory of the country, intra-Community supply, intra-Community purchase, export and import and carriage across the territory of the country.
- inducing taxpayers (economic operators and natural persons purchasing heating oils) and entities transporting "sensitive" goods to and across the territory of Poland to report taxable transactions, including VAT and, in the case of excise goods, also excise duty, which will increase tax revenues and fuel charge revenues.

Tools:

a register of data on the transport of selected "sensitive" goods (in particular liquid fuels, alcohol, raw tobacco, vegetable oils, medicines with a risk of unavailability on the Polish market) is kept in an ICT system by the Head of the National Revenue Administration. The provision of data related to taxable activities towards certain goods will be associated with the submission of the transfer declaration by the obligated persons and it is automatically connected with the collection of geolocalisation data sent by GPS localisers. Control services have an access to the data from the system on the road, in order to target inspections at undeclared carriage.

A draft amendment to the Regulation on goods whose carriage is covered by the monitoring system for road and rail freight has envisages inclusion of LPG in the monitoring system. In addition, a draft amendment to *the Act of 9 March 2017 on the system for monitoring road and rail freight transport* foresees incorporation into the system for monitoring of the supply of heating oils other than exempted from excise duty on account of their intended use, as specified in Article 89(1)(9), (10) and (15)(a) *of the Act on Excise Duty* (covered by a specific, reduced excise duty rate related to the use of these oils for heating purposes).

Addressees:

entities pursuing economic activity, participating in trading in "sensitive" goods indicated in the Act and the regulation issued thereunder as well as carriers and drivers of transport means. From the second half of 2019, these will also comprise entities, including natural persons purchasing goods not exempted from excise duty on account of their intended use, subject to a specific, reduced excise duty rate related to their intended use for heating purposes (heating oils).

Responsible body:

Minister of Finance, Head of the National Revenue Administration.

Date:

- draft regulation of the Minister of Finance amending the *Regulation on goods whose carriage is covered by the system of monitoring road and rail freight transport* (No. 856 in the list of legislative works of the Minister of Finance) - planned entry into force this year;
- a draft amendment to *the Act on the monitoring system for road and rail freight transport and on the amendment of other acts* (UA 39) - the essential part of the Act will come into force by 1 September 2019, with a transitional period until the end of this year.

Estimated financial effect:

in the first year of functioning of the regulations introducing the obligation to submit notifications for LPG transport (i.e. this year), the state budget revenues from excise duty are expected to increase by PLN 50 million, and in the next year by PLN 673 million. In the first year of application of the regulations introducing the obligation to report the transport of heating oils (i.e. in 2020), an increase in the state budget revenues by PLN 200 million is envisaged.

Revenue (PLN million) yoy	2019	2020
expected outcome	50	823.3

4. Improving the efficiency of administrative enforcement

Objectives:

- increasing the effectiveness of tax and customs duties collection,
- increasing the level of voluntary compliance with tax obligations,
- raising awareness of taxpayers of the benefits of voluntary payment of public-law liabilities and the financial consequences of forced enforcement of obligations subject to administrative enforcement,
- implementation of the judgement of the Constitutional Tribunal of 28 June 2016,
- simplification of procedures in enforcement proceedings in administration, including the procedure for examining allegations and motions for discontinuance of enforcement proceedings by eliminating the duplication of procedural activities of the creditor and the enforcement authority,
- simplifying the procedure for the recovery of the common property of the spouses and the debtor in rem, while ensuring the legal protection of the persons concerned in administrative proceedings and reducing the costs of investigations for the debtor's spouse and debtor in rem,
- simplifying the convergence of enforcement by amending the rules for the settlement of maintenance and customs claims and simplifying the procedure for the transmission of documents between enforcement authorities,
- simplifying enforcement of movable property by introducing a new form of sale of movable property by the debtor under the supervision of the enforcement authority.

Tools:

- amendment to the *Act on Enforcement Proceedings in Administration and certain other acts*, including, but not limited to:
  - establishment of a new system for the calculation of enforcement costs in administrative enforcement proceedings - implementation of the judgement of the Constitutional Tribunal of 28 June 2016. (file ref. no.: SK 31/14),
  - introduction of preventive and disciplinary tools within the new system of calculation and collection of enforcement costs, resulting in reduction of irregularities in timely payment of public-law liabilities.

- amendment to the *Act on Enforcement Proceedings in Administration and certain other acts* (UD326) consisting in, inter alia, streamlining administrative enforcement with respect to procedures, coincidences and forms of sale of seized movables.

Addressees:

Obligated parties, the Head of the National Revenue Administration and other authorities of the National Revenue Administration, other creditors and enforcement authorities referred to in *the Act of 17 June 1966 on enforcement proceedings in administration.*

Responsible body:

Minister of Finance, Head of the National Revenue Administration.

Date:

- 1 October 2019 – draft act amending the *Act on enforcement proceedings in administration and certain other acts* (UD326),
- 1 August 2021 – draft act amending the *Act on enforcement proceedings in administration and certain other acts* (UB14).

Estimated financial effect:

it was assumed that the planned solutions would reduce the duration of enforcement proceedings by 14%, which would translate into an increase in the efficiency of enforcement proceedings by nearly 10%. With the amount of receivables constituting state budget income (covered by enforcement proceedings) amounting to approximately PLN 15 billion, an increase in the efficiency of enforcement by 1.4% should increase state budget income by approximately PLN 210 million annually.

Taking into account the average duration of enforcement proceedings of 555 days (approx. 1.5 years), it should be assumed, however, that the full increase in income will be attained within a few years. It should be noted that there are pending proceedings in which the procedures amended by the draft act were initiated before the date of entry into force of the draft regulations. For these reasons, it is assumed that the full amount of the increase in state budget revenues from the change in the regulation of enforcement costs will materialize in the third year of application of the Act.

Revenue (PLN million) yoy	2019	2020
expected outcome	55.6	55.6

5. Other measures in the tax area

5.1. Tightening the qualification of revenues to the source of “non-agricultural economic activity”

Objective: limiting the scale of illegitimate qualification of revenues received by natural persons to the source of "non-agricultural economic activity" and, as a result, limiting tax arbitration and labour market dualism.

The Minister of Finance in consultation with the Minister of Entrepreneurship and Technology, the Minister of Investment and Economic Development and the Social Dialogue Council will develop consensual regulations tightening the qualification of revenues to the source of "non-agricultural business activity", minimising the interference in the freedom of choice of the model under which entrepreneurs conduct their business activity.

Tools:

amendments to *the Personal Income Tax Act* and other regulations tightening the qualification of revenues to the source of "non-agricultural business activity".

Addressees:

natural persons and entities employing such persons.

Responsible body:

Minister of Finance, Head of the National Revenue Administration, Minister of Entrepreneurship and Technology, Minister of Investment and Economic Development.

Date:

planned entry into force of the solution - 1 January 2020

5.2. Taxation of digital enterprises

Objective: taxation of revenues of digital enterprises providing services in the territory of the Republic of Poland.

The mismatch between the current international corporate tax rules and the realities of the 21st century as well as the challenges posed by the digitisation of the economy makes it necessary to create a specific tool to ensure fair taxation of digital companies.

The issue of appropriate taxation of digital business models is analysed in international (OECD) and EU fora, among others. Work concerning the arrangements related to so-called long-term international solution is to lead to the publication of the final report by the OECD in 2020. Due to uncertainty regarding implementation of an efficient, long-term solution in the international forum within a foreseeable time horizon, an introduction of a so-called temporary solution to the problem of taxation of digital business models in the form of a tax on selected digital services has also been considered.

In this latter context, a preliminary report published by the OECD in March 2018 provided guidance on how to design such a solution so as to make it as cost-efficient as possible and consistent with the international tax system. On the other hand, the European Commission proposed a draft directive on the so-called digital services tax. This proposal received support of most countries but was not adopted due to the unanimity requirement.

In the absence of the agreement on the so-called 'temporary solution' within the EU and in view of the urgent need to address the issue of taxation of digital business models, some Member States (e.g. France, Spain, Italy, UK, Austria) have announced or are considering introducing a temporary tax unilaterally in their domestic law.

Tools:

Development of legislation on the taxation of digital companies.

Addressees:

the largest digital enterprises providing services in the territory of the Republic of Poland.

Responsible body:

Minister of Finance, Head of the National Revenue Administration, Minister of Entrepreneurship and Technology.

Date:

planned entry into force of the solution - 1 January 2020

Estimated financial effect for measures described in sections 5.1-5.2:

a sample of about 16.3 thousand tax payers was used to estimate the effects of tightening the qualification of revenues to the source of "non-agricultural economic activity". It was assumed that as a result of the change in the rationale for classifying revenues to the source of "non-agricultural business activity", additional revenues from taxation of personal income according to the tax scale may amount to approximately PLN 1,247.4 million.

The estimation of revenues from the taxation of digital enterprises was based on the forecast of EU revenues from digital services tax for 2019 as specified in the European Commission report[14] and on the forecast of revenues from CIT in Poland for 2019, presented in the 2019 Budget Act at PLN 34.8 billion. It was estimated that the revenue from this tax in Poland could amount to approximately PLN 217.5 million in 2020.

Revenue (PLN million) yoy	2019	2020
expected outcome	0	1464.9

5.3. Tightening of the recycling levy

Objective: Reducing the use of plastic bags, implementation of the *Directive (EU) 2015/720 of the European Parliament and of the Council of 29 April 2015 amending Directive 94/62/EC as regards reducing the consumption of lightweight plastic carrier bags*.

Tools:

undertaking legislative work consisting in the amendment to *the Act of 13 June 2013 on the management of packaging and packaging waste*, aiming at the fastest possible tightening of the system of levies for plastic bags by extending the obligation to pay the recycling levy to bags over 50 micrometers and imposing the obligation to transfer the indicated funds on a monthly basis, while maintaining the current amount of the fee.

The analysis of the first year of the recycling levy shows a worrying tendency for traders to offer plastic bags with a slightly higher thickness, e.g. 51 micrometers, instead of plastic bags up to 50 micrometers thick. Thus, these bags are not subject to a recycling fee and can be offered by commercial units for any fee or even free of charge. This is not beneficial from the point of view of waste prevention because, despite a certain reduction in the number of lightweight plastic bags, this results in an increase in the number of thicker bags being placed on the market.

Addressees:

entrepreneurs running retail or wholesale trade units, where plastic purchase bags are offered, intended for packaging products offered in these units (excluding very lightweight plastic carrier bags with a wall thickness below 15 microns).

Responsible body:

Minister of Environment.

Date:

1 September 2019

Estimated financial effect:

the effects for 2019 have been estimated on the basis of data on revenues from the recycling levy obtained by 15 March 2019. The estimated financial impact for 2020 is based on an average consumption of plastic bags by the analysed population (38.4 million people) of 150 pieces/year at a price of PLN 0.20 per piece. The estimation takes into account the impacts in 2019, including those resulting from the inclusion of all plastic bags in the recycling levy from September 2019 and the impacts for eleven months of 2020 (monthly settlement period assumed).

[14] *COMMISSION STAFF WORKING DOCUMENT IMPACT ASSESSMENT Accompanying the document Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence and Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services* (COM(2018)147 final) - (COM(2018)148 final) - (SWD(2018)82 final)), pp. 69-70.

Revenue (PLN million) yoy	2019	2020
expected outcome	63	1419

5.4. Indexation of the excise duty rate for alcoholic beverages, tobacco products, raw tobacco, novel products,

Objective: indexation of the excise duty rate by 3% for excise goods being stimulants, i.e. ethyl alcohol, beer, wine, wine products, intermediate products, tobacco products, raw tobacco, novel products.

The last change in excise duty for ethyl alcohol took place on 1 January 2013 and amounted to 15%, while for cigarettes and smoking tobacco it was about 5% (also on 1 January 2013). The growth of the rate by 3% results from the inflation growth since the last change.

Tools:

amendment to the *Act of 6 December 2008 on Excise Duty* which determines the excise duty rates for individual excise goods.

Addressee:

excise entities operating in the field of alcoholic beverages, tobacco products, raw tobacco and novel products, consumers of these products, tax offices and customs and tax control offices.

Responsible body:

Minister of Finance, Head of the National Revenue Administration.

Date:

planned entry into force of the Act - 1 January 2020

Estimated financial effect:

the following estimates assume that the sales of excise goods covered by the increase will be maintained at the level of 2018. The expected budget effect includes PLN 353 million for alcoholic beverages excluding cider and perry and PLN 579 million for tobacco products, raw tobacco and novel products. Cider and perry have been excluded from indexation of excise on stimulants (these products are subject to a preferential excise duty rate of PLN 97 per 1 hectolitre of finished product) in order to develop this market and indirectly support the market of raw materials from which they are produced, as well as electronic cigarettes. The effect for 2020 includes VAT.

Revenue (PLN million) yoy	2019	2020
expected outcome	0	1146.4

5.5. Introduction of excise duty on liquid for electronic cigarettes and novel products

Objectives:

- ensuring uniform tax treatment of substitutes for traditional tobacco products,
- better state control over the production, movements and sale of liquid for electronic cigarettes and novel products,
- taxation of liquid for electronic cigarettes and novel products with excise duty will make them subject to the obligation of marking with excise stamps. As a consequence, an additional element confirming the legal origin of these products will be introduced.

Tools:

Act of 12 December 2017 amending the Excise Duty Act, amended by *Act of 22 November 2018 amending the Act amending the Excise Duty Act*.

The most important changes include:

- taxation of liquid for electronic cigarettes and novel products at a zero rate by 30 June 2020,
- the obligation to submit a tax return to the competent head of the tax office,
- taxation of liquid for electronic cigarettes at a rate of PLN 0.5 per millilitre and novel products at a rate of PLN 141.29 per kilogram and 31.41% of the weighted average retail selling price of smoking tobacco from 1 July 2020,
- an obligation to mark liquid for electronic cigarettes and novel products intended for sale with excise duty stamps from 1 July 2020,
- applying to these products in the territory of the country the procedure of excise duty suspension or production of these products outside a tax warehouse , using the institution of prepayment of excise duty as of 1 July 2020.

Addressees:

25 entities involved in the manufacturing, import and intra-Community acquisition of liquid for electronic cigarettes and novel products.

In addition, 16 Revenue Administration Regional Offices and 44 tax offices competent for excise duty and 16 customs and tax control offices in connection with imposing of excise duty on new products and the obligation to mark them with excise duty stamps.

Responsible body:

Minister of Finance, Head of the National Revenue Administration.

Date:

the provisions of the Act introducing excise duty on two new categories of products came into force on 1 February 2018 However, until 30 June 2020, a zero rate for novel products and liquid for electronic cigarettes shall be in force. These products will be taxed at a positive rate of excise duty as of 1 July 2020.

Estimated financial effect:

Due to the absence of data on current sales of liquid for electronic cigarettes, approximate annual sales figures for liquid for electronic cigarettes of approximately 150,000 litres were used for the analysis. Novel products appeared on the Polish market at the beginning of April 2017. The market for novel products is therefore an emerging market for which no data are available. Therefore, no significant share of excise duty on novel products in revenues from excise duty on new excise goods is expected. It is estimated that the amount of income from excise duty on novel products will be marginal.

In the field of marking of liquids for electronic cigarettes, it is estimated that the state budget expenditure in part 19 of chapter 75095 will amount to approximately PLN 383 thousand in annual terms. However, due to the fact that entities obliged to mark excise goods with excise duty stamps pay to the budget an amount representing at least 80% of the costs of producing excise duty stamps, the actual cost incurred by the state budget will amount to approximately PLN 80 thousand. The inclusion of novel products and liquids for electronic cigarettes in the excise duty suspension system across the country will require the adjustment of the EMCS system to the changes introduced. Adjustment of the Zefir system will be also required, e.g. as regards the new form of tax return. Due to the fact that these systems are maintained and developed within the framework of long-term projects, it is not possible to separate the amounts of funds related to the solutions introduced in this bill. However, due to a small number of taxpayers, it is assumed that the tax on new products will be collected within the current structure and human resources of the National Revenue Administration.

Revenue (PLN million) yoy	2019	2020
expected outcome	0	37.46

5.6. Continuation of tax wedge reduction

Objective: to reduce the personal income tax burden on taxpayers by:

— exemption from taxation of employees' income until the age of 26,

— increase in flat-rate tax deductible costs (KUP) for employees,

— reduction of tax rate from 18% to 17%.

Several options have been considered to meet the above objectives. Fiscal effects are presented in the matrix below.

Options (PLN billion)	**PIT 17% - ½ x I threshold**	**PIT 17% - I threshold**	**PIT 17% - ½ x I threshold**	**PIT 17% - I threshold**
	PIT zero < 26 years old – I threshold		**PIT zero < 26 years old – ½ x I threshold**	
2x KUP	10.1	11.8	9.7	11.4
> 2x KUP (rounded lump sums)	10.8	12.5	**10.4**	12.1
3x KUP	12.4	14.1	12	13.7

The following assumptions were adopted:

— the **amount of income covered by the exemption for employees until the age of 26** will be limited by to PLN 42,764 annually (an amount corresponding to a half of the income constituting the upper limit of the first tax bracket). This limit will apply to revenues earned as of 1 January 2020, while for revenues earned in 2019 it will be lower and will amount to PLN 10,691 (¼ of PLN 42,764 = PLN 10,691),

— **over two-fold increase in flat-rate tax deductible costs for employees, flat-rate amounts rounded**. The new (increased) amount of flat-rate tax deductible costs will come into force on 1 January 2020 and will apply to revenues generated as of 1 January 2020,

— **reduction of the tax rate from 18% to 17% for income up to PLN 42,764**. The reduction of the rate is linked to the change of the tax scale (from two to three levels), the new tax scale will apply to revenue gained as of 1 January 2020.

Tools:

Amendment to the *Act of 26 July 1991 on Personal Income Tax*.

Addressee:

natural persons taxing their income according to the tax scale.

Responsible body:

Minister of Finance.

Date:

planned entry into force of the solution – 1 January 2020

Estimated financial effect:

Revenue (PLN million) yoy	2019	2020
expected outcome	0	-10429

Table 22. Summary of financial effects of other measures in the tax area

Revenue (PLN million) yoy	2019	2020
expected outcome	63	-6373.3

Source: Ministry of Finance estimates.

Measures strengthening the system of social security contributions in 2018-20

SUMMARY

Collecting contributions for social insurance, health insurance, Labour Fund, Guaranteed Employee Benefits Fund and Bridging Pensions Fund and achieving the highest possible income of the Social Insurance Fund are the priority tasks of the Social Insurance Institution. Measures strengthening the system of social security contributions in 2017-18 included:

- improvement of public finance management,
- optimisation of the targeting of public expenditure,
- simplifying the payment of social security and health insurance contributions,
- enabling a greater control of short-term exemptions in order to eliminate fraud.

The effect of these measures was the implementation of a new system of collection of contributions (e-Składka), extension of activities aimed at effective recovery of outstanding contributions and implementation of the system of electronic sick leave (E-ZLA).

For 2020, additional systemic measures are planned under the jurisdiction of the minister competent for social security, increasing the receipts from contributions, comprising: ►reducing the avoidance of pension and retirement benefit contributions and ► waiving the limitation of the annual base for pension and retirement benefit contributions. There are also plans to rebuild the functioning model of Open Pension Funds, under the responsibility of the Minister of Investment and Development. This will entail, among others, additional income for the Social Insurance Fund from the pension contribution currently being transferred to the accounts of OFE members.

The financial effects of implemented and planned measures strengthening the system of social security contributions are estimated at 721 million in 2019 and additional PLN 15 billion in 2020, including PLN 3.5 billion due to the reconstruction of the OFE operational model.

Table 23. Financial effects of undertaken and planned measures in the area of social insurance contributions

Revenue (PLN million) yoy	2018*	2019	2020
expected outcome	371	721	14 980

Source: Social Insurance Institution and Ministry of Finance estimates.
* - execution.

Table of contents

1. E-Contribution (e-Składka) and other measures to recover outstanding contributions

Objectives:

- tightening of the collection system of social security and health insurance contributions,
- simplifying the payment of social security and health insurance contributions,
- increasing the amounts recovered as a result of enforcement measures.

Legal basis:

- *Act of 13 October 1998 on the Social Security System,*
- *Regulation of the Council of Ministers of 21 September 2017 on detailed rules and procedures in matters concerning the settlement of contributions which the Social Insurance Institution (ZUS) is obliged to collect,*
- *Act of 17 June 1966 on Enforcement Proceedings in Administration,*
- *Act of 17 November 1964 - Code of Civil Procedure,*
- *Act of 6 July 1982 on land and mortgage register and the mortgage,*
- *Act of 29 August 1997 - Tax Ordinance.*

Tools:

new rules of payment and settlement of contributions collected by ZUS: **e-Składka**. Before 2018, payers paid contributions to four separate accounts of social insurance, health insurance, Labour Fund (FP) and Guaranteed Employee Benefits Fund (FGŚP) and Bridging Pensions Fund (FEP). Since 1 January 2018, the payers have been paying the contributions due for all insurance and funds by means of one payment, with the use of an ordinary payment document. Payments marked by payers with individual contribution account number (NRS) are booked on accounts and settled proportionally to cover due contributions (social insurance / FEP / health insurance / FP and FGŚP) in accordance with:

- the share of premiums shown in the settlement declaration for the last settlement period,
- universal distribution of contributions on the basis of currently binding interest rates on contributions - if there is no settlement declaration on the account.

In the first place, the oldest claims on the fund are covered. This rule limits the statute of limitations for contributions and the accrual of interest on arrears. Until December 2017, premiums were paid to a bank account separate for each fund and insurance, hence premium receivables were paid by three or four transfers. Moreover, in order to fully identify the payment, it was necessary to enter numeric identifiers (NIP, REGON, PESEL or a series and number of passport / ID card) in the payment form, as well as to specify the type of payment and the settlement period for which the payments were made. The Social Insurance Institution (ZUS) settled such a payment starting from the period indicated in the payment order. As a result, arrears persisted for various past periods, even for many years, while at the same time contributions were paid for the current period. At the same time, the payer of contributions could freely choose the fund and the contributions he wanted to pay (e.g. only health insurance).

Settlement of payments starting from the oldest receivable has also an impact on the right to benefit from sickness insurance benefits for persons who voluntarily apply to this insurance. If an entrepreneur loses its entitlement to the sickness benefit because it failed to pay contributions on time, he must reapply for sickness benefit in order to recover them. However, it must be taken into account that 90 days (waiting period) must pass before the entrepreneur is again entitled to the sickness benefit. Such limitation stems from Article 4(1)(2) of the *Act of 25 June 1999 on cash benefits from social insurance in case of sickness and maternity*. In order to avoid such a break, pursuant to Article 14(2) of *the Act of 13 October 1998 on the social insurance system*, persons subject to voluntary sickness insurance may apply to ZUS for consent to pay the contribution after the deadline if they are delayed in paying the contribution or if the contribution is not paid in full. An interested entrepreneur should submit an application in this matter to the (ZUS). The settlement method of payments starting from the oldest receivable has an impact on enhancement of payment discipline also in this group of payers.

Payments with an incorrect NRS shall be returned immediately to the sender's account. In each of these cases, the data of the payer of premiums are established and information concerning the lack of payment for the last month is sent from the ZUS branch, followed by checking whether the correct payment has been made.

Moreover, **claim enforcement activities** have been intensified. From January 2018, among others, the catalogue of sources for acquiring funds under the enforcement procedure was extended to include the following solutions:

- modification of the TWZA application - it supports users in direct execution of the ZUS's duties as a creditor and branch directors as enforcement authorities related to the service of enforcement coincidences established after 7 September 2016. It enables handling forced recovery of receivables within the framework of execution for other creditors (coincidence of enforcement) in accordance with *the Act of 10 July 2015 amending the Act - Civil Code, the Act - Code of Civil Procedure and certain other acts*,
- enforcement from receivables arising from POS payment terminals - enforcement from such receivables is more effective and minimizes the risk of concurrence of enforcement conducted by another enforcement authority, and thus, the risk of dividing the amounts among other creditors,
- cooperation with the Committee of Clearing Agents (Polish Bank Association) in the area of computerisation of correspondence related to enforcement of claims arising in connection with the operation of payment terminals,
- enabling the PWI application to select accounts to take enforcement action (e.g. debt and non-warning accounts, or admonition and non-execution accounts),
- exchange of messages with banks via teletransmission (integration with OGNIVO) in view of the entry into force of the revised enforcement provisions on 8 September 2016 (ZUS is the first of the authorised institutions to start such exchange),
- Security Register - it supports users in actions aimed at imposing security on debtors' assets, including, among others, the acquisition of data on debtor’s assets (data collected from the Central Vehicle Register and the Land and Mortgage Register system) and attachment (requests for entry, deletion, declarations/certificates, decisions).

From January 2018, in order to limit the statute of limitations, the possibility of seizing funds accumulated on the insured person's subaccount and a guaranteed payment in the event of his/her death and filing an application for their payment by a beneficiary was introduced. These amounts may be subject to enforcement by means of an enforcement measure, such as seizure.

Addressees:

payers of contributions.

Responsible body:

Social Security Institution.

Date:

from 1 January 2018

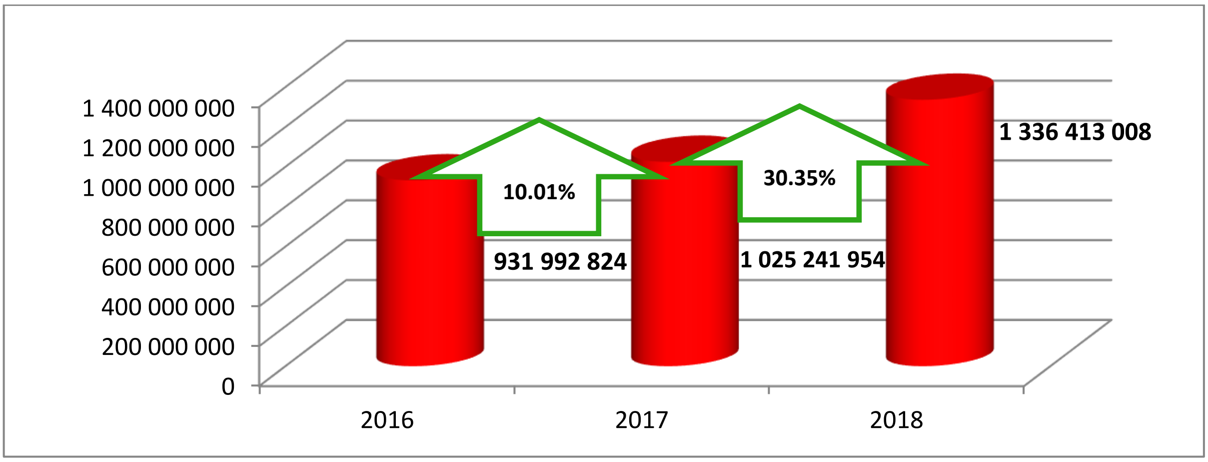
Estimated financial effect:

as of 2 January 2018, statements of account of NRS payments are accepted, and payments are booked and settled in the accounts of contribution payers. In total, from January to the end of December 2018, payers of contributions transferred payments amounting to PLN 257,222.7 million to the NRS 30 409 294. This means that in 2018 the amount of payments transferred to the NRS was higher by almost PLN 20 billion (i.e. PLN 19,613.7 million) than the total amount of payments made by payers of contributions in the period from January to December 2017. The increase in contributions to the NRS on account of contributions collected by the ZUS in relation to the level of 2017 contributions amounted to 8.3%; after adding proceeds from enforcement, the increase amounted to 9.0%.

The rule in force since 1 January 2018 stating that payments to the NRS first cover arrears including default interest has triggered significant changes in the arrears in the accounts of payers paying their own insurance premiums. Their debt for the years 1999-2017 decreased in 2018 by PLN 708 million (currently PLN 3,460 million against PLN 4,168 million), including **PLN 145.3 million** for the years 1999-2013 (currently PLN 1,363.0 million against PLN 1,508.3 million). If no sealing measures were taken, the amounts for the period 1999-2013 would be time-barred.

The amounts recovered by the Institution under own enforcement significantly increased – by more than 30% compared to 2017. In 2014-17, the percentage of amounts recovered as a result of enforcement measures decreased in relation to all arrears covered by enforcement measures (from 13.5% in 2014 to 10.3% in 2017). In 2018, this indicator increased to 11.5%. In the framework of the enforcement proceedings, PLN 2.1 billion was recovered, i.e. by PLN 370 million more than in the corresponding period of 2017, including **PLN 226 million** reflecting the increase of the aforementioned ratio in relation to 2017.

Figure 1. Amounts in PLN enforced in 2016-18 (own enforcement)



Bank account attachment is one of the most effective means of enforcement.

Figure 2. Number of bank account attachment orders issued in 2016-18

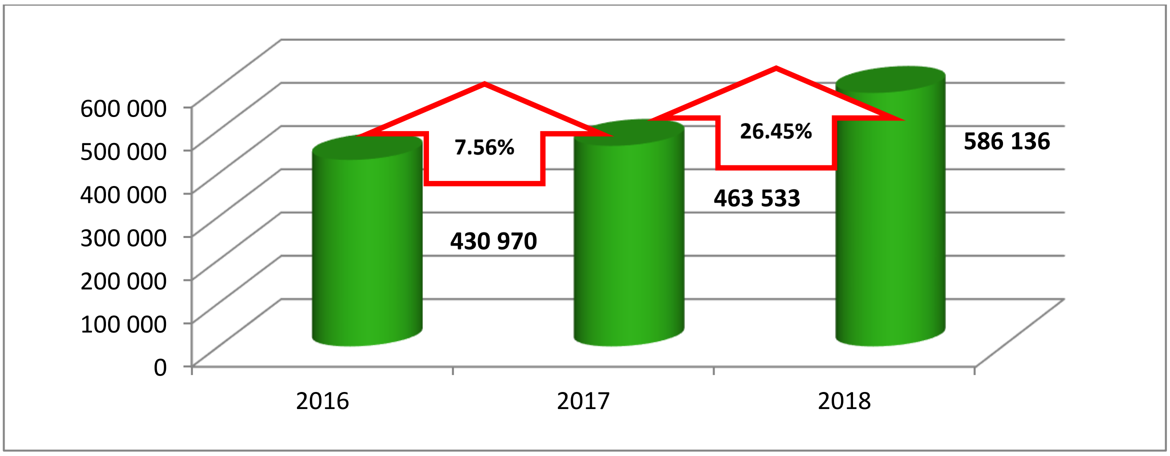
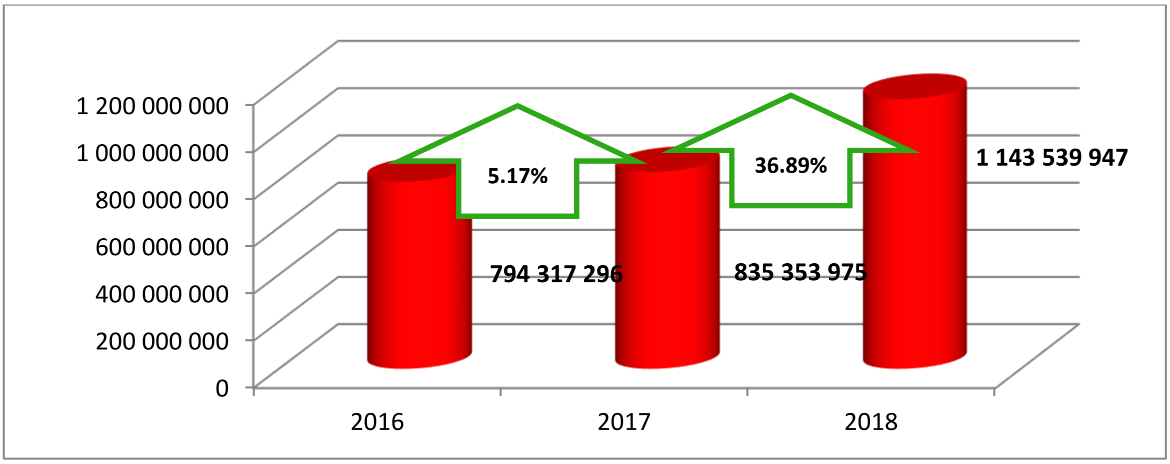


Figure 3. Amount of payments from bank account attachment in 2016-18 in PLN



In 2019-20, as a result of extension of the tightening measures, the percentage of recoveries is expected to increase further to 13.4% in 2019 and 15.3% in 2020. This will translate into an increase in recovered contributions by PLN 372 million in 2019 compared to 2018 and by PLN 396 million in 2020 compared to 2019.

Revenue (PLN million) yoy	2018*	2019	2020
expected outcome	371	372	396

* - execution

2. E-ZLA and short-term benefits

Objectives:

- a possibility of issuing and signing sick leaves in electronic form,
- control of sick leave accuracy by insured persons,
- elimination of abuses,
- sealing and rationalisation of expenditure from the sickness fund,
- reducing the loss of premiums by reducing sickness absenteeism.

Tools:

issuing medical leaves in electronic form and creating a central register E-ZLA enables:

- greater control of short-term sick leaves,
- more opportunities to eliminate abuses,
- elimination of excessive bureaucracy and saving time,
- fast access to information,
- participation of employers in the verification of documentation that significantly contributes to the settlement of employee absenteeism.

In order to eliminate fraud and rationalise sickness fund expenditure, the following changes are planned from 2020:

- the introduction of the so-called waiting period with regard to the childcare allowance and maternity allowance and determining the waiting period for allowances as ►90 days for persons insured on a mandatory basis, ►80 days for persons insured on a voluntary basis. The legislation in force provides for a waiting period for sickness benefit entitlement of ►30 days for persons insured on a mandatory basis (e.g. employees) and ►90 days for persons insured on a voluntary basis (e.g. persons carrying out non-agricultural activities and persons cooperating with them, persons working under an agency or contract of mandate and persons cooperating with them). The waiting period currently applies only to sickness benefit, it does not apply to childcare allowance and maternity allowance,

- introducing the principle that the right to a new period of benefit is created only if the new disease occurs after 90 days from the end of the previous inability to work, regardless of whether the new disease is caused by the same or a different cause of inability to work. Currently, sickness benefit is granted for 182 days, and in the case of tuberculosis or inability to work due to an illness occurring during pregnancy - for 270 days. Periods of continuous incapacity for work also for various reasons, are included in one period of benefit. In the case of breaks in inability to work and illness after a break for another reason, even after 1 day of break, the right to a new period of benefit arises. On the other hand, in the case of breaks in inability to work and illness after a break for the same reason, periods of inability before and after a break shall be included in a single period of benefit, if the break does not exceed 60 days.

Addressees:

physicians, payers of contributions, insured persons.

Responsible body:

Social Security Institution.

Date:

- E-ZLA – from 1 December 2018,
- changes in allowances – from 1 January 2020

Estimated financial effect:

in December 2018, electronic sick leave accounted for 99.7% of total issued sick leave and at the end of February 2019 - 99.93% (due to own illness, childcare and care for other family members). In February 2019, 2.4 million temporary inability to work certificates for a total of 24.9 million days of absence (due to illness, childcare and care for other family members) were registered in the Register of Medical Certificates. Compared to February 2018, the number of days of sick leave decreased by 7.1%, while in relation to January 2019, the number of days of sick leave decreased by 12.5%. The number of medical certificates decreased by 7.0% compared to February 2018 and by 8.4% compared to January 2019.

The implementation of E-ZLA contributed to a decrease in the number of unauthorized sick leaves, which results in a reduction in expenses on account of sickness benefits and an increase in income from contributions (an employee, instead of being on sick leave, works and pays contributions for it). It is estimated that the increase in revenues from premiums for the implementation of E-ZLA will amount to PLN 0.35 billion in 2019 and PLN 0.16 billion in 2020. The proposed changes to sickness, maternity and care allowances will have similar effects. On the one hand, expenditure from the sickness fund will be significantly reduced, and on the other hand, an increase in contributory income can be expected. The expected increase in income from contributions due to the reduction in the number of benefit days will amount to PLN 0.4 billion in 2020.

Revenue (PLN million) yoy	2019	2020
expected outcome	349	565

3. Reducing avoidance of payment of pension and disability benefit contributions

Objectives:

- tightening of the contribution collection system for social security and health insurance on junk employment contracts,

- reducing avoidance of contributions by using junk contracts instead of employment contracts,
- broadening the revenue base from junk contracts on which social security contributions are paid,
- increase in proceeds of the Social Insurance Fund.

Tools:

tightening the rules for being subject to pension and disability insurance under junk contracts.

Addressee:

payers of contributions, insured persons.

Responsible body:

Minister of Family, Labour and Social Policy, Social Insurance Institution (ZUS) .

Date:

from 1 January 2020

Estimated financial effect:

introduction of the proposed measures concerning the subjection to pension and disability insurance under "junk" contracts would increase the amount of social insurance premiums written by PLN 3.1 billion (the net effect of the change, taking into account the impact on PIT is PLN 2.5 billion).

Revenue (PLN million) yoy	2019	2020
expected outcome	0	3 100

4. Abolition of the limitation of the annual base for the assessment of pension and disability benefit contributions

Objectives:

- extension of the annual base of assessment of contributions for pension and disability insurance in a given calendar year beyond the amount referred to in Article 19 of *the Act of 13 October 1998 on the social insurance system*,
- increase in incomes of the Social Insurance Fund,
- no need for continuous monitoring of the amount of income received by the payer of premiums as well as by the insured, especially when the insured person performs several types of work.

Tools:

change in the rules for being subject to pension and disability insurance by abolishing the upper limit of contributions for pension and disability insurance from 2020. The contribution to the pension and disability insurance will be paid from the total revenue, analogically to the contribution to the sickness and accident insurance. Currently, the annual basis for the assessment of pension and disability insurance contributions in a given calendar year may not be higher than the amount specified in Article 19 of the *Act of 13 October 1998 on the social insurance system*. Once this income is reached, pension and disability contributions are not paid.

Addressee:

payers of contributions, insured persons.

Responsible body:

Minister of Family, Labour and Social Policy, Social Insurance Institution (ZUS) .

Date:

from 1 January 2020

Estimated financial effect:

the abolition of the limitation of the annual base for the assessment of pension and disability insurance premiums will result in an increase in premium income by approximately PLN 7.45 billion in 2020 and PLN 2.4 billion in 2021 (the net effect of the change, taking into account the impact on PIT and CIT, amounts to PLN 5.2 billion in 2020 and PLN 1.8 billion in 2021).

Revenue (PLN million) yoy	2019	2020
expected outcome	0	7 450

5. Reconstruction of the OFE model functioning

Objective: reconstruction of the functioning model of OFE (Open Pension Funds) as part of the *Capital Building Programme*, which aims to increase the financial security of citizens by creating a voluntary funded pension scheme in Poland and long-term investment products.

The measure complements the creation of Employee Capital Plans.

Tools:

Drafting the Act amending certain Acts in connection with the transfer of funds from open pension funds to individual pension accounts. Planned changes will include:

- transformation of Powszechne Towarzystwo Emerytalne (Pension Fund Management Company) into Towarzystwo Funduszy Inwestycyjnych (Investment Fund Management Company),
- transfer of funds from Open Pension Funds (OFE) to Individual Pension Accounts (IKE),
- leaving the contribution, which is currently being transferred to OFE in the public obligatory pension system - redirecting it to the Social Insurance Fund,
- introduction of a transformation fee on funds transferred to individual pension accounts. The pension contribution paid by an insured person in the public obligatory pension system is not subject to PIT, and the payment of pensions is subject to PIT. If savings accumulated in IKE are withdrawn, PIT is not collected. A transformation fee (at the total level of 15%) therefore will be charged on funds transferred to individual pension accounts. The level of the fee corresponds to the effective rate of taxation of pensions. The funds transferred to the IKE would be subject to capital gains tax exemption,
- the possibility for an OFE member to submit a declaration on the transfer of funds from the OFE to the Demographic Reserve Fund and recording the value of the transferred funds on accounts in the FUS. No transformation fee is charged when selecting this option. IKE is the default option.

Addressee:

OFE members, Pension Fund Companies, OFE, Social Insurance Institution (ZUS).

Responsible body:

Minister of Investment and Development, Minister of Family, Labour and Social Policy.

Date:

The Act is planned to enter into force in 2020. It is assumed that the transformation fee will be classified as income of the social security subsector in 2020 according to the ESA2010 methodology, whereas it will actually be paid in two equal instalments in 2020 and 2021.

Estimated financial effect:

The proposed changes mean additional income in the FUS from the pension contribution currently transferred to the accounts of OFE members (PLN 3,469 million in 2020). It has been assumed that the one-off income from the transformation fee will amount to PLN 19,300 million in total, however, its payment will be divided into two equal instalments, each amounting to PLN 9,650 million, payable in 2020 and 2021.

Revenue (PLN million) yoy	2019	2020
expected outcome (total)	0	13119
permanent measures		3469
one-off measure	0	9650

Source: Social Insurance Institution and Ministry of Finance estimates.

One-off measures in 2019-21

Within the *Programme* horizon, one-off measures presented below will have a significant impact on the general government balance: ►sale of greenhouse gas emission allowances falling within the competence of the Minister of Environment and the Minister of Energy, ►allocation of frequency resources in the 3.7 GHz, 26 GHz and 800 MHz bands falling within the competence of the Minister for Computerisation, and the one-off transformation fee relating to the reconstruction of the functioning model of Open Pension Funds, as described in Annex 2.

The financial impact of these measures in cash terms (minimum option) is presented in the table below.

Revenue (PLN million)	**2019**	**2020**	**2021**
expected outcome	5 698	17 834	12 045

Table of contents

1. Auctions for greenhouse gas emission allowances

Objective: to achieve the long-term objective of reducing greenhouse gas emissions in the European Union.

Tools:

the auctioning of greenhouse gas emission allowances pursuant to Article 10 of *Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC* (hereinafter referred to as 'the Directive').

Addressees:

emitters of greenhouse gases subject to the provisions of the Directive.

Responsible body:

Minister of Environment, Minister of Energy.

Date:

auctions take place each year, the auction proceeds are transferred to EU Member States in accordance with the agreed allocations of the pool of emission allowances.

Estimated financial effect:

the estimate of the financial impact was prepared assuming the number of allowances to be auctioned as shown in the table below.

Allowances (million)	2020	2021	2022
Allowances designated for sale*	80.64	44.12	46.89
Additional, unused allowances in derogation for years 2013-19**	49.52	24.76	
Total	130.16	68.88	46.89

* - as estimated by the Ministry of Environment.
** - total amount of additional allowances as estimated by the Ministry of Energy, sales in 2020 were assumed at a level of 2/3 of their total number, and in 2021 to the remaining 1/3.

Article 10c(5) of the Directive[15] provides that additional, unused allowances may be sold in 2020. The condition is that Poland notifies such intention by 30 September 2019, while the sale of unused allowances in 2020-21, according to the above projection, requires the application of the Polish party and obtaining the consent of the European Commission.

The number of allowances to be sold in 2020 or 2021 may decrease if any part of the allowances, due to their large supply in the market, is transferred to the Market Stability Reserve. However, it is currently not possible to determine whether this mechanism will be used or how many allowances will be transferred. This information will only be available for each year in May 2020 and 2021 respectively.

[15] Article 10c(5) "[...] Any allowances not allocated under this Article by 2020 may be allocated over the period from 2021 to 2030 to investments selected through a competitive bidding procedure as referred to in paragraph 2, unless the Member State concerned informs the Commission by 30 September 2019 at the latest of its intention not to allocate all or part of those allowances over the period from 2021 to 2030 and of the number of allowances to be auctioned in 2020 instead".

Revenue (PLN million)	2019	2020	2021	2022
From allowances designated for sale		7 626.81	4 268.01	4 652.73
From unused allowances	5 698	4 683.53	2 395.20	
Total	5 698	12 310.34	6 663.21	4 652.73

In the calculations, in accordance with the assumptions of the Ministry of Environment, the average price per allowance was assumed at the following levels: in 2020 - EUR 22.79 in 2021 - EUR 23.31 and in 2022 - 23.91 and the EUR/PLN exchange rate - at the level of 4.15. Full revenues from the sale of unused allowances in the amount of PLN 4,683.53 million in 2020 and PLN 2,395.20 million in 2021 are achievable only if all additional emission allowances resulting from the unused opportunities created by the derogation are sold, their number is in line with the estimates of the Ministry of Energy and the prices and prices of allowances are in line with the estimates of the Ministry of Environment.

2. Revenue from allocation of frequency resources in the 3.7 GHz, 26 GHz and 800 MHz bands

Objective: to allocate frequency resources in the 3.7 GHz, 26 GHz and 800 MHz bands.

Tools:

Fees for reservation of frequencies in the 3.7 GHz, 26 GHz and 800 MHz bands.

Addressees:

entities obliged to pay frequency reservation fees.

Responsible body:

Minister of Computerisation, Office of Electronic Communications.

Date:

fees collected by the UKE will constitute the revenue for the state budget in 2020.

Estimated financial effect:

estimation of the financial result assuming that the amendment to the *Act of 16 July 2004 Telecommunications law* enters into force, the amendment to the regulation on tenders, auctions and competitions for the reservation of frequencies or orbital resources. In the *Programme* scenario a minimum value has been adopted.

Revenue (PLN million)	2019	2020
min.		3 500
max.		5 000