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## | International double taxation

## Introduction

International double taxation is a very important issue to entrepreneurs from all over the world attracting also the attention of economists and financial experts. Nobody particularly likes to pay taxes and of course nobody likes to pay tax twice for the same thing.

Double taxation arises when the same income, asset or financial transaction is subject to taxation in more than one country (in most cases – in two countries). In typical situations, when a resident of one country makes a taxable gain in another country, he may be obliged to pay domestic tax according to the law of his country and also to pay the tax in the country where the income was gained, where the asset is located or where the transaction was concluded.

For example, if a Polish company pays loan interest to a company from abroad, such interest may be taxed according to both Polish and foreign legislations. The foreign recipient of interest arising in Poland will add to its taxable base abroad. Before that, this interest will be subject to withholding tax (please see below for details regarding the withholding tax in Poland).

To mitigate the negative consequences of such situations, authorities in some countries tend to make bilateral tax agreements. Based on such treaties, under certain conditions, tax paid in one country can be exempt from taxation in another country. Double Taxation Treaties (“Tax Treaties”) are designed to keep certainty of treatment for cross-border trade and to prevent tax discrimination against business interests abroad.

## Double Tax Treaties

The concept of international double taxation prompted significant debate in the past. Since the integration of the global economy, entrepreneurs and tax specialists had been looking for procedures allowing to avoid double taxation. Furthermore, tax authorities regarded the elimination of such excessive taxation as a way to mitigate tax evasion in their countries.

A significant role in such process was taken by the Organization for Economic Cooperation and Development (OECD), founded in 1948 (as OEEC), to help administer the Marshall Plan in Europe and later extended to non-European countries (31 members currently). The OECD develops common solutions to identical cases of double taxation but also deals with raising the standard of living, supports economic growth, contributes to the growth of world trade and more. Poland became a member of the OECD in 1996.

The Model Tax Convention of the OECD ("Model Convention") created in 1963 was announced in order to avoid international double taxation by providing rules for taxing income and capital (it does not apply to VAT). The rules from the Model Convention are generally accepted worldwide and are being used to resolve the most common international taxation issues. Bilateral Tax Treaties concluded by OECD member countries generally follow the Model Convention. There are almost 3,000 such treaties currently.

Tax Treaties are agreements allowing harmonization of tax systems of two countries and applied to companies and individuals involved in cross-border investment and trade. Changes to the Model Convention are published by the OECD in advance to give time to the member countries administration to discuss the new content.

## International double taxation system in Poland

Poland has entered into Tax Treaties with 84 countries including all the EU member states. These Treaties have priority over Polish domestic law.

All taxpayers registered in Poland are liable to corporate income tax which is payable on worldwide taxable income and capital gains. Non-residents are subject to tax on their Polish source income and capital gains. In general, there is no special tax rate for capital gains in Poland. Capital gains are usually added to the regular income of a company and based on the standard tax rates.

Interest, royalties and dividend paid abroad are also subject to withholding tax in Poland. The standard rates of withholding tax are: 20% for interest, 20% for royalties and 19% on dividends. The said rates may be reduced according to the provisions of the Tax Treaties. Using the lower rates (even 0%) is possible if the payer of the interest/royalties/dividends has a certificate of residence of their recipient issued by the recipient's local tax authorities. The certificate of residence is an authorized certification that a certain entity or individual is legally resident within a tax authority's jurisdiction.

## Implementation of EU directives

Before Poland joined the EU in 2004, it was obliged to undertake steps necessary to implement the European Council Directives on tax matters. The most important implemented Directives are the Parent-Subsidiary Directive and Interest and Royalties Directive. Based on the said Directives, payment of dividends made by a company with its registered office in Poland to a foreign company can be free of tax provided that the following conditions are jointly met:

- dividends are paid to a non-resident company,
- the beneficiary is subject to income tax in other EU countries or the European Economic Area,

- the beneficiary directly has held at least 10% shares of the dividends payer for a period not less than 2 years (this requirement does not have to be met at the time the above payments are made).

Furthermore, Poland may impose withholding tax on interest and royalties at a rate not higher than 5% once conditions similar to the above are met (however, the shareholder condition refers to 25% of shares not 10%). From July 2013 no withholding tax will apply to interest and royalties so their treatment will be identical to dividends.

## Methods for eliminating double taxation

In order to avoid taxation of the same income in two countries, the Tax Treaties concluded by Poland provide two methods for the avoidance of double taxation:

- exemption with progression method, or
- tax credit method.

**Exemption with progression** means that the country of the taxpayer's residence exempts income from foreign sources. However, the taxpayer must declare this in his tax return. The tax authorities first calculate the tax on the total income (both taxable and exempt). Then the average tax rate on the total income is determined. Finally, such rate is applied to the taxable income only. Most of the Tax Treaties concluded by Poland introduce this method of avoiding double taxation.

Under the tax credit method, all income is subject to tax, but the taxpayer is entitled to a tax credit for the tax paid abroad. This means that he can deduct the tax paid abroad from the tax due at home. However, countries using the credit method do not refund taxes if the taxpayers pay foreign taxes at a higher rate so the tax credit is limited to the domestic tax rate. This method is also introduced in the Tax Treaties which Poland signed and in cases where there is no Tax Treaty in place.