



| The concept of permanent establishment

Introduction

The concept of permanent establishment (PE) is extremely important issue for international double tax treaty law concerning cross-border activities and avoiding the contravention of tax law. It is PE existence that determines whether, or not, the tax authorities of certain country has right to impose tax on the entrepreneur's profits (for further information regarding international double taxation please see the relevant article in the tax section).

As a rule, a foreign company's profits are subject to taxation in country where certain activity takes place if the enterprise is deemed to constitute a PE. The OECD Model Convention (announced in order to avoid international double taxation by providing rules for taxing income and capital) introduces the general definition of a PE. According to this model, PE is constituted by a fixed place of business or a place of management, a branch, an office or factory unless some activities carried out by foreign enterprise last for a period less than a defined number of months.

PE in the Polish Law

After the Poland's accession to the European Union the existing EU regulations regarding taxes became applicable. The OECD Model Tax Convention states that "an enterprise in one state shall not be subject to a direct tax on its business profits based on net income in the other state unless it carries on business in that other state through a permanent establishment ("PE") located in the other state." According to the Polish CIT Act, entities having their seat or management in Poland are subject to taxation with respect to their global income regardless of where it was generated. The other entities are subject to taxation in Poland only with regard to income gained in Poland.

The definition of a PE introduced by Polish Law is based on the OECD Model Tax Convention. According to the Polish CIT Law, a foreign PE may mean:

- permanent place of business through which the entity whose seat or management office within the territory of one state pursues its activities, in whole or in part, within the territory of another state and, in particular: the place of management, branch, office, factory, workshop or place of extraction of natural resources;
- a construction site or construction, assembly or installation works carried on within the territory of one state by an entity with its seat or management office on the territory of another state;
- a person who operates on the territory of one country on behalf and for the benefit of an entity with its seat or management office on the territory of another country, if such person holds and exercises a power of attorney to enter into agreements on its behalf.

When analyzing the tax status of the foreign investor in Poland one should remember that the meaning of foreign PE can be different if the double tax treaty concluded between Poland and given country provides for specific provisions or exceptions.

If the enterprise runs its business activity through PE, income which could be derived if it was a separate enterprise, should be attributed to that PE (costs should be allocated accordingly). In case of general costs that cannot be allocated directly to a PE and costs which are not strictly connected with the profit, the allocation key should be set up on the basis of profits which made by the permanent establishment.

Branch as an example of PE

In a view of the above, income which can be allocated to the PE of the foreign company is subject to the Polish corporate income tax at a rate of 19%. The regulations regarding taxable income, tax deductible costs, depreciation, etc., applicable to a branch are the same as those applicable to the Polish companies. The foreign PE must calculate and pay monthly CIT installment (if taxable income exceeds tax deductible costs) and not later than three months after the tax year it must submit the yearly CIT return. Provided that no tax due arose and there is a tax loss from the activities in Poland, such loss can be utilized against the future tax profits for the next 5 years, but only 50% of the loss can be deducted in one year.

On mutual terms foreign entrepreneurs may have their branch in Poland, which has become quite a popular form of PE in Poland. The purpose of a branch is to provide an organizational foundation in Poland as a basis for foreign direct business activities. The range of operations carried on by a branch should not be wider than the ones of a foreign parent company (head office). It is also worth noticing that a branch of a foreign entrepreneur has no separate legal personality in Poland and hence, it is regarded as a part of its head office.

A branch of the foreign entrepreneur carrying on business activity in Poland is considered to be a PE as defined in the Double Tax Treaties agreements concluded by Poland which follow the OECD Model Tax Convention. A PE exists even if the company employs an agent other than an independent agent who regularly acts for the company and concludes contracts there.

If the foreign entrepreneur is not in the phase of setting up a branch in Poland yet, he may consider opening a representative office. A representative office can be established only for representation (advertising) and promotion purposes of a foreign entrepreneur. A representative office does not have a legal personality and is treated as an organisational part of its head office.

Both branch and representative office must keep the accounting records according to the Polish accounting law.

Summary

The PE issue is important issue to entrepreneurs from all over the world since all the modern tax treaties use PE as the main instrument to establish taxing jurisdiction. What is interesting, the OECD Model Tax Convention is not the only template. There is also the US and the UN model tax convention, but especially the latter is different from the OECD model on the treatment of PE.

In the UN convention the definition of PE is relatively broad allowing host countries to cover more activities of the foreign entrepreneur with the domestic taxation. Nevertheless, it should be emphasized that the bilateral Double Tax Treaties signed by Poland follow the OECD Model Tax Convention (Poland has entered into Tax Treaties with 84 countries).