Real Estate Tax Services News

Keeping you informed

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Protocol to the double tax treaty between Poland and the Netherlands announced

In brief

On 29 October 2020, representatives of Poland and the Netherlands signed a new Protocol (the "Protocol") to the double taxation treaty ("DTT") that exists between the two countries ("PL-NL Treaty").

The prevention of abuse is a key objective of the Protocol

The new Protocol intends to eliminate double taxation with respect to the taxes in the scope of the DTT without facilitating tax evasion or avoidance (including through "treaty-shopping" arrangements and conduit companies aimed at obtaining reliefs intended for the indirect benefit of residents of third jurisdictions). This is a direct copy of the new preamble to the OECD Model Tax Convention 2017, as originally enshrined in Article 6 (1) of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("MLI").

Principal purpose test (PPT) and real estate clause will be added to the PL-NL Treaty

The Protocol introduces measures to tackle the improper use of the PL-NL Treaty by implementing a so-called "minimum standard" under the MLI. This is the first time that the MLI has had implications for the functioning of the PL-NL Treaty.

According to the information published on the website of the Polish Ministry of Finance, the Protocol will introduce the following:

- a general anti-avoidance rule in the form of a principal purpose test ("PPT") [1];
- a real estate-rich company clause;
- new provisions on permanent establishment;
- a transparent entity clause;
- rules for determining tax residence of persons other than natural persons with double tax residence.

The most relevant items in the above for businesses and investment structures (for whom the PL-NL Treaty is relevant) are the PPT and real estate-rich company clauses.

The PPT first requires the tax authorities to investigate, having regard to all relevant facts and circumstances, whether obtaining a tax benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit. Doubt arises from the fairly low threshold used to invoke the first element of treaty abuse; that one of the principal purposes of any arrangement or transaction is to obtain a treaty benefit(s) directly or indirectly. Where tax authorities have "reasonably concluded" that one of the principal purposes of a taxpayer's arrangement or transaction is to obtain treaty benefits, the taxpayer may still obtain these if it is established that granting the benefit under such circumstances would be in accordance with the object and purpose of the relevant provisions of the tax treaty. The second part of the PPT may be perceived as a dividing line between arrangements or transactions whose principal purpose is to obtain a treaty benefit and convey the envisaged treaty benefit, and those that do not. In practice, the assessments under the PPT may trigger disputes with tax authorities, and a potential area of controversy will stem from foreign structures with Polish real estate assets held by Dutch holding entities.

Furthermore, as the content of the Protocol has not yet been published, the full scope of the real estate clause is not yet known. In the MLI, the clause may apply if the relevant value threshold is met at any time during the 365 days preceding the alienation of shares. Under the current Polish domestic provisions, in turn, the general rule is to test the real estate company status on the last day of the month preceding the transaction. Irrespective of which point in time the threshold of the real estate company should be assessed, the introduction of the real estate clause may have an impact on the direct and indirect owners of real estate entities.

When the Protocol starts to apply?

The next step will be the ratification process in both countries.

Due to the COVID-19 situation, it may be difficult to finalise the whole ratification process before 1 December 2020 to allow the amendments to take effect as of 1 January 2021. It can also be expected that the Protocol will include a transitional period, but at this stage there is no official confirmation in this respect.

Our view

The signed Protocol will certainly have a major impact on existing investment structures involving the Netherlands and Poland. Investors which use Dutch holding companies that have Polish real estate subsidiaries will need to verify if disposal of these shares will trigger capital gains tax in Poland by virtue of the real estate clause. Moreover, the currently modified changes to the Polish Corporate Income Tax Law relating to the modification of the domestic real estate clause as well as the introduction of a new definition of "real estate company" will need to be carefully observed. Finally, any amendment to the ownership structure of Dutch companies holding Polish real estate entities may be targeted by the Polish tax authorities via the PPT, if they lack a clear non-tax investment purpose and an adequate degree of economic substance. Although the findings of the Canadian Federal Court of Appeal (CFCA) in the recently decided case of *Alta Energy* (12 February 2020) imply that proving economic substance is not a required condition of accessing treaty benefits, it remains to be seen if such a path will be followed by the Polish tax authorities and courts under the PPT.

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[1] Article 7(1) of the MLI: "*Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement*".

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