https://doi.org/10.18778/1509-877X.2015.04.01

Artykuły

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Taxation of Capital Investment Income in DTCs concluded by Poland with the Czech Republic, Hungary and Slovakia – Recent Developments

1. Introduction

Poland is a party of 86 DTCs with respect to the elimination of double taxation of income and capital and for the prevention of tax evasion (comprehensive tax treaties). Starting from the early 1970. and 1980. up to now, Polish treaty practice is based on the OECD Model Convention on Income and Capital (hereafter: the OECD MC).[1] However the influence of some recommendations characteristic for the UN Model Convention on Elimination of Double Taxation between Developed and Developing Countries (hereafter: the UN Model) is also clearly visible despite to the fact whether the treaties in question were concluded before Poland's membership in the OECD or after or whether or not the other contracting state is the OECD

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[1] W. Wijnen, J. de Goede, *The UN Model in Practice 1997–2013*, p. 131. See: http://www.oecd.org/ctp/treaties/2014-model-tax-convention-articles.pdf (accessed: 24 April 2016).

on non-OECD MS. [2] This is true also in case of DTCs concluded by Poland with the Czech Rep., Hungary and Slovakia.[3]

From the perspective of development of the Polish treaty practice, three periods can be distinguished.

1) first period covers DTCs concluded by Poland before political and economic transformation initiated in 1989[4];
2) second period covers DTCs concluded by Poland or changed by the amending protocols after 31 December 1989 and before its membership to the OECD on 22 November 1996, and
3) third period covers DTCs concluded or changed by the amending protocols after Poland became the OECD Member State on 22 November 1996 – up to recent years.

Before joining the OECD, Poland concluded the vast majority of its DTCs, including DTCs with the Czech Rep. in 1993 (hereafter PL-CZ DTC)[5], Hungary in 1992 (hereafter: PL-H DTC)[6] and Slovakia in 1994 (hereafter: PL-SK DTC).[7] After joining the OECD, Poland systematically

[2] Z. Kukulski, *Konwencja Modelowa OECD i Konwencja Modelowa ONZ w polskiej praktyce traktatowej*, Lex a Wolters Kluwer business, Warszawa 2015, pp. 355–367 and cf. *Umowy o unikaniu podwójnego opodatkowania*, ed. M. Zasiewska, A. Oktawiec, J. Chorązka, ABC a Wolters Kluwer business, Warszawa 2011, pp. 111–114; K. Prazuch, *Poland*, [w:] *Recent tax treaty developments around the globe*, ed. M. Lang, t. 59, Wien 2009, pp. 331–335.

[3] In DTCs concluded by Poland with the Czech Rep., Hungary and Slovakia many provisions based on the UN Model can be distinguished. These include i.e. furnishing of services provision in Article 5 (3)(b) of the PL-CZ DTC, the corresponding adjustment exclusion as provided in Article 9(3) of the PL-CZ DTC, exclusive source state taxation of pensions and other similar remuneration paid made under a public scheme which is a part of the social security system of a source state, instead of residence-state taxation as recommended by the OECD, as provided in Article 18 of the PL-H DTC as amended by the amendibng protocol signed on 27 June 2000.

[4] For the analysis purposes the date of 31 December 1989 is appointed as the starting point of the transformation of Polish tax treaty practice after the communist regime era.

[5] Agreement between the Republic of Poland and the Government of the Czech Republic for the avoidance of double taxation with respect to taxes on income and capital signed in Warsaw on 24th June 1993.

[6] Convention between the Republic of Poland and the Republic of Hungary for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, signed in Budapest on the 23rd day of September 1992.

[7] Agreement between the Republic of Poland and the Government of the Slovak Republic for the avoidance of double taxation with respect to taxes on income and capital signed in Warsaw on 18th August 1994.

continues to expand its tax treaty network adopting it to the recent OECD's developments – via amending the existing tax treaties through the amending protocols, including DTCs with Hungary – amended in 2000[8] and with Slovakia – amended in 2013[9], or via concluding the new tax treaties – as it took place in case of the PL-CZ in 2011.[10] It is worth to mention that after Poland joined the OECD, not only DTCs with the Czech Rep., Hungary and Slovakia were amended or replaced by the new tax treaties, also other tax treaties concluded by Poland with the other OECD MS and non-OECSD MS: Austria, Belgium, Denmark, Island, Luxembourg, Norway, South Korea, Switzerland and the US were renegotiated. Moreover, due to the growth of tax avoidance practices with some EU MS, Poland changed some neuralgic provisions in the tax treaties in force (i.e. immovable property clause in PL-SK DTC, complex exchange of tax information clauses based on the current wording of Article 26 OECD MC, overriding the banking secrecy (Article 26 (5) of the OECD MC) in DTCs with the Czech Republic and Slovakia, *switch-over* clause provided in Article 23A(4) of the OECD Model in DTCs with Luxembourg and Slovakia and limitation of benefits clause (LOB clauses) which start to be present is some recently signed DTCs or changed *via* the amending protocols, including DTCs with Belgium, India, Israel, Saudi Arabia, South Korea, Sweden, United Arab Emirates, Slovakia.

[8] The PL-H DTC was signed before both countries joined the OECD. However, the amending protocol to the treaty signed on June 2000 changed the allocation rule of taxing rights between the contracting states with respect to pensions (Art. 18). Before the change, the PL-H DTC followed the OECD Model's recommendations (exclusive right to tax attributed to the country of residence of the recipient). The amending protocol introduced the rule clearly based on the UN Model's recommendations: pensions paid within the social security scheme are taxable only in the source state.

[9] Protocol, signed on 1st August 2013, between the Republic of Poland and the Slovak Republic amending the Agreement between the Republic of Poland and the Slovak Republic with respect to taxes on income and on capital, singed at Warsaw on the 18th August 1994.

[10] Agreement between the Republic of Poland and the Czech Republic for the avoidance of double taxation and for the prevention of fiscal evasion with respect to taxes on income, signed in Warsaw on 13th September 2011.

2. Dividend taxation in DTCs between Poland and the Czech Rep., Hungary and Slovakia

In general dividend taxation in DTCs concluded by Poland with the Czech Rep., Hungary and Slovakia is based on the provisions of Art. 10 (1) and (2) of the OECD Model. However, DTCs with the Czech Rep. and Hungary provide single reduced rate of withholding tax on dividends (5% PL-CZ DTC and 10% PL-H DTC). Contrary the DTC between Poland and Slovakia – before the amending protocol was signed in 2013 – followed the OECD Model's recommendations. It reduced the rates of withholding tax on dividends up to 5% (interoperate dividend payments) and 15% (all other cases). The amending protocol provides: zero rate applicable to dividends received by a company (other than a partnership) who is a **beneficial owner** of such payments which **holds directly at least 10%** of the capital of the company paying the dividends on the date the dividends are paid and has done so or will have done so for uninterrupted **24-months period** in which that date falls (participation exemption – PS Directive). Same provision was adopted in DTCs recently concluded or changed via amending protocols with some EU and EEA MS: i.e. Cyprus, Denmark, Ireland, Luxembourg, Malta, Norway, Switzerland and the UK (minimum holding requirement might be different depending on the treaty in question).[11]

3. Interest taxation in DTCs between Poland and the Czech Rep., Hungary and Slovakia

DTCs concluded by Poland with Czechia, Hungary and Slovakia follow also the OECD Model's provisions in respect to the elimination of double taxation of interest. However the recommended reduced rate of withholding tax is lower – 5%, except DTC with Hungary where is the same as in the OECD MC[12].

One of the constant feature of the Polish treaty practice is the presence in many DTCs, including treaties with Czechia, Hungary and Slovakia of

[11] See: M. Wilk, *Klauzula rzeczywistego beneficjenta (beneficial owner) w międzynarodowym prawie podatkowym,* LEX a Wolters Kluwer SA, Warszawa 2015, pp. 286–292.

[12] For example: DTC between Poland and Georgia reduces the withholding tax rate on interest up to 8%, while some DTCs fix the minimum withholding tax rate at the level not exceeding 12% (DTCs with Egypt and Tunisia) or 15% (DTCs with Chile and Uruguay).

a special provisions granting the exemption from taxation at source of certain categories of interest. This provision is not based either on the OECD or on the UN Models. Such exemption usually applies to interest paid to / or by / or guaranteed by/ the government of the other contracting state, including any political subdivision or local authority thereof, the central bank or any financial institution owned or controlled by that government. Some DTCs, including tax treaty with the Czech Republic extend the scope of this exemption to interest on any loan or credit of whatever kind granted by a bank. Similar provision is present in Poland's DTCs with Austria, Belgium, Denmark, Ireland, Finland, Germany, Norway and the UK.[13]

4. Royalties taxation in DTCs concluded by Poland with the Czech Rep., Hungary and Slovakia

Polish tax treaty practice follows the UN Model in respect to elimination of double taxation of royalty payments. The UN Model does not provide any recommendations with respect to maximum withholding tax rates. As a rule, DTCs reduced the withholding tax rates on royalties up to 10% or 5%. This is also the case of DTCs concluded by Poland with the Czech Rep. (10%), Hungary (10%) and Slovakia (5%).

DTCs concluded by Poland, including DTCs with the Czech Rep., Hungary and Slovakia, follow also the UN Model recommendations with respect to the definition of royalties. Article 12(3) of the UN Model broadens the scope of the term "royalties" on payments of any kind received as a consideration for the use or right to use **films or tapes used for radio and TV broadcasting** and on payments for the use and or right to use **industrial, commercial and scientific equipment (leasing of equipment)**. This typical UN Model provision is present in more than 80% of DTCs concluded by Poland, and it creates a lot of practical issues I will discuss later. Moreover, the protocol amending the PL-SK DTC broaden behind the UN Model's definition of royalties. This term as used in the PL-SK DTC covers payments of any kind received as a consideration for the use of, or the right to use, **any copyright** (encompassing literary, artistic or

[13] See also: Z. Kukulski, *Klauzula zwalniająca odsetki w związku z pożyczką udzieloną przez bank zagraniczny w umowach o unikaniu podwójnego opodatkowania zawartych przez Polskę*, „Kwartalnik Prawa Podatkowego" 2009, Nr 2, pp. 49–68.

scientific work including cinematograph films and films or tapes for television or radio broadcasting). It is clearly visible that it is not a closed catalogue, as recommended by the UN Model, but the exemplification only.

5. The Application of DTCs concluded by Poland with the Czech Rep., Hungary and Slovakia – Recent Developments

5.1. Taxation of profits distributed by a joint-stock partnership established in Poland to its Slovak shareholder (komanditná spoločnost)

Until the 31st December 2013, joint-stock partnerships incorporated and registered in Poland were fiscal transparent entities. Profits distributed to their shareholders were taxable in their hands only. Before Poland changed its CIT regime issues related with the proper qualification for taxation purposes of profit distribution made by a joint-stock partnerships to their shareholder created a lot of practical problems.

In the case I SA/Po 1268/15 of 28 August 2015, the Regional Administrative Court in Poznań[14] during the reconsideration of the case has decided that in the light of the CITA provisions in force at the time of the case, Slovak shareholding in a Polish joint-stock partnership constituted a P.E. within the meaning of Article 5(1) of the PL-SK DTC. This issue was decided by the Supreme Administrative Court in a similar case of 17 May 2013 (II FSK 1894/11) on the basis of the DTC between Poland and Cyprus.[15] According to the Court, the concept of the P.E. contained in Art. 5(1) and 5 (2) of the PL-SK DTC is broad enough to cover different organizational forms of conducting business activity as well as different manifestations of such activity. This abstractive concept of international tax law makes possible the proper allocation of taxing rights between two contracting states with respect to business income and as such does not lead to the establishing any new entity (taxpayer) in a source state.

Joint-stock partnership applying for an individual tax ruling argued with tax authorities whether it should act as a withholding agent with

[14] Judgment of the Regional Administrative Court in Poznań I SA/Po 1268/15 of 28 August 2015, http://www.orzeczenia.com.pl/orzeczenie/ugu00/wsa,I-SA-Po-1268-15,podatek_dochodowy_od_osob_prawnych_interpretacje_podatkowe/4/ (access on: 17.10.2016).

[15] Judgment of the Supreme Administrative Court II FSK 1894/11 of 17th May 2013, http://orzeczenia.nsa.gov.pl/doc/F5E9E647DA (access on: 17.10.2016).

respect to dividend distribution made to its Slovak shareholder (limited partnership – **komanditná spoločnost**). In applicant's opinion, such profits (called according the Code of Commercial Companies – dividend) could not be classified for taxation purposes as dividends (within the meaning of Article 10 (3) of the PL-SK DTC) or even as business profits (within the meaning of Article 7 of the PL-SLO DTC). It should be rather regarded as "other income" within the meaning of Article 22 of the PL-SK DTC. Therefore Polish joint-stock partnership – due to the fact of being a **fiscal transparent entity** – was not obliged to act as a withholding agent and collect a tax on dividends, because such income was exclusively taxable in the country of shareholder's residence. In order to sustain its point of views, the applicant claimed that according to the wording of Article 10(3) of the PL-SK DTC the term "dividend" means income form shares as well as income from other corporate rights which was subject to the same taxation treatment as income from shares by the tax law of the State of which the company making the profit distribution.

Moreover, the applicant argued also that such profits cannot be classified also for taxation purposes as business income from sources located within the territory of Poland, due to the fact that shareholding as such and participation in joint-stock partnership's profits could not be regarded as conducting of business activity in Poland, which is a **crucial element** of the concept of P.E. Similar position was adopted by the Supreme Administrative Court in resolution II FPS 1/11 of 16.01.2012.[16]

The Regional Administrative Court dismissed the complaint argumentation and sustained the contrary position presented by tax authorities.

In the case I SA/Po 1127/14 of 27 May 2015, the Regional Administrative Court in Poznań[17] upheld the taxpayer's position and decided that – in the light of the CITA in force since 1st January 2014 – dividend payment made from the future profits by a joint-stock partnership to its Slovak shareholder (limited partnership - **komanditná spoločnost**) is taxable at source at the rate of 5% as provided in Article 10(2) of the PL-SK DTC. Therefore there is no doubts that a joint-stock partnership incorporated and registered in Poland, having since that date the status of CIT-payer must fulfill its

[16] Resolution of the Supreme Administrative Court II FPS 1/11 of 16.01.2012, http://orzeczenia.nsa.gov.pl/doc/3447C0D267 (access on: 17.10.2016).

[17] Judgment of the Regional Administrative Court in Poznań I SA/Po 1127/14 of 27 May 2015, http://www.orzeczenia-nsa.pl/wyrok/i-sa-po-1127-14/podatek_dochodowy_od_osob_prawnych_interpretacje_podatkowe/1a852e4.html (access on: 17.10.2016).

withholding agent's duties. The dispute in this case concerned a different issue than a proper income qualification for taxation purposes (transitional periods of application of the CIT regime to joint-stock partnerships).

5.2. Royalty payments and problems related with proper income qualification for taxation purposes

Broad definition of royalties, based on Article 12(3) of the UN Model, leads also to many practical issues related to the proper application of DTCs concluded by Poland with the Czech Rep., Hungary and Slovakia.

In case I SA/Po 1264/00 of 21st August 2001 the Supreme Administrative Court in Poznań[18] dismissing taxpayer's complain, has decided that **fees** paid for the guarantee services for the **purely technical assistance or consultancy services** provided by engineers, attorneys and accountants constitute royalty payments within the meaning of Polish domestic tax law and therefore Article 12(1) and (2) of the PL-H DTC shall apply. According to the Court, "know-how" is the information concerning the way of production not covered by patents or license agreement because of its non--inventive nature. This term covers also technical knowledge and special properties discovered by a producer as the result of scientific research carried on independently from the competitors and not disclosed for public. Moreover, it is considered that know-how provider is obliged neither to performance any active role in the course of application of the available formula nor to guarantee positive results of its application.

It is also worth to mention that neither PL-H DTC nor PL-SK DTC contain the furnishing of services provision – as recommended by Article 5(3) letter b) of the UN Model, otherwise different qualification of such fees – as business income – for taxation purposes might be possible. This provision is present only in Article 5(3)(b) the PL-CZ DTC. It provides that the term "permanent establishment" also encompasses the furnishing of services, including consultancy or managerial services, by an enterprise of a Contracting State or through employees or ether personnel engaged by the enterprise for such purpose, but only where activities of that nature continue in the territory of the other Contracting State for

[18] Judgment of the Supreme Administrative Court in Poznań I SA/Po 1264/00 of 21st August 2001, http://www.orzeczenia.com.pl/orzeczenie/ukrre/nsa,I-SA-Po-1264-00,podatki_i_inne_swiadczenia_pieniezne_do_ktorych_maja_zastosowanie_przepisy_ordynacji_podatkowej/ (access on: 17.10.2016).

a period or periods **exceeding** in the aggregate six months within **any** twelve month period.[19]

In DTCs concluded by Poland with the Czech Rep., Hungary and Slovakia, the term "royalties" covers also consideration for the use or for the right to use of industrial equipment (leasing of equipment), as recommended by Article 12(3) of the UN Model.

In case II FSK 816/12 of 13th March 2014, the Supreme Administrative Court in Warsaw[20] upheld the complain of the Slovak non-resident taxpayer involved in sale and leasing of rail wagons and spare parts to Polish contactors. The Court decided that the term "industrial equipment" is not defined in the DTC in question, however according to Article 3(2) of that treaty (terms not defined) it should have the meaning it has at the time under the domestic law of the State to which the treaty applies. Article 21(1)(1) of the CITA *expressis verbis* covers consideration for the use of means of transport as royalty payments.

Similar issues were decided by the Regional Administrative Court in Warsaw in case III SA/Wa 3346/14 of 9th June 2015[21] where the Court also sustained taxpayer's complain. In the Court's view, definition of "royalties" contained in DTCs concluded by Poland with Germany, the UK and the Czech Rep., does not cover *expressis verbis* consideration for the use or for the right to use computer programs, but payments of **any kind** received as a consideration for the use or the fight to use **any copyrights** of literary, artistic or scientific works. Fact that computer program is protected by the copyrights laws in the same manner as literary, artistic or scientific work, does not itself authorizes to consider remuneration paid for the use of it as royalties for taxation purposes. Moreover, according to the Polish Copyright Act, computer programs are listed as a separate category of works protected alongside literary, artistic and scientific works.

In that case, Polish resident CIT-payer applying for an individual tax ruling, pointed out that in the core of its business activity purchases computer programs from its foreign partners (including Czech partners).

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[19] W. Wijnen, J. de Goede, *The UN Model…*, p. 120; see also: D. Mączyński, *Międzynarodowe prawo podatkowe*, Lex a Wolters Kluwer business, Warszawa 2015, pp. 71–75.

[20] Judgment of the Supreme Administrative Court in Warsaw of 13th March 2014, http://www.orzeczenia.com.pl/orzeczenie/5ok6g/nsa,II-FSK-816-12,podatek_dochodowy_od_osob_prawnych/ (access on: 17.10.2016).

[21] Judgment of the Regional Administrative Court in Poznań III SA/Wa 3346/14 of 9th June 2015, http://orzeczenia.nsa.gov.pl/doc/40BC93EECC (access on: 17.10.2016).

According to the license agreement, computer programs are delivered on the electronic carrier and it is not possible to install them on the taxpayer's servers, modify or copy them. Polish taxpayer is allowed to use them solely for its own purposes. However, in order to realize some engineering projects, taxpayer is allowed to share the computer stations were these programs were installed with his business partner for a consideration. Taxpayer's business partner may access these programs only in taxpayer's seat (in fact he has the possibility to use these programs).

Tax authorities disagreed with taxpayer's position. In their point of view, fact that taxpayer may use these programs only for his own use without right to distribute them **does not preclude such payments to be classified for taxation purposes as royalties.** In tax authorities opinion, computer programs are protected in the same manner as any literary, artistic or scientific works, which are mentioned *expressis verbis* in Article 12(3) of PL-CZ DTC. The Court dismissed this argumentation and sustained taxpayer's claims and qualified payments made by the taxpayer as business income. However, in my opinion, the judgment in this case was clearly based on the literary interpretation of Article 12(3) of – *inter alia*- the PL-CZ DTC only and possibly could lead to double taxation if contrary approach (theological interpretation) would have been applied by tax authorities of the other contracting state. In the nearest future, DTCs will face the constant threat caused by the challenges of the digital economy that definitely will affect the application of DTCs[22].

Conclusions

The Czech Rep., Hungary, Poland and Slovakia share similar experience of political and economic transformation initiated in late 80. and early 90. of the last century. Each of these countries due to their membership in the OECD and in the EU had to adopt their domestic tax systems and tax treaty policy to the standards of Western democracies.

The Czech, Hungarian, Polish and Slovak tax treaty network is impressive and constantly developing. Recent trends and challenges elaborated by the OECD influence these countries' tax treaty policy and are visible also in their DTCs. Especially, elimination of double taxation with respect to capital investment income follows the OECD Model. However, some

[22] See: T. Rosembuj, *Taxing Digital*, el Fisco- G.L.E.T.S.L., Barcelona 2015, pp. 30–39.

UN Model's recommendations, especially these aimed on protection of sourced-income taxation (i.e. royalties) have their strong impact on DTCs concluded between Poland and the Czech Rep., Hungary and Slovakia.

Different domestic tax law solutions with respect to fiscal transparency of partnership and recently introduced new approaches into Polish CIT-regime have strong influence on the application of some of DTCs concluded by Poland with some of these countries, especially PL-SK DTC. Before Poland changed its CITA in 2013, hybrid status of Polish joint-stock partnership created many practical problems with the proper qualification for taxation purposes of income distributed by that entity to its foreign shareholders. Same interpretation problems were caused by the broad definition of royalties based on Article 12(3) of the UN Model and adopted in many DTCs concluded by Poland, including tax treaties with the Czech Rep., Hungary and Slovakia. It is hard to decide whether from fiscal interests' perspective is advisable for a DTC to follow the OECD or the UN Model's recommendations especially in case where the economic strength of the two contracting states is at least the same as it is in case of the Czech Rep., Hungary, Poland and Slovakia. It can turn out that in some cases excessive protection of sourced-taxation rights might disturb free movement of capital investments and cause harm for both: taxpayers and contracting states.

STRESZCZENIE

Opodatkowanie dochodów z kapitałów pieniężnych w bilateralnych umowach w sprawie unikania podwójnego opodatkowania dochodu i majątku zawartych przez Polskę z Republiką Czeską, Węgrami i Słowacją – ostatnie zmiany

Artykuł dotyczy opodatkowania dochodów z kapitałów pieniężnych na gruncie bilateralnych umów w sprawie unikania podwójnego opodatkowania dochodu i majątku zawartych przez Polskę z Republiką Czeską, Węgrami i Słowacją. Autor analizuje w nim wpływ rekomendacji KM OECD i KM ONZ na polską praktykę traktatową w odniesieniu do opodatkowania dywidend, odsetek i należności licencyjnych, w tym w umowach Polski z Republiką Czeską, Węgrami i Słowacją. W ocenie Autora, umowy Polski z tymi państwami łączą rozwiązania oparte na KM OECD jeśli chodzi o eliminację podwójnego opodatkowania dywidend i odsetek oraz na KM ONZ w zakresie należności licencyjnych. Podobieństwo norm rozdzielających roszczenia podatkowe w odniesieniu do tych kategorii przychodów (dochodów) rodzi podobne problemy związane ze stosowaniem tych umów. Problemy te koncentrują się wokół właściwej kwalifikacji prawnej dla

celów opodatkowania dywidend wypłacanych przez spółkę komandytowo-akcyjną zagranicznym akcjonariuszom zanim Polska zmieniła w 2013 uregulowania w tym zakresie obowiązujące w podatku dochodowym od osób prawnych oraz należności licencyjnych. W przypadku należności licencyjnych, zastosowanie właściwej normy rozdzielającej roszczenia podatkowe między umawiające się państwa jest utrudnione ze względu na szeroką, opartą na KM ONZ, definicję „należności licencyjnych. Zarówno jedno jak i drugie zagadnienie dotyczy bilateralnych umów podatkowych zawartych przez Polskę z Republiką Czeską, Węgrami i Słowacją; Autor ilustruje je analizując najnowsze orzecznictwo polskich sądów administracyjnych.