Real Estate Tax Services News

Keeping you informed

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

In brief

On 29 October 2020, 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 provisions of the new Protocol have been published on the Polish Ministry of Foreign Affairs' website.

The prevention of abuse is a key objective of the Protocol

The provisions of the Protocol implement changes proposed under the Base Erosion and Profit Shifting ("BEPS") initiative. These changes are reflected in the latest version of the OECD Model Tax Convention and were originally enshrined in Article 6 (1) of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS ("MLI"). The Protocol introduces the following:

- rules for determining the tax residence of persons other than natural persons with double tax residence;
- new provisions concerning the definition of permanent establishments (PE);
- a "real estate-rich" company clause;
- a general anti-avoidance rule in the form of a principal purpose test ("PPT") accompanied by special rules enabling the disapplication of the PPT;
- clarification of the scope of "dividend-like" income (i.e. income from shares) from the perspective of withholding tax (WHT), aimed at including liquidation proceeds, income from purchase of own shares as well as income from transfer of investment certificates;
- imposition of a 0% WHT on dividends received by the recognised pension fund of a contracting state.

Selected amendments

Dual tax residence

The Protocol, following the MLI provisions as well as the OECD Model Tax Convention 2017, introduces new rules for tackling dual tax residence situations. It provides that if a person other than an individual is considered resident in both contracting states, the competent authorities of both states will determine its residence for the purpose of the treaty through mutual agreement based on the following: its place of effective management, the place where it is incorporated or otherwise constituted, and any other relevant factors. If no agreement is reached, such person shall not be entitled to any relief or exemption from tax provided by the treaty except to the extent and in such manner as may be agreed upon by the competent authorities.

New provisions on PE

Another important change is reflected in the update of Article 5 of the PL-NL Treaty, aimed at the elimination of abuse of the preparatory or auxiliary activities exemptions, the splitting of one contract into several contracts/activities and abuse via the "dependent agents" principle (the definition of a "dependent agent" is widened in the Article). In essence, the Protocol implements a number of BEPS-oriented solutions aimed at preventing non-residents from avoiding a PE.

Real estate-rich company clause

The Protocol introduces the "real estate-rich" company clause. It states that gains in respect of the disposal (or "alienation") of shares or other comparable interests (e.g. trust or partnership interests) derived by a resident of a contracting state may be taxed in the other contracting state. The gains may be taxed if, at any time in the 365 days preceding the alienation, these shares or comparable interests derived more than 75% of their value directly or indirectly from immovable property situated in that other contracting state.

It should be noted that under the MLI and the OECD Model Convention, the relevant value threshold is 50% of the value derived from immovable property.

In addition, the Protocol provides for a new clause in Article 13 of the PL-NL Treaty which enables residents of a contracting state who are recognised pension funds (which are generally exempt from tax in that state) to be liable to tax on income received from the disposal of real estate-rich entities solely in the country of their residence (and not in the source country where the immovable property is situated).

General anti-avoidance provisions: PPT

The Protocol introduces new wording in respect of the general anti-avoidance rule in the Article 29 (1) of PL-NL Treaty, providing that a benefit under the treaty shall not be granted in respect of an item of income 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. This does not apply where 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 treaty.

Correspondingly, paragraph 2 of Article 29 of the PL-NL Treaty contains the principle of "alternative relief", which enables a taxpayer to claim a treaty benefit despite the arrangement falling within the scope of the PPT.

Clarification of the scope of dividend-like income (income from shares) for WHT purposes

The Protocol states that income from the liquidation (or partial liquidation) of a company, income from the purchase of own shares by a company, as well as income from the distribution of certificates of an investment fund is treated as dividend-like income. In practice, this legislative amendment means that income from these types of transactions will be treated as dividend-like income and thus subject to 0%, 5% or 15% WHT rate (as applicable) in the source country.

0% WHT on dividends and interest received by recognised pension fund of a contracting state

The Protocol will include recognised pension funds within the scope of WHT exemptions in relation to dividends and interest.

When the Protocol starts to apply?

The Protocol will be effective on and after the first day of the third month following the exchange of the notification instruments between the Governments of Poland and the Netherlands. It will apply from 1 January of the year following its coming into force. Taking this into account, the new provisions resulting from the Protocol shall most likely be effective on and after 1 January 2022. The ratification process should be monitored.

Our view

The published Protocol will have a significant impact on existing investment structures which have interests in the Netherlands and Poland, particularly in the light of the new provisions concerning the “real estate-rich” company clause, creation of PE, and the PPT.

In particular, investors which own Polish real estate companies via Dutch holding companies will need to verify if the disposal of the Dutch shares will trigger a capital gain taxation in Poland by virtue of the real estate-rich company clause. Moreover, the 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” should be carefully monitored. Finally, any amendment to the ownership structure of the Dutch holding company and Polish real estate subsidiary may be targeted by the Polish tax authorities through the PPT, if they lack a 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 providing 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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