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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org

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FINAL REPORT

APPENDIX 9

GUIDELINES FOR FOREIGN INVESTORS

NICOM CONSULTING LTD
pl. Inwalidow 10
01-552 Warszawa

MAXWELL STAMP PLC
2 HAT & MITRE COURT
ST. JOHN STREET
LONDON EC1M 4EL

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MAXWELL STAMP PLC

APPENDIX 9

GUIDELINES FOR FOREIGN INVESTORS

CONTENTS

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GUIDELINES FOR FOREIGN INVESTORS

1. INTRODUCTION

1.1 BASIC STRATEGY

The restructuring programme prepared by Maxwell Stamp for Hydro-Vacuum SA, presents the following basic strategies in the section regarding the possible participation of a foreign partner in the restructuring (privatisation) of the enterprise.

1. The most important elements which may improve the functioning of Hydro-Vacuum are access to export sales markets and new technology.

2. The strategic direction of changes at Hydro-Vacuum is linked to the enterprise's privatisation. There should also be the participation of a foreign strategic partner in privatisation. Such involvement, however, requires major financial investment, and therefore unambiguous declarations from an investor or group of investors.

In so far as the conditions of the second strategy are met then it clearly carries with it the elements of the first strategy. However, if negotiations being carried out do not end with a decision from the foreign partner to purchase a significant shares in Hydro-Vacuum, then the realisation of the strategy may become the first stage on the route to the company's privatisation.

1.2 EXPORT SALES AND ACQUISITION OF TECHNOLOGY

In order to achieve these strategic objectives, cooperation with a foreign partner may be realised in many forms, of which the most suitable seem to be the following two options:

a) the signing of a long-term agreement on cooperation between Hydro-Vacuum and a foreign partner;

b) the creation of a joint venture company in which the activities would include, amongst others, the distribution of Hydro-Vacuum products on foreign markets and the provision of services aiming at assisting in obtaining modern technology.

1.3 PRIVATISATION

The take up of a packet of shares in Hydro-Vacuum by a foreign investor may take place only according to the procedure defined in Chapter 3 of the act dated 13th July 1990, on the privatisation of state enterprises - hereinafter referred to as the privatisation act. This procedure assumes the sale of shares belonging to the State Treasury to private investors (including foreign investors) by the Ministry of Ownership Transformations(1):

1. through tenders;
2. in the framework of a public flotation;
3. as the result of negotiations undertaken on the basis of a public invitation.

In the case of Hydro-Vacuum, the procedure assuming the sale of a controlling packet of shares as a result of negotiations conducted with a private investor by officials representing the Ministry of Ownership Transformations, would be the optimum approach.

2. CURRENT REGULATIONS REGARDING THE PARTICIPATION OF FOREIGN INVESTORS IN THE PRIVATISATION OF POLISH ENTERPRISES

2.1 MAIN REGULATIONS ON PRIVATISATION

The primary act regulating the participation of foreign investors in the privatisation process is the act dated the 13th July 1990, on the privatisation of state enterprises (Journal of Law No. 51, pos. 298, with later amendments). This act regulates the procedures for "commercialising" state enterprises, through the means of making available equity (shares) for sale in companies owned entirely by the State Treasury and the means of liquidating state enterprises with the aim of making the assets of privatised enterprises available to private entities.

The second exceptionally important normative regulation is the act dated the 14th June, 1991, on companies with foreign participation (Journal of Law No. 60, pos, 253, with later amendments). This act regulates the procedures and form of creating joint venture companies in Poland, guarantees for foreign investors regarding the transfer of assets and profits abroad, and other obligations and rights of shareholders.

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(1) The Ministry of Privatisation

The means of functioning for companies with foreign participation in Poland is also defined - besides the regulations contained in the act mentioned above - in the Commercial Code from 1934. The Commercial Code regulates in detail questions such as: the organisational structure of companies, the mutual rights and obligations of shareholders, the means of liquidation, mutual clearing and other aspects.

2.2 THE CRITICAL PATH

The critical path will vary somewhat according to the realisation of the specific strategic objectives presented in the introduction to this memorandum.

2.2.1 Cooperation Agreement

The conclusion of an agreement on cooperation does not require any detailed procedure. However, in order that it meets the strategy it should be prepared according to the example proposed below:

MODEL COOPERATION AGREEMENT

On the ..... in Warsaw
between ..... hereinafter referred to as X
and ..... hereinafter referred to as Y
an agreement on cooperation was concluded as follows:

Clause 1

The parties declare that they are prepared to fully cooperate in the spheres defined by the subject of activity for each of the parties, throughout the entire period that this agreement is in effect.

Clause 2

The detailed sphere of cooperation will be established by the suitably authorised representatives of the parties for each year of cooperation no later than November of the preceding year.

Clause 3

1. The subject of cooperation will in particular be the joint promotion and sales in Poland and abroad of products manufactured by each of the Parties.

2. With this aim in mind, X undertakes to make available information on Y's products (folders, prospectuses, technical descriptions and advertising material) in its distribution network, promotional and marketing offices and controlled by it, irrespective of the names, and also to indicate in its own advertising materials that it cooperates with Y.

3. Y undertakes to conduct the promotion of X's products in Poland, to make available all information on these products to any interested party by its own distribution and advertising network and controlled by it, as well as indicate in its advertising materials that it cooperates with X.

Clause 4

Each of the parties undertakes to accept orders for the products of the other party and to deliver them to customers through its own distribution network.

Clause 5

The realisation of the duties arising from Clause 4 shall be carried out by each of the parties according to the conditions defined in a separate contract. These contracts may not, however, define conditions less favourable for the contractor than the conditions on which each of the parties sells its products through intermediaries, agents or commission agents, or conditions which are offered to any other distributors in any other country.

Clause 6

Each of the parties undertakes to grant the other party access to its commercial and technical information. However, information constituting a production secret may be granted to each of the parties for a fee according to financial conditions no less favourable then granted to other entities.

Each of the parties undertakes that, if it is the wish of the other party, it will not make available to any other person the information obtained on the basis of Clause 6 of this agreement.

2.2.2 New Joint Venture (Subsidiary) Company

In the event of the creation by a foreign investor of a joint venture with Hydro-Vacuum, the following steps will have to be taken:

1. Preparing a draft founding deed for the company (the articles of association for a limited liability company or the statutes for a joint stock company).

2. The drawing up of the articles of association or the statutes by a public notary.

3. Signing the documents in the presence of a public notary.

4. Making the contributions from shareholders for covering shares (equity) in the company.

5. Appointing the members of the company's bodies.

6. Submitting an addition to the court of registration for the company's incorporation.

The whole procedure is relatively straightforward and in general does not require the consent of a state administrative body at any of its stages.

However, it should be clearly pointed out here that it is inadvisable that a company created according to this procedure should be created by an in-kind contribution from the Polish partner.

The reason is that in such a situation the additional consent of the Minister for Ownership Transformations would be required, and where there would be a majority holding by a foreign partner, the consent of the Minister of Internal Affairs is also required, which would significantly prolong the procedure of creating the company. This is why it would be advisable to cover the contribution made by the Polish partner exclusively in cash.

The contribution of the foreign partner may be made:

1. in Polish currency originating from the sale in a foreign currency bank of convertible currency, and using the currency exchange rates announced by the National Bank of Poland

2. in non-cash form on condition that it is brought from abroad (it is then exempt from customs payment) or acquired for Polish currency obtained by the foreign partner from the sale of foreign currency in a foreign currency bank.

Polish law does not define the minimum size of the contribution required from a foreign partner. The commercial code only defines the requirements with regard to the minimum size of the founding capital for a limited liability company (a minimum of 40,000,000 zloty, i.e. about US$2,500) and for a joint stock company (a minimum of 1,000,000,000 zloty, i.e. about US$60,000).

There are no legal limitations regarding the degree of control in a joint venture company by the foreign partner. He may hold more than 50% of the shares (equity), without the necessity of gaining any consent for this, even if the remaining part of the shares (equity) in this company belongs to the State Treasury.

The creation of a company with an exclusively foreign shareholding is possible. A foreign partner may also buy out all the shares (equity) belonging to Polish partners in a company. The procedure of creating a joint venture company usually lasts about one month unless a problem occurs that requires the consent of one of the administrative bodies indicated above. This usually prolongs the process by 2-3 months.

The partners are obliged to pay the following fees connected with the creation of a company:

1. A notary tax, the size of which is dependent on the size of the company's founding capital:

   a) up to 100,000,000 zl - 3% of the capital;

   b) over 100,000,000 zl up to 200,000,000 zl - 3,000,000 zl + 2% of the excess over 100,000,000 zl;

   c) over 200,000,000 zl up to 500,000,000 zl - 5,000,000 zl + 1% of the excess over 200,000,000 zl;

   d) over 500,000,000 zl - 8,000,000 zl + 0.5% of the excess over 500,000,000,zl.

   The tax cannot in principle exceed 50,000,000 zl.

2. A treasury fee, amounting to:

   a) where the company's capital is below 100,000,000 zl - 2% of the capital;

   b) from 100,000,000 zl up to 200,000,000 zl - 2,000,000 zl + 1% of the excess 1,000,000 zl;

   c) from 200,000,000 zl up to 300,000,000 zl - 3,000,000 zl + 0.5% of the excess over 200,000,000 zl;

   d) over 300,000,000 zl - 3,500,000 zl + 0.1% of the excess over 300,000,000 zl.

3. An entry fee for the application for incorporating the company - 300,000 zl.

   The dollar rate on the 10th March 1993 - US$1 = 16,500 zl.

The commercial code states that the most important resolutions of the assembly of shareholders in a limited liability company are passed with a majority of 2/3 of the votes, and the most important resolutions of the assembly of shareholders in a joint stock company, with a majority of 3/4 of the votes, unless the articles of association or the statutes of the company foresees more stringent requirements in this sphere. Less important resolutions are passed with an absolute majority of the votes cast (50% + 1).

2.2.3 Foreign Acquisition of a Polish Company

In the event of a decision being made on the participation of a foreign investor in the privatisation of Hydro-Vacuum, the privatisation process should proceed as follows:

1. On an application from the director and workers council, the Minister of Ownership Transformations will carry out the transformation of the enterprise into a joint-stock company owned entirely by the State Treasury (the application for "commercialisation" must include the opinion of the general assembly of employees at the enterprise and the founding body). This has been achieved for Hydro-Vacuum.

2. From the moment the company is entered into the commercial register a two year period commences during which the equity belonging to the State Treasury should be sold to private investors.

3. The sale of equity in Hydro-Vacuum should be carried out as a result of negotiations which a private investor conducts at the Ministry of Ownership Transformations (the negotiations are preceded by the preparation of a valuation of the enterprise). The sales agreement should be drawn up in the form of a notary deed. The parties to the agreement are obliged to pay a notary tax and treasury fee.

4. On the strength of the privatisation act, 10% of the equity in the company shall be acquired free of charge by the employees of Hydro-Vacuum. The law also guarantees them the right to purchase a further 10% of the equity on preferential conditions. As a result of this, a foreign investor will theoretically only be able to purchase up to 80% of the equity in the company, unless the employees do not fully take advantage of their right to purchase the 10% of shares on preferential conditions. However, in practice it may turn out that a foreign investor will only be offered for sale less than 80% of the equity in a company as the State Treasury frequently retains a certain amount of the equity with the aim of retaining an influence on the activities of companies coming into being as a result of state enterprises being privatised.

The experience of existing practice shows that capital privatisation takes place over a relatively long period of time (occasionally over 6 months). Frequently delays result from the postponement of negotiations at the Ministry of Ownership Transformations, which is found to be connected with attempts by the Polish side to encourage foreign investors to accept additional liabilities in the areas of investment and social issues. It should be recognised that sometimes the equity price is fixed at a relatively modest level, but correspondingly it contractually obliges investors to additional investments in the enterprises acquired. In certain cases, there have been cases of clauses in contracts prohibiting foreign investors from carrying out large reductions in employment over a fixed period.

A foreign investor in deciding on this acquisition route should be aware of the likelihood of the occurrence of a variety of issues during negotiations, which in practice are impossible to avoid.

For this reason, this means of preceding is the most time absorbing, costly and its result may not necessarily be favourable for the investor.

2.2.4 Summary of Alternatives

A LONG-TERM CONTRACT ON COOPERATION	
STRENGTHS	**WEAKNESSES**
1. The simple procedure.	1. A solution not leading to capital ties.
2. The short period of realisation.	2. Lack of influence on the functioning of Hydro-Vacum.
3. The minimal risk for the foreign investor.	3. Limited opportunity of fully achieving satisfactory economic results.
4. Ease of withdrawing from the venture.	
5. Minimal costs.	

A JOINT VENTURE COMPANY	
STRENGTHS	**WEAKNESSES**
1. The creation of an independent legal person.	1. Significant costs.
2. The relatively short period for realisation.	2. Unsatisfactory influence on the functioning of Hydro-Vacum.
3. The creation of capital ties with the Polish partner.	3. Incurring risk in operating on an unstable market.
4. The possibility of expansion on the Polish market.	
5. The minimal dependence on administrative consent.	

CAPITAL PRIVATISATION	
STRENGTHS	**WEAKNESSES**
1. The possibility of ensuring control over the activities of Hydro-Vacum.	1. The large risks of the operation.
2. The potentially greatest chances of achieving significant financial success.	2. The unpredictable duration of procedures (typically fairly long).
3. The creation of significant support and infrastructure for further activity in Poland.	3. The possibility of encountering problems during negotiations.
	4. The large number of issues requiring administrative consent.
	5. The extremely high costs.

3. PRIVATISATION IN RELATION TO FOREIGN INVESTORS - FACTORS FOR CONSIDERATION BY FOREIGN COMPANIES

In the basic directions for privatisation for 1993 proposed to Parliament, the need for a clearer intensification and acceleration of privatisation processes in Poland is emphasised. The budget act passed recently assumes obtaining revenues from sales, lease and rental of asset components belonging to the State Treasury of about 8,800,000,000,000 zl. This fact indicates the intention to significantly increase budget revenues as a result of privatisation activities.

In the near future the passing of an act on general privatisation and reprivatisation is anticipated. The government is evidently anticipating that the programme for general privatisation will interest foreign investors. Hitherto their involvement in capital privatisation has been regarded unsatisfactory. This has resulted in part from favouring in government agendas the priority of privatisation through liquidation, which in practice cannot be used in the privatisation of large enterprises. This fact caused a noticeable standstill in the privatisation of large companies in 1992.

Foreign investors are deterred in particular by the excessive demands of the Polish party with regard to the forms of payment for equity purchase, the limited chances of obtaining tax concessions and setting off in instalments for the payment of equity, the long period of negotiations and the placing in sales agreements of clauses introducing additional conditions of a social nature (maintaining the size of employment throughout a fixed period of time, investment obligations, the financing of buildings and social services at an enterprise).

It should be noted that foreign investors are in practice the only entities undertaking negotiations regarding the purchase of equity in large enterprises. Polish private capital does not constitute any competition whatsoever due to the meagreness of domestic financial resources.

4. SELECTED CONDITIONS OFFERED TO FOREIGN INVESTORS BY POLISH LAW

Presented below are selected legal conditions for the functioning of companies with foreign participation.

4.1 THE TAX LIABILITIES OF COMPANIES WITH FOREIGN PARTICIPATION

As entities subject to Polish law, companies with foreign participation are subject to the same tax regulations as other entities on the market.

The basic tax burdens are:

1) income tax on legal persons, regulated in the act dated 15th February 1992 (Journal of Law from 1993, No. 21, pos.86).

2) tax on goods and services, regulated in the act dated 8th January 1993 (Journal of Law from 1993, No.11, pos.50).

The subject of taxation by income tax is the income achieved in the tax year, that is the excess of sums of revenue over the costs incurred. The basic rate for the tax amounts to 40% of the income achieved. Only for tax on incomes from dividends paid to legal persons for their participation in the profits of other legal persons with their registered office in Poland, and for tax on revenues achieved from copyright, inventions, trade marks, designs and know how, does the tax amount to 20%. It should be emphasised that the amount of tax paid from dividends may be deducted by a tax payer from the amount of tax calculated using the 40% rate if, of course, apart from capital investments in other legal person, the tax payer conducts a different economic activity.

On the 5th July 1993 the regulations of the act on tax for goods and services (VAT) will come into effect. The subject of taxation is sales, i.e. the amount due from the sale of goods, reduced by the amount of tax paid by entities involved earlier in the production cycle. The tax rate amounts to 22%, whilst in the export of goods and services is 0%. The 0% rate should not be confused with exemption from this tax as in the event of exports a tax payer may, by applying this rate, apply for a tax refund for tax paid by the predecessors in the sales chains which does not occur in the event of exemption from taxation.

4.2 PREFERENCES FOR FOREIGN INVESTORS WITH REGARD TO INVESTMENT

Companies with foreign participation may obtain (on the basis of an individual decision from the Minister of Finance) a periodic exemption from income tax. In order for a company to obtain this

exemption, the foreign shareholders should contribute to the founding capital or equity a contribution in convertible currency the equivalent of no less than 2,000,000 ECU, converted into Polish currency according to the purchase rate announced by the National Bank of Poland on the date of making the contribution or of covering the equity, and in addition the company should meet at least one of the following conditions:

1. conduct activity in regions particularly threatened by a high level of structural unemployment;

2. ensure the introduction of new technologies in the national economy;

3. ensure the sales of goods and services for export to an amount no lower than 20% of the total value of sales.

This exemption may be given only to those companies in which foreign entities make their contribution to the founding or equity capital by the 31st December 1993.

This exemption can also be taken advantage of by companies in which foreign investors carry out the purchase from the State Treasury of equity or shares, wherein the value of the transaction should also amount to at least 2,000,000 ECU.

Decisions on granting exemptions are taken on the individual application of interested companies by the Minister of Finance, after the Minister of Ownership Transformations and the relevant minister for the particular industry have previously given their opinions.

The amount of relief from income tax from this may not exceed the value of the transaction of acquiring equity or shares from the State Treasury or the equivalent contribution to the founding or equity capital made by a foreign shareholder.

The regulations of the act do not define the duration of exemptions. It is defined each time individually in the decision of the Minister of Finance.

Foreign investors may apply to the Minister of Finance for a promissory note i.e. a decision in which they will be promised an exemption from income tax.

It should also be stressed that the in-kind contributions made by foreign partners to cover their shares or equity in companies, take advantage of exemptions from the payment of duty on condition that they are not disposed of by the company within three years.

If during the income tax exemption period, and during a two year period from the lifting of the exemption, the liquidation of the company is commenced or a lowering in its capital occurs, then the company will be obliged to pay the tax for the entire period of the exemption period.

4.3 THE TRANSFER OF PROFITS

In Poland the principle of full transfer by foreign entities of incomes from participation in companies is in effect. These entities have the right, after paying the tax on dividends due, to purchase in a foreign currency bank foreign currency for the amount paid out to them in the division of profits, as well as to transfer abroad the full amount without a separate foreign currency consent. The purchase of foreign currency is carried out on the basis of a named certification issued by the chartered auditor who has conducted the inspection of the company's balance sheet.

In establishing the size of taxation on dividends for a foreign partner, the provisions of agreements regarding the avoidance of double taxation signed by Poland with other states should be taken into account. It should be mentioned at the same time that incomes from participation in companies being legal persons spent during the tax year on acquiring shares or equity from the State Treasury or for the purpose of purchasing bonds, are free from income tax on condition that they are not disposed of until the end of 1993. In addition incomes from the sale of shares or equity in companies are free from income tax in 1993. This regulation is to be shortly extended to 1995.

Irrespective of the transfer of profit, foreign investors have the right, after paying due taxes, to purchase in a foreign currency bank, foreign currency and transfer it abroad without separate foreign currency consent for:

1. the amount achieved from the sale or remission of shares or equity in a company;

2. the amount due to them in the event of the liquidation of a company;

3. the amount achieved as compensation for expropriation or use of other means giving rise to effects equal to expropriation.

The right to transfer abroad the entire nett wages (i.e. after deducting the personal tax due) of foreign employees of company goes together with the unrestricted transfer of incomes of foreign partners. In accordance with foreign currency law, a company may only pay employees their wages in Polish currency, these employees have the right to purchase in a foreign currency bank foreign currency amounting to the value of their wages for work at the company.

4.4 GOVERNMENT GUARANTEES FOR FOREIGN INVESTORS

Every foreign investor is guaranteed under current regulations to compensation amounting to the size of the investor's share in the company's assets if he incurs damages as a result of expropriation or the application of other means giving rise to effects equal to expropriation. This principle affects only those investors whose national law applies a similar principle with regard to potential Polish investors.

Every foreign investor may apply to the Minister of Finance with an application to grant him a written guarantee for the payment of compensation.

The detailed principles for the payment of compensation to investors are defined by agreements on protecting and mutual support of investments concluded by Poland.

It should be reminded that compensation, free of any taxation, may be fully transferred abroad (in foreign currency, of course).

4.5 THE ACQUISITION OF PROPERTY BY FOREIGN INVESTORS

The acquisition of property by companies with foreign participation, in which the foreign partners directly or indirectly hold at least 50% of the capital, is regulated by the act of 24th March 1920, on the acquisition of property by foreigners. According to this act, the consent of the Minister of Internal Affairs, issued on an understanding with the Minister of National Defence and other appropriate ministers, is required for the purchase of property by a company controlled by foreign entities. The consent is valid for one year. If during this period a public notary does not draw up a deed of sale then it loses its effect.

The acquisition of property without consent or after the period of validity has expired, is legally null and void.

As in-kind contribution to a company is also connected with the transfer by a partner of ownership rights to the company, then if the in-kind contribution is property and a majority holding in the company is held by foreign partners, before making the in-kind contribution consent should also be obtained from the Minister of Internal Affairs. If this in-kind contribution is to be contributed by a state legal person then in addition the consent of the Minister of Ownership Transformations is required if the in-kind contribution is the enterprise itself, a part of it capable of performing economic tasks, or property.