Selected legal and practical aspects of the risk of losing the right to lump sum tax on corporate income

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***Abstract*— The subject of this article is an analysis of the determinants related to the loss of the right to lump-sum taxation on corporate income, commonly known as Estonian CIT. The author analyzes a catalog of negative conditions contained in the CIT Act, the existence of which obliges taxpayers to return to the classic taxation model. Particular attention is paid to dynamic employment conditions and stringent requirements regarding, among other things, the timely preparation and signing of tax reports. The article analyzes the current interpretation, which indicates a lack of tolerance for even temporary violations of statutory limits. The final conclusion points to the need to introduce remedial (corrective) mechanisms that would protect taxpayers from the severe consequences of inadvertent formal errors.**

Keywords— Estonian CIT, lump sum tax on corporate income, loss of the right to lump sum tax.

I. INTRODUCTION

The introduction of a lump sum tax on corporate income, commonly known as the "Estonian CIT," into the Polish tax system was hailed as a breakthrough in corporate income taxation. This mechanism, based on deferring the tax liability until profit distribution, is intended to stimulate investment and simplify settlements. However, the practical application of these regulations reveals a number of challenges, the most serious of which is the risk of a sudden and often unexpected loss of entitlement to this form of taxation.

A key area of uncertainty for taxpayers remains the catalogue of so-called negative conditions and events that trigger the expiration of the right to a flat-rate tax. Imprecise statutory wording, evolving interpretations by tax authorities, and procedural rigor mean that remaining safely within the Estonian regime requires constant vigilance from company management boards and their advisors. This article analyzes the legal determinants and practical aspects of the risk of losing preferential tax treatment. It focuses on identifying the most common interpretation pitfalls related to, among other things, employment levels and stringent requirements for timely preparation and signing of tax reports, while also pointing out the far-reaching financial consequences of a sudden return to the classic CIT model.

II. RISK

In recent years, there has been a significant increase in interest in understanding the nature of risk, as it is a phenomenon present in all areas of human activity. In business, it is impossible to avoid risk because when making decisions, we do not always have full information and cannot always accurately predict future developments (Zawadzka, 1996, p. 9).

The literature on risk definitions offers a variety of views on its essence. Some publications treat risk as a statistical measure, but this does not capture its essence. There is no universally accepted definition of risk due to its complexity and ambiguity, leading to disputes on the subject.

R. Moeller points out that "the concept and understanding of risk adopted by one specialist may differ significantly from that adopted by another, even though both work in the same enterprise and study similar areas" (Moeller, 2011). It is generally believed that there is only one risk, although there are different approaches to defining it (Gędek, 2018, p. 119).

The definition of risk is often based on assessing the probability of a specific outcome, i.e., loss. However, the degree of risk and the degree of probability of loss are not always the same. The difference between them becomes apparent when we analyze the magnitude of risk and the

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probability of loss. Although a higher probability of loss might suggest a higher risk, in practice this is not always true (Garbiec, 2022, p. 10).

Today, in the context of financialization, increasingly strong connections are being observed between the real economy (the goods and services market) and the financial economy (the financial services market). The increased mobility of financial capital, which moves freely between countries, primarily through capital market operations, is contributing to a shift in the perspectives of risk management.

Tax risk resulting from the complex structure of statutory conditions and the rigor of tax authorities force companies to analyze specific determinants with a high level of risk for the taxpayer.

III. KEY RISK DETERMINANTS

Generally, to benefit from lump-sum taxation on corporate income, the conditions specified in Articles 28j and 28k of the Corporate Income Tax Act of 15 February 1992 must be met. The tax administration is obligated to verify whether entities that have chosen this type of taxation meet the statutory requirements, which include:

- the value of revenues (gross) earned as of the last day of the last tax year under the so-called classic CIT system.

The regulations stipulate that in the case of a company opting for the lump sum tax on corporate income, or using the lump sum tax on corporate income (CIT), less than 50% of the business income earned in the tax year immediately preceding the tax year in question may come from receivables, interest and proceeds from all types of loans, the interest portion of leasing payments, sureties and guarantees, copyrights or industrial property rights, including the sale of such rights, the sale of the exercise of rights in financial instruments, and transactions with related parties – if no economic value is generated in connection with these transactions or if this value is insignificant.

- The 3-FTE rule

under an employment contract or incurring remuneration expenses for the payment of wages to individuals employed under a contract other than an employment contract, specifying the employee's details: first name, last name, PESEL number, type of contract concluded – employment contract, contract other than an employment contract, period of employment (number of days), full-time employment, monthly value of the remuneration paid – regarding a contract other than an employment contract

- property rights

Whether shareholders held property rights related to the right to receive benefits as founders (founders) or beneficiaries of a foundation, trust, or other entity or fiduciary legal relationship, excluding founders and beneficiaries of a family foundation. This regulation aims to ensure full transparency of the ownership structure and prevent the transfer of profits to third parties outside of fiscal control. Holding certain property rights in entities constitutes a barrier to entry into the flat-rate tax system, forcing taxpayers to precisely separate personal assets from operational ones.

- violation of the ownership structure

Whether the company held shares in any company, held participation titles in investment funds or a collective investment institution, all rights and obligations in a company other than a legal person, and other property rights related to the right to receive benefits as a founder (founder) or beneficiary of a foundation, trust, or other entity or a legal relationship of a fiduciary nature. The lump sum tax is reserved exclusively for entities with a simple structure (ownership transparency), where the shareholders are exclusively natural persons. The consequences of "breaking" this structure, including through the joining of a legal entity to the company, the acquisition of shares in another entity by a company taxed at the lump sum, or the creation of fiduciary relationships (private foundations, trusts). Any change in the composition of shareholders that violates the statutory list (Article 28j, paragraph 1, points 4 and 5) results in the ex lege loss of the right to the lump sum tax, which imposes on taxpayers the obligation to exercise special diligence in restructuring and transaction processes.

- Bankruptcy/liquidation

Whether the company has ever been declared bankrupt or liquidated. The initiation of these proceedings results in the mandatory loss of Estonian CIT entitlement on the day preceding the occurrence of these events, which necessitates settling the tax under general rules.

- Passive income limit

Less than 50% of operating income generated in the previous tax year, calculated taking into account the amount of value added tax due. If a company begins to generate excessive revenue, for example, from receivables, interest, guarantees, or copyrights, it loses its right to the lump sum tax. This is a closed list of passive income – including interest, dividends, receivables, and income from copyrights – indicating the purpose of the regulation, which is to limit the system's availability to holding and portfolio companies.

- Late signature

If the signature on a properly prepared financial statement is submitted even one day after the deadline, the tax administration may consider the transition invalid. The company is then forced to revert to the general rules, pay the outstanding corporate income tax (9% or 19%), along with high default interest.

IV. OVERVIEW OF KEY INTERPRETATIONS AND CASE LAW

The essence of the Estonian corporate income tax system is a departure from the traditional income tax model, which requires regular advance payments of income tax on earned income. In this form of lump-sum taxation on corporate income, tax is generally payable only when profits are distributed, for example, in the form of dividends. In practice, this solution means greater freedom to reinvest funds and support business development without ongoing income tax liabilities.

Estonian corporate income tax (CIT) case law is becoming increasingly favorable to taxpayers, softening the tax

authorities' strict approach. Key rulings from the Supreme Administrative Court and the Provincial Administrative Court address issues such as the lack of loss of the right to lump sum tax for late submission of a report and a flexible approach to employment requirements, which are the most common determinants of loss of the right to Estonian corporate income tax (CIT).

Administrative courts indicate that the list of passive income is closed. They also emphasize that the burden of proof that a transaction does not generate added value rests with the authority. If a company can prove, for example, that intermediation in sales between related entities has an economic justification (margin, logistics, risk), this income is not included in the 50% limit.

In numerous interpretations, the Director of the National Tax Information (KIS) has consistently indicated that the loss of the right to lump-sum taxation on corporate income occurs on the day preceding the opening of liquidation or declaration of bankruptcy. Case law emphasizes that the opening of liquidation is an irreversible event in the context of a given tax year. The court confirmed that even if a company withdraws from the liquidation process, this does not automatically restore the right to Estonian CIT for the same period. The rationale of the provision is to ensure taxpayer stability; an entity in liquidation, by definition, does not pursue the investment objective that underlies the lump-sum tax. Furthermore, administrative courts often emphasize that the bankruptcy and liquidation provisions of Estonian CIT are preventative in nature. The goal is to prevent situations in which a taxpayer "escapes" profits into the liquidation process, attempting to avoid dividend taxation (so-called "exit tax"). Liquidation is considered to contradict the very idea of Estonian CIT, which is intended to support continuation and development, not the cessation of business activity.

The applicability of flat-rate taxation on corporate income (so-called Estonian CIT) is contingent upon the submission of a notification of the election for such taxation (ZAW-RD). The basic regulation on this matter is contained in Article 28j, Section 1, Item 7 of the CIT Act. This provision applies to the transition to Estonian CIT after the end of the adopted tax year. However, it is possible to transition to Estonian CIT during the tax year (i.e., before the end of the taxpayer's adopted tax year). A company transitioning to Estonian CIT during the year must first close its books and prepare a financial statement. Notification of the change must be submitted by the end of the first month of the first year in which it will be subject to the flat-rate tax, and the notification must be timely correlated with the completion of the remaining activities – closing the books and preparing the report.

As stated in Article 28j, Section 5 of the Corporate Income Tax Act, financial statements must be prepared in accordance with accounting regulations, and the signing of the financial statements by authorized persons confirms the correctness (compliance with the provisions of the Accounting Act) of the financial statements' preparation. Therefore, the financial statements are deemed prepared on the date of their signing. Therefore, the date of actual preparation of the financial statements, from a formal and legal perspective, should be considered the date of affixing the signatures required by the Accounting Act. A signature on the financial statements constitutes the completion of work on their preparation and demonstrates the final preparation of the financial statements. A later signing of the financial statements means that they were not prepared on time and, therefore, are not prepared in accordance with the provisions of the Accounting Act, which violates the provisions of Article 28j, Section 5 of the Corporate Income Tax Act. Consequently, it means that the flat-rate tax on corporate income was not effectively elected.

The Ministry of Finance has recognized the problem of overly stringent sanctions for formal errors. In September 2025, a draft amendment was published, which provides, among other things, for a tax amnesty. A breakthrough came with the ruling of the Regional Administrative Court in Kraków, which ruled that a late signature should not automatically result in the loss of the right to the lump sum tax if the report itself was prepared on time.

Another key factor that excludes companies from Estonian CIT is the employment limit. A taxpayer employing a specified number of people (3) under an employment contract, converted to full-time equivalents (FTEs), for a period of 300 days in a tax year, may be subject to flat-rate taxation on corporate income. The required period should be calculated cumulatively for all required FTEs. However, the legislator does not require this provision to combine a "period of at least 300 days in a tax year" with each separate FTE. In determining how to properly understand, based on the rules of Polish syntax, the provision of Article 28j, paragraph 1, item 3, letter a of the Corporate Income Tax Act, it should be noted that the analyzed text constitutes a logical sequence specifying the conditions for granting the right to benefit from flat-rate taxation on corporate income. These conditions are equal, although not equivalent, because only the employment of at least 3 people on a full-time basis (subject to modifications in the number of required employees, as is the case with "small taxpayers" or "starters") under an employment contract - who cannot be shareholders or partners of that taxpayer - for a period of at least 300 days in a tax year, opens the possibility of considering the issue of meeting the conditions under the so-called Estonian CIT regime.

According to the Supreme Administrative Court, an analysis of the aforementioned provision leads to the conclusion that the phrase "for a period of at least 300 days in the tax year," which describes one of the conditions for lump-sum taxation on corporate income, should be understood to mean that a taxpayer employing a specified number of people on a full-time equivalent basis for a period of 300 days under an employment contract may be subject to lump-sum taxation on corporate income, and the required period should be calculated cumulatively for all required full-time equivalent positions. In Article 28j, paragraph 1, item 3, letter a of the Corporate Income Tax Act, the legislature does not require combining the "period of at least 300 days in the tax year" with each separate full-time equivalent position. This is especially true since a full-time equivalent position is to be understood as a full-time equivalent

position. A different interpretation would mean that if it were necessary to hire an employee, including for various unforeseen circumstances, this would have to occur in the first two months of the calendar year and should continue until the end of the calendar year. Moreover, in the case of employing, for example, two people on a half-time basis, to meet the requirement for a full-time equivalent, the employment would have to occur simultaneously. Otherwise, it would not be possible to combine periods of employment.

It is obvious that during an employee's employment—for various reasons, including unforeseen circumstances—employers are often, through no choice of their own, placed in a situation where the employee resigns from further employment during the tax year, including by abandoning their job. A situation should also be allowed where the employer is forced, for example, to terminate the employee's employment during the tax year as a disciplinary measure. Furthermore, the very nature of business activity (e.g., seasonality) often forces employers to hire more people, for example, for six months of the year, and to limit employment for the remainder of the year. In such a situation, the requirement to combine a "period of at least 300 days in the tax year" with each separate full-time equivalent position leads to unjustified rigorism, resulting in the loss of the ability to continue this form of taxation, especially in the second year of being subject to the lump sum corporate tax.

In this regard, the Supreme Administrative Court has relaxed employment requirements, recognizing that employment does not have to be permanent for 300 days per year, which is beneficial for companies with seasonal work.

V. Conclusions

The punitive nature of Estonian CIT taxation does not only apply "forward," but often forces corrections and payment of overdue tax with interest. It also results in a ban on returning to Estonian CIT for the next three years.

Analysis indicates that the risk of losing the right to lump-sum tax on corporate income stems primarily from breaching employment limits and errors in entering the system. Case law highlights the tax administration's strict approach to formal deadlines, although favorable interpretations in this regard have emerged.

Estonian corporate income tax (CIT) is an attractive taxation method for companies willing to reinvest profits, but its effective application requires, above all, knowledge of key court rulings. It is crucial for entrepreneurs to stay up-to-date with current rulings to avoid the risk of losing the benefits of Estonian corporate income tax.

The Estonian corporate income tax model significantly improves an organization's financial liquidity. The elimination of the need to maintain current tax records in the traditional sense and the deferral of corporate income tax payments until profit distributions ensure that funds remain within the company and can be used operationally. For many businesses, this translates into greater financial stability and the ability to respond more quickly to market needs. The ability to retain earned capital within the company without immediate taxation facilitates business development, financing new projects, and scaling up ongoing and planned transactions. Increasing share capital does not immediately entail a tax burden, further strengthening the company's investment potential.

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