Analysis: China – Poland Income Tax Treaty

See treaty text.
Type of treaty: Income Tax
Based on UN Model Treaty
Signed: June 7, 1988
Entry into force: July 1, 1989
Effective date: January 1, 1990
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Article 1 Personal Scope

See treaty text.
Persons who are resident of one or both States.

Article 2 Taxes Covered

See treaty text.

- Taxes on total income, on elements of income;
- Taxes on gains from alienation of movable or immovable property; and
- Taxes on capital appreciation.

China

- The individual income tax;
- The income tax concerning joint ventures with Chinese and foreign investment;
- The income tax concerning foreign enterprises; and
- The local income tax.

Poland

- The income tax (*podatek dochodowy*);
- The tax on wages and salaries (*podatek od wynagrodzen*);
- The equalisation tax (*podatek wyr wnawczy*);
- The tax on immovable property (*podatek od nieruchomosci*); and
- The agricultural tax (*podatek rolny*).

As well as application to the taxes existing at the time the Treaty was signed (listed above) there is a provision applying the Treaty to any identical or substantially similar taxes which are imposed after the date of signing of this Treaty.
Article 2 contains a general definition of taxes on income and property. Paragraph 3 of Article 2 contains a closed catalogue of taxes covered by the Convention.

Article 3 General Definitions

See treaty text.
"China": The entire territory of the People's Republic of China in which the Chinese tax legislation is effectively applied. It includes its territorial sea and the adjacent areas and the sea bed and subsoil over which China may, in accordance with domestic and international law, exercise sovereign rights for the purpose of the exploration and exploitation of the natural resources of the sea bed and subsoil and the waters above these.
"Poland": The Polish People's Republic, with geographical definition worded as for the definition of China.
"Person": Includes an individual, company or any other body of persons.
"Company": Any body corporate or any entity which is treated as a body corporate for tax purposes.
"Nationals": All individuals possessing Polish or Chinese nationality and a legal person, partnership, association deriving their status as such from the laws in force in that State.
Any terms not specifically defined take their meaning from the tax law of the State concerned.

According to the standpoint presented by Polish administrative courts, both the OECD Model Convention and the Commentary to the Convention should not be considered as a source of law. However, they should be taken into account when interpreting double tax treaties to which Poland is a party.
In the context of Article 3 of Chinese-Polish Treaty Polish tax administration announced that the term "China" within the meaning of that Treaty does not extend to Hong Kong (the ruling of the Polish Ministry of Finance of February 14, 2008, ref. no. DD7/0682/68/ZDA/08/1464/07). Consequently, no double tax treaty applies in relationships involving Hong Kong and Poland and any income paid to that jurisdiction would trigger withholding taxes at the general rate of 19 percent (dividends) or 20 percent (interest and royalties). Moreover, in lack of treaty protection, fees for intangible services may also trigger 20 percent withholding tax in Poland.

Article 4 Resident

See treaty text.

"Resident": Any person who is liable to tax in one of the Contracting States by reason of his domicile, residence, place of Head Office, place of effective management or any other criterion of a similar nature.

Residence: Individuals

In the case of individuals apparently resident in both Contracting States, the usual tiebreaker tests apply:

- He will be deemed to be a resident of the State in which he has a permanent home. If he has a permanent home in both States, he will be deemed to be resident in the State with which his personal and economic relations are closer (centre of vital interests).

- If unable to determine the State where the centre of vital interests lies, then resident of the State in which he has a habitual abode.

- If he has a habitual abode in both States, then resident in the State of which he is a national.

- If a national of both States or of neither of them, then the competent authorities must settle the question by mutual agreement.

Domestic law

China

An individual is tax resident in China if he habitually resides there. This is taken as presence for more than one calendar year. The precise extent of exposure to and rates of Chinese tax depends on whether the individual has been present in China for more than five years without spending more than 90 days in aggregate or 30 consecutive days per calendar year outside China.

Poland

A person will be considered resident if he is present for more than 183 days in the calendar year. Also Article 25 of the Civil Code defines the place of residence as the location where a natural person abides with the intention of remaining permanently. It is clear from this provision that two factors are decisive as to the place of residence: one objective, i.e. the fact of abiding; and one subjective, i.e. the intention to remain permanently. These factors must appear simultaneously in order for a place of residence to exist. However, a temporary interruption (for example, connected with travel) does not affect an individual's place of residence.

Residence: Companies

If a company appears resident in both States, e.g. because one determines residence according to the place of legal incorporation and the other according to place of management then residence is to be decided by reference to the place of effective management. However, where the place of effective management is in one State but the Head Office is in the other State the place of effective management will not necessarily determine the company's tax residence: In these cases the Chinese and Polish tax authorities must come to a mutual agreement as to in which State the company is resident. This rule reflects the importance placed by China on the place of the Head Office.

Domestic law

China

Companies incorporated in China are considered tax resident. Additionally, under the Corporate Income Tax Law which became effective as of January 1, 2008, China now determines company residence according to the place of effective management. This is interpreted as the exercise of the overall management and control of production, business, employees, finance and assets of a company

(Articles 2 and 3 of the CITL). Thus day to day control as well as strategic management must be considered and the definition is very broad.

Poland

A business entity that has its seat or its principal place of business in Poland may be classified as a domestic corporation. In practical terms, this means that entities organised under Polish law that, according to the data disclosed in the relevant records, have their seat or principal place of business in Poland are deemed to be domestic corporations.

Relevant records include:

- The National Court Register in which companies organised under commercial law are entered (for example, limited liability companies and joint-stock companies); and

- The State-owned enterprises register in which entities organised under the special regulations on State-owned enterprises are entered.

Partnerships and fiscally transparent enterprises

Residence is to be determined as for companies.

Domestic law

China

The default position is that partnerships are treated as transparent unless an election is made for the partnership to be taxed as a separate entity.

Poland

Partnerships are not taxpayers for income tax purposes. Instead, the partners are liable for income tax. Income from a partnership that is not a legal entity is taxed in the hands of each partner, in proportion to his/her distributive share in the partnership. In the absence of evidence to the contrary, the partners' shares are presumed to be equal.

However, as of January 1, 2005, the provisions governing corporate income tax apply also to all foreign partnerships that do not possess legal status if such partnerships have their seat abroad and are subject to corporate income tax in the country in which the seat is located. Thus domestic partnerships are treated as transparent but foreign partnerships may be treated as taxable entities providing they are treated as such in the country where they are tax resident.

Article 5 Permanent Establishment

See treaty text.

This Article defines the term "permanent establishment". The profits of an enterprise of one of the Contracting States can only be taxed on an arising basis in the other Contracting State to the extent that they are attributable to a permanent establishment in that other State.

This Treaty broadly uses the OECD and UN definitions. Three types of permanent establishment are envisaged: A fixed place of business, a service permanent establishment and an agency permanent establishment.

Fixed placed of business

In this context a "permanent establishment" means a fixed place of business through which the business of the enterprise is wholly or partly carried on. The list of types of establishment particularly included follows the UN Model and involve:

- A place of management;

- A branch;

- An office;

- A factory;

- A workshop;

- A mine, an oil or gas well, a quarry or any other place of extraction of natural resources; and

- A building site, construction or assembly or installation project which lasts for more than six months.

Supervisory activities in connection with such activities are also included. Note the departure here from the more usual period of 12 months, reflecting the use of the UN Model Convention.

According to the OECD Commentary, a “fixed place of business” means to be established at a distinct place with a certain degree of permanence, however, it could be a pitch in a market place, or even part of the premises of another enterprise. There is no requirement that the premises be owned. The Commentary offers the example of an employee of Company A who is allowed to use an office at the premises of Company B. This could create a permanent establishment for Company A in the country of Company B if the arrangement persists for long enough and if the employee is carrying out activities which are more than merely “preparatory or auxiliary” (see below).
The OECD considers that to be fixed, a place of business must be at a specific geographic point. However, if the permanent establishment consists of mechanical equipment only, then there is no requirement for mechanical equipment to be fixed to the soil.
As to what constitutes a reasonable period of time to give the necessary degree of permanence, most countries will not consider a presence of less than six months to give rise to a fixed place.
The usual exclusions from the definition of permanent establishment are given so that the following will not constitute a permanent establishment:

a. The use of facilities solely for the purposes of storage, display or delivery of goods or merchandise belonging to the enterprise;

b. The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

c. The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

d. The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;

e. The maintenance of a fixed place of business solely for the purpose of carrying on any other activity of a preparatory or auxiliary character; and

f. Any combination of the above providing that the overall activity of the fixed place of business is of a preparatory or auxiliary character.

To apply this Article, it is necessary to be able to make a distinction between functions that are core to a business and those that are merely preparatory or auxiliary. What constitutes core functions will vary from one business to the next. However, any fixed place of business from which the business is partly managed will constitute a permanent establishment even if its function otherwise appears to be preparatory or auxiliary. Also, if services are rendered to other companies within the corporate group or to third party customers then this would not be preparatory or auxiliary because activities only count as preparatory or auxiliary if they are carried on “for the enterprise” itself.
Note that despite incorporating many features of the UN Model Convention, this Article at paragraph 4(b), unlike the UN Model, excludes “delivery of goods or merchandise” from the definition of what may be considered a permanent establishment. Thus a warehouse would not normally be considered a permanent establishment under this Treaty.

Service permanent establishment

This Treaty follows the UN Model in specifically providing that services provided by an enterprise may result in a permanent establishment, even though there is no fixed place of business.
The furnishing of consultancy and other services, whether through an enterprise's own employees or by other personnel hired for the purpose where a project (and any connected project) will give rise to a permanent establishment where the activities last for more than six months within any 12-month period. There is little guidance available as to what is meant by “same or connected” but Commentary on the OECD Model suggests that commercial connections rather than geographic connections are paramount.
The Protocol states that providing consultancy services in connection with the sale or lease of machinery or equipment through employees or other personnel will not cause a permanent establishment to arise.
Where the services are merely preparatory or auxiliary, as set out above, no permanent establishment will arise.

Agency permanent establishment

Dependent agents may constitute a permanent establishment. Where a person is acting on behalf of a resident of a Contracting State and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the resident, that resident is deemed to have a permanent establishment in that other State, unless the activities of the agent are limited to those listed at a) to f) above. Where the activities of the agent are merely preparatory or auxiliary, or where the agent is an independent agent (e.g. a general commission agent acting in the ordinary course of his business) the presence of the agent will not give rise to a permanent establishment unless the agent works wholly, or almost wholly on behalf of the foreign enterprise.

General

The fact that a company has a subsidiary in the other Contracting State does not mean that the subsidiary is a permanent establishment of that company, unless it binds the parent company in contract as per the rule for dependent agents. This rule applies generally to groups of companies.

Domestic law

The definition of an agency permanent establishment has been widened by Article 3 of the CITL to include business activities carried out for the principal other than purchases and sales. Storage or delivery of goods will also give rise to an agency permanent establishment. Regarding a fixed place of business, the Implementation Rules, effective January 1, 2008 provide that the definition of a permanent establishment (stated as being an establishment or site) will encompass:

- Any establishment from which management or business operations are conducted;
- A representative office;
- An establishment conducting management or business operations;
- A factory, farm or site for exploration of natural resources;
- A site from which services are provided;
- Construction, installation and assembly sites;
- Sites for making or repairs;
- Exploration sites;
- Other engineering projects;
- Other establishments and sites for conducting production and business operations.

The general rules is that a permanent establishment will exist if a site or project lasts for more than 6 months in a 12 month period.

Under Circular 403 Interpretation and implementation notice for HK's Double Tax Arrangement a permanent establishment will exist if services have been provided in China for more than six consecutive months in any 12-month period. Counting starts from the arrival of the first employee in China and only ceases when the last employee leaves the country.

The Poland-China Double Taxation Treaty ("Poland - China DTT") includes a construction clause that refers to supervision at building sites or construction, installation or assembly projects.

As of 1 January 2007, domestic tax law contains a definition of foreign permanent establishment. The Polish CIT Act defines a permanent establishment as:

- A fixed place of business where enterprise business is wholly or partly conducted;
- A building site, construction or assembly project, or installation project performed in one contracting state by an enterprise from the other contracting state;
- A person acting in a contracting state on behalf of an enterprise based in the other contracting state if such person has and habitually exercises authority to conclude contracts;

unless a relevant taxation treaty states otherwise.

It must be stressed, however, that the domestic definition of a permanent establishment will only apply to non-treaty countries.

There were no recent judgments by Polish administrative courts or rulings by Polish tax authorities concerning this article.

Article 6 Income from Immovable Property

See treaty text.

The general rule is that income derived by a resident of a Contracting State from immovable property in the other State may be taxed in that other State. Thus, for instance, if a resident of one State owns a building in the other State and receives rent, that rent may be taxable in the other State. This treatment also applies to income from immovable property used by an enterprise and to income from immovable property used for the performance of independent personal services.

Immovable property is defined as per the domestic law of the State in which the property is located but it will include livestock and equipment used in agriculture, forestry, general property rights and rights for the working of natural resources.

There is no extension giving the Situs State any right to tax income from movable property of a permanent establishment.

Article 7 Business Profits

See treaty text.

Only profits actually arising from a permanent establishment may be taxed by the source State. If an enterprise has both a permanent establishment in a State and also derives other income, say, dividends or interest unconnected with the permanent establishment, then the dividends or interest may only be taxed in accordance with Articles 10 and 11 of the Treaty and not this Article.

Although this Treaty uses elements of the UN Model as well as the OECD Model, the recent OECD work on attribution of profits to permanent establishments is relevant to this treaty. The aspects of Article 7 of this Treaty which are based on the UN Model are those concerned with the deductibility of expenses in arriving at the taxable profits. The Commentary on the UN Model relating to the rules on deductibility of expenses makes it clear that the extra provisions are present so that all necessary definitions and clarifications on this matter are set out in the text of the treaty rather than merely in a Commentary. The central aim of Article 7 in this Treaty is identical to that in the OECD Model Convention: The profits attributable to a permanent establishment are those which would be earned by the establishment if it were a wholly independent entity dealing with its head office as if it were a distinct and separate enterprise operating under conditions and selling at prices prevailing in the regular market (per paragraph 2 of Commentary on Article 7, UN Model).

The starting point for the computation will be the branch accounts. Provided there is symmetry in the amounts recorded and in the methods of valuation applied in recording the transactions in the books of the different parts of the enterprise, the accounts will normally be an acceptable basis for attributing profit to the permanent establishment. However, any assumptions used in maintaining branch accounts, for instance, an assumption that the branch acts as principal in all cases, when in fact it only acts as intermediary would lead to a downwards adjustment in profit allocated to the branch.

The usual provision providing for the deduction of expenses from the profits of the permanent establishment in accordance with the rules laid down by domestic law is present. Deductions for executive and general administrative expenses are permitted whether incurred in the State where the permanent establishment is situated or elsewhere. There are some particular rules:

As per the UN Model Convention, no deductions are permitted for certain payments by the permanent establishment to the Head Office or any of the enterprise's other offices, unless they represent reimbursement for actual expenses:

- Royalties, fees and other similar payments in return for the use of patents;
- Commission or fees for specific services performed or for management; and
- Interest on money lent to the permanent establishment except in the case of a banking enterprise).

On the other hand, no amounts charged by the permanent establishment to the Head Office, or any other office of the enterprise for these items are to be included in the taxable profits of the permanent establishment.

The OECD, in 2008, published its final report on the attribution of profits to permanent establishments (July 17, 2008) ("the 2008 Report") and updated the Commentary on Article 7 of the Model Treaty. When interpreting a tax treaty, it is generally agreed that the latest version of the OECD's Commentary on the Model Treaty should be used. These notes follow the 2008 version of the

Commentary. The “authorised OECD approach” to attributing profits to a permanent establishment now requires that there is a two step process.

Firstly, a functional and factual analysis should be carried out, along the lines set out in the OECD's transfer pricing guidelines, to establish the economically significant activities and responsibilities undertaken by the permanent establishment. This will involve establishing the rights and obligations arising out of transactions between the permanent establishment and third parties, e.g. the sales revenue arising from independent customers generated by the permanent establishment as opposed to by the head office. If the permanent establishment takes the form of a factory, then it would assume the obligation to pay for the raw materials which it uses. The OECD then recommends that “significant people functions” relevant to the attribution of economic ownership of assets are identified to support the attribution of economic ownership of assets of the enterprise to the permanent establishment. Economic ownership is defined as the right to income from an asset or the right to depreciate it. Tangible property should be attributed to the location where it is in use. Economic ownership of intangibles rests with the location in which the risks associated with the intangibles is borne: For instance, if an enterprise owns a patent for a particular drug which is sold by distributor companies in many countries, the economic ownership would rest in that part of the enterprise responsible for commissioning the research to develop the drug and which would bear the losses if medical trials failed. A further set of “significant people functions” are then to be identified: This time, those relevant to the assumption of risks so that an allocation of risks borne by the enterprise can be made to the permanent establishment. For instance, road building equipment may be economically owned by a permanent establishment in Country A but the head office, located in Country B, may have the power to determine on which road building projects the equipment is used and hence the head office bears the risk associated with profits or losses arising from the equipment. The more risks that are managed by the permanent establishment, the higher the share of the profit of the enterprise to be attributed to it. The 2008 Report looks for the place of active decision taking rather than mere “rubber stamping”. Note that no such distinction between asset management and risk assumption functions is required in the case of enterprises in the financial sector, because it is considered highly likely that these functions would be carried out by the same people.

Secondly, taking into account the picture built up in the functional and factual analysis, the profits of the permanent establishment must be determined. Although this is relatively simple in the case of transactions with third parties, transactions and dealings with other parts of the enterprise must be determined using the rules laid down in the OECD's Transfer Pricing Guidelines. This means that goods and services provided by head office must carry an arm's length mark up. Pricing policies should be properly documented, which in practice may prove troublesome as firms may not take the same care in documenting the terms of transactions within the firm as they would with third parties. In determining the profits attributable to the permanent establishment, part of the enterprise's interest costs on its borrowings should be allocated to the permanent establishment. The amount of capital needed to support to functions carried out by the permanent establishment on the assumption that it is a separate entity must be calculated. Then, this total theoretical capital must be broken down into debt and equity (or “free capital” in OECD terms). The greater the risks undertaken by the permanent establishment, the higher the proportion of its notional capital that will be regarded as “free capital”. Several methods of establishing the split between “free capital” and debt capital are suggested, including the use of thin capitalisation practices in the State in which the permanent establishment is located. Once the amount of notional debt capital has been determined, an allocation of the enterprise's interest liabilities can be made to the permanent establishment. Note that only actual interest liabilities can be allocated. If the enterprise as a whole has paid no interest to external lenders, then there can be no allocation of interest liability to the permanent establishment. The only exception to this rule is where the permanent establishment is involved in treasury dealings with other parts of the enterprise. Whilst this may well be the case in banking enterprises, it would be unusual in other enterprises. Generally, the interest rates used and the terms of the notional loans to the permanent establishment must be such as would be found between parties dealing at arm's length. This aspect of the AOA ought to be acceptable in interpreting a treaty such as this one which uses elements of the UN Model: in the introductory remarks to the Commentary on Article 7 of the UN Model, at paragraph 4 “...an allocable share of such payments, e.g. interest and royalties, paid by the enterprise to third parties should be allowed.”

When deciding what transactions should be recognised between the permanent establishment and other parts of the enterprise, the OECD recommends that the only internal transactions which can be recognised in arriving at the permanent establishment's profits are those which relate to real and identifiable events. These would include the physical transfer of goods, the provision of services, the

use of intangibles and the transfer of financial assets. Whilst the internal records (e.g. the branch accounts) are the starting point for identifying these transactions, the true test is whether there has been an internal dealing of economic significance. The 2008 Report suggests the following tests are used when considering whether an internal dealing should have any effect on the profits of a permanent establishment:

1. Is the documentation consistent with the economic substance of the internal dealings?

2. Are the arrangements such that they are not too different from dealing which one group company might have with a fellow group company? For instance, credit periods should be similar in similar circumstances.

3. Are the dealings consistent with the OECD principles for attributing profits to permanent establishments?

Allocations of head office expenses, e.g. for strategic management or centrally managed support functions such as payroll may be set against the profits of the permanent establishment, but the arm's length principle must be observed.

The allocation of profits to dependent agent permanent establishments

A dependent agent is not part of the taxpayer enterprise and will file his tax returns independently. Normally the enterprise will make payments to the agent for his services. The question is: Should the host State merely tax the profits of the agent (the "single taxpayer approach" or should there be an additional charge on the enterprise which is using the services of the agent? The amount of the charge would depend on the excess of the enterprise's profits over the amount paid to the agent which was attributable to the activities of the agent. For instance, a dependent agent may be paid for the sales he procures on a commission basis, but the selling enterprise may make a profit on those sales even after taking into account the (arm's length) commission paid to the agent. The OECD recommends that States should always consider whether the enterprise has made a profit in respect of business transacted via the agent which is in excess of amounts paid to the agent. Hence the host state may tax both the dependent agent and the foreign enterprise.

Alternative method of attribution of profits

This Treaty permits an allocation of the profits of the enterprise to a permanent establishment based on an apportionment of the total profits of the enterprise. This is sometimes known as the unitary, or indirect method of apportionment. It is only acceptable to use this method if it has been customary to do so and in any case, the outcome must be in accordance with the result which would be obtained by using the Authorised OECD Approach (AOA) as set out above.

As is usual no profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

The same method of attribution is to be used year by year unless there is good and sufficient reason to the contrary.

Domestic law

China

The general rule is that permanent establishments are taxed on Chinese source income only. The rules of the Enterprise Income Tax Law are applicable to permanent establishments. The term used in domestic law is "establishments or sites". It has been the practice to limit the use of permanent establishments by foreign enterprises in favour of corporate forms and joint ventures although this appears to be changing. Note that representative offices have been widely used and there are detailed rules for determining the taxable profits of such an office.

Poland

A branch or a representative office that has taxable income must pay ordinary corporate income tax at the normal corporate tax rate in the same way as a subsidiary. If the income of a branch or representative office cannot be determined based on the financial records maintained, such income will be determined based on a profit rate as a percentage of total gross income as follows:

- 5 percent in the case a wholesale or retail trade;

- 10 percent in the case of construction or assembly activities, or transportation services;

- 60 percent in the case of agency activities, if earnings are derived in the form of a commission;

- 80 percent in the case of services or expertise of an attorney; and

- 20 percent in the case of other sources of income.

(Act on Corporate Income Tax, Article 9, section 2a.)
As per the interpretation of the Polish tax authorities, income of a foreign entity obtained via its permanent establishment and generated before the PE is entered as a branch in the enterprise register and registered for tax purposes (i.e. before the branch becomes a Polish taxpayer) should be recognized as corporate income subject to taxation in Poland (ruling of the First Mazovian Tax Office in Warsaw dated February 9, 2006, no. 1471/DPD1/423-122/05/KK).
On 22 July 2010, the OECD Council approved the update of the OECD model convention, amending article 7. The changes were a consequence of the 2008 Report.
The 2008 Report promotes the concept of "functionally separate entity approach" as an exclusive method for allocating profits to a permanent establishment and the market price principle for the determination of those profits.
Implementation of the 2008 Report required substantial changes to article 7.2. The principle of assigning a permanent establishment profits which it could have achieved as a permanent, separate and independent company still stands. Similarities to the previous wording however are limited, as under article 7.2 in its current wording the profits attributable to the permanent establishment include profits from transactions with other parts of the same company. In addition, article 7.2 as it stands today indicates that upon the calculation of a permanent establishment income the functions performed, assets used and risks assumed by the company through the establishment, as well as through other parts of the company should be taken into account.
Previous article 7.3 on indirect costs allocation was replaced and now sets forth obligation of the authorities of the contracting states with respect to cooperation aimed at preventing double taxation. By removing existing 7.4 and 7.5 the profits apportionment method was abandoned as well as carry forward of the formula adopted for profit assigning. Repetition of article 5.4(d) included in article 7.6 was also deleted. Article 7.7 (now article 7.4) was left unchanged.
Chile, Mexico, Greece, Turkey and Portugal, citing various reasons reserved the right not to apply the article 7 in its new wording.

Article 8 Shipping and Air Transport

See treaty text.

The general rule is that profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated. If the place of effective management of a shipping enterprise or of an inland waterways transport enterprise is aboard a ship or boat, then it shall be deemed to be situated in the Contracting State in which the home harbour of the ship of boat is situated.

Article 9 Associated Enterprises

See treaty text.

This Article contains the usual OECD provisions regarding transfer pricing. Associated enterprises must adopt the arm's length principle in their dealings with each other, and to the extent that they do not, a Contracting State may make an upwards adjustment to taxable profits.
According to Polish administrative courts, in order to make the adjustment, the tax authority should prove that the special conditions of the transaction should be considered as an effect of the relations between the parties. It is not sufficient to prove that the margin on transactions with related parties is lower than with unrelated parties. It is also required to prove that both groups of transactions were comparable (ruling of the Administrative Court in Krak w of June 3, 2009, no I SA/Kr 1374/08). In other words, it can be indicated that "conditions" created or imposed between two related parties include not only the price but all elements of the transaction which may have influence on the price (e.g. ruling of the Supreme Administrative Court of July 4, 1996, no I SA/Kr 33/96).
According to Polish courts, the burden of proof in the adjustment proceedings is on the side of the tax administration. Namely, the tax authorities should prove that all the conditions to apply the adjustment proceeding were met and all these conditions should be reflected in the evidence gathered by the administration (ruling of Administrative Court in Lublin of November 4, 2005, no I SA/Lu 227/05).
It should be noted that there is no established standpoint of Polish courts as regards the possibility of making the adjustments in case when the taxpayer is not aware that the transaction is not concluded in line with the arm's length principle (i.e. when the taxpayer has no intention to transfer the profits). In some rulings it is stated that the correction is possible irrespective of the awareness or will of the taxpayer (e.g. ruling of the Supreme Court of April 22,1999, no III RN 184/98). In other rulings it is

stated that the correction is possible if the transfer of profits is made intentionally (e.g. ruling of the Supreme Administrative Court of December 15, 1997, no SA/Rz 1254/96).
Note that cost sharing agreements or general services agreements entered into between associated enterprises will not necessarily give rise to a transfer pricing agreement where these are concerned with the allocation of executive, general administrative, technical and commercial expenses, research and development expenses and similar other expenses.
There is no specific provision for a corresponding downwards adjustment to taxable profits in the other State. However, any double taxation resulting from transfer pricing adjustments may be eliminated by agreement of the two States using the Mutual Agreement article of this Treaty.

Article 10 Dividends

See treaty text.

This Article provides for the source State to levy withholding tax on dividends paid to a resident of the other Contracting State at a rate which may be lower than that charged under domestic law. The recipient of the dividend must also be the beneficial owner.
Withholding tax under this Treaty: 10 percent.
Paragraph (3) defines the term "dividends" to include income from shares or other rights (which are not debt-claims) which participate in profits. Also included is income from other corporate rights which is treated as income from shares under the law of the State in which the distributing company is tax resident. There is no inclusion of distributions of profits from joint ventures.
Paragraph (4) provides that where, say, a Polish company receives a dividend from a Chinese company, and that dividend is effectively connected with a permanent establishment which the Polish company has in China, then the dividend income will be deemed to be part of the income of the permanent establishment and the provisions of Article 7 dealing with the attribution of business profits will apply.
Paragraph (5) contains the usual provision that a State does not have the right to levy any tax on a dividend unless either the dividend is paid by a resident company or received by a resident shareholder. Thus the fact that a dividend paid by, say, a Polish company may be sourced from profits earned by a permanent establishment which that Polish company has in China, does not give China any taxing rights over that dividend, unless of course, it is received by Chinese shareholders.

Domestic law

China

Per Article 4 of CITL which came into effect on January 1, 2008: 10 percent withholding tax.
This replaces the previous exemption from withholding tax for dividends.

Poland

Withholding tax of 19 percent but zero under the Polish participation exemption if the dividend is paid to a parent company in an EEA Member State providing that:

- The company that pays dividends or similar payments is a Polish taxpayer with its seat or management board in Poland;

- The entire income of the recipient of dividends or similar payments, regardless of where it is obtained, is taxable in the EU, or from January 1, 2007 in the EEA (the EU plus Norway, Liechtenstein and Iceland);

- The minimum shareholding is 10 percent as of January 1, 2009. Pursuant to transitional provisions, the minimum shareholding is 20 percent from January 1, 2005, through December 31, 2006, and 15 percent from January 1, 2007, through December 31, 2008; and

- The recipient of the dividend must be:

- A company of which the entire income, regardless of where it is obtained, is taxable in the EEA; or

- A foreign branch of the company located in the EEA, if the income of that branch is taxable in the country in which this branch is located;

- The shares must have been held for a continuous period of at least two years. This condition is fulfilled also if the two-year period terminates after the day on which the company receives dividends.

Article 11 Interest

See treaty text.

Maximum rate of withholding tax 10 percent providing the recipient is also the beneficial owner. However, interest arising in one of the States and paid to the government, the local authorities or the central bank or any other financial institution wholly owned by the government of the other State is to be exempt from withholding tax. This treatment also applies to loans indirectly financed (usually stated as being guaranteed or insured) by these lenders.
Interest is defined as income from debt-claims of every kind whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits. The term includes income from government securities, bonds and debentures and premiums and prizes attaching to these securities as well as other bonds. Penalty charges for late payment are excluded from the definition.
There are the usual provisions such that interest received by a non-resident but which relates to a permanent establishment which that non-resident has in the other Contracting State is taxed under Article 7 and thus escapes withholding tax. Also, interest paid by an enterprise which is borne by a permanent establishment is deemed to arise in the State in which the permanent establishment is situated. Hence, if the permanent establishment and the recipient are in the same State, no withholding tax can arise.
As is usual under the Model Conventions, there is a provision limiting the treaty benefit to an arm's length amount of interest where there is a special relationship between the payer and the beneficial owner.

Domestic law

China

Withholding tax of 10 percent, unless paid in connection with a permanent establishment which the recipient has in China. Interest on certain governmental loans may be exempt.

Poland

Withholding tax of 20 percent.

Article 12 Royalties

See treaty text.

The rate of withholding tax depends on the intellectual property in respect of which the royalties are paid; in all cases the beneficial owner must be a resident of the other State:
7 percent (expressed as a rate of 10 percent applied to 70 percent of the gross amount) in respect of payment for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.
10 percent: Payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematographic films and films or tapes for television or radio broadcasting, any patent, know-how, trade mark, design or model, plan, secret formula or process.
There are the usual provisions such that royalties received by a non-resident but which relate to a permanent establishment which that non-resident has in the other Contracting State are taxed under Article 7 and thus escape withholding tax. Also, royalties paid by an enterprise which are borne by a permanent establishment are deemed to arise in the State in which the permanent establishment is situated. Hence, if the permanent establishment and the recipient are in the same State, no withholding tax can arise.
Where the payer and beneficial owner are connected and the amount of royalties exceeds an arm's length amount, the excess amount paid will not enjoy the treaty benefits and will be liable to tax in the payer's State at the normal domestic rate of withholding tax.

Domestic law

China

Withholding tax of 10 percent.

Poland

Withholding tax of 20 percent.
To benefit from a reduced rate provided under the Poland - China DTT, a certificate of residence must be presented to the Polish company paying royalties.
Polish tax authorities issued a ruling stating that expert services with respect to opening a production line as well as operator training purchased from an entity residing in China should be subject to withholding tax in Poland. Tax authorities stated that such services should qualify as information related to acquired experience in an industrial, commercial or scientific field, i.e. know how - (treated as royalties under Article 12 section 3 of the Poland - China DTT).

Article 13 Capital Gains

See treaty text.

Generally this Treaty grants the right to tax capital gains to the State in which they arise.
This reflects the UN Model Treaty which this Article follows closely and the nature of Chinese domestic law on the taxation of capital gains but is a departure from the more usual rule, that a State may tax gains of non-residents by exception only. There is an exception for gains on certain international transport assets.
The term "alienation" is used in connection with events giving rise to capital gains. This will include normal disposals of assets and also events such as exchange of assets, expropriation, gifts and the passing of assets to another on death. Not all States levy tax in all these situations, but the meaning of the term "alienation" is sufficiently wide to give them the right to do so if their domestic law provides for a charge to tax in a particular situation.
The examples of particular gains which each State may tax which are present in many of China's treaties are absent in this Treaty.

Domestic law

China

Non-residents are taxed on gains on the disposal of Chinese property via a withholding tax.

Poland

A gain to a foreign entity from the sale of real property in Poland is subject to corporate income tax on general principles. The amount of gain is equal to the amount received for sale minus expenditures incurred for purchase of the real property, reduced by the depreciation write-offs and any capital invested in the real property during the period of ownership. Foreign corporations are also taxable on gains on other Polish assets such as shares in Polish companies whose main assets directly or indirectly consist of real estate. There is a limited exemption under Polish tax law that applies to interest or discount on State Treasury bonds offered on foreign markets and to income from paid redemption of such bonds.
Individuals are taxed on gains from disposals of Polish property including shares in Polish companies whose main assets directly or indirectly consist of real estate.
There were no recent judgments issued by Polish administrative courts or rulings issued by Polish tax authorities concerning this article.

Article 14 Independent Personal Services

See treaty text.

This Treaty has separate Articles governing the taxation of income from permanent establishments (see Articles 5 and 7) and income from professional services. This Article provides that where a resident of one of the States has a "fixed base" in the other State, income in respect of professional services attributable to that fixed base may be taxed in the country in which it is situated. Thus a Polish accountant with an office in China will be taxable in China on profits attributable to the Chinese office. The attribution of profits is dealt with in the same way as for other business profits under the provisions of Article 7.
This treatment will also apply to professional services performed in the other State by individuals present in the other State for more than 183 days in aggregate in the calendar year concerned.
The term "professional services" is defined to include especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Article 15 Dependent Personal Services

See treaty text.

Salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of employment are taxable only in that State unless the employment is exercised in the other State. If so, remuneration derived from the other State is taxable in the other State. However, the other State (the source State) will not tax provided:

- The recipient is present in the other State for no more than 183 days in aggregate in the calendar year concerned.
- The remuneration is paid by, or on behalf of, an employer not resident in the other State; and
- The remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

The purpose of this Article is to ensure symmetry in taxation. If the employer is not taxable in a State, because it is neither resident there nor has a permanent establishment there then it will not receive any tax deduction in that State for wages and salaries paid. Wages and salaries paid by the employer

in respect of short term employment postings of employees to that State are correspondingly exempted from tax in that State in the hands of the employee.
There is special provision for remuneration received for work aboard a ship or aircraft operated in international traffic.

Hiring out of labour

The term "employer" used in paragraph 2 of this Article has not been defined either in the treaty or in the OECD Model Convention. Therefore, in the context of the practice of international hiring-out of labour one should refer to the Commentary on the OECD Model Convention. In this respect it should be noted that the term "employer" ought to be understood as the person having the rights to the produced work and bearing the related responsibility and risks. When workers are hired internationally, these functions are to a large extent exercised by the user of the labour. In this context, the competent authorities may examine each case separately to establish who in fact is the actual employer and thus look at a number of circumstances connected with the employment:

- Who bears the responsibility or risks for the product of the hired employee's work;
- Who has the authority to instruct hired employees;
- Whether the work is performed at a place which is under control and responsibility of the user of labour;
- How is the remuneration paid to the hirer calculated;
- Whether the tools and materials are essentially put at the hired employee's disposal by the user of labour;
- Whether the number and qualifications of the employees are solely determined by the hirer.

Treatment of stock options

The treatment of employee stock options is not expressly dealt with and can be difficult as entitlement to the benefit taxable as a result of the option may have accrued partly whilst the employee was working temporarily in one of the States but there may be no taxable event, such as exercise of the option until the employee returns to the other State. A State is permitted to tax that part of the taxable benefit that can be related to the portion of the entitlement period spent working in that State.
Determining the extent to which an employee stock option benefit is derived from employment exercised in a particular State has to be done on a case by case basis, taking into account all relevant facts and circumstances. Whether a period of employment would be considered in allocating taxing rights between two States would depend on whether the entitlement to exercise the stock option was contingent upon continuing employment during that period. If an option was granted with a right to exercise, say, in three years' time, regardless of continuing employment then time elapsing between grant and exercise would not count towards an apportionment of the taxing rights over the benefit in the absence of any other factors.
Periods of employment before the option was granted may be considered in the apportionment of taxing rights if the grant of the option was contingent upon a minimum period of employment or attainment of performance objectives.
Once the option is exercised, any further benefit to the employee, normally in the form of a capital gain on a disposal of the shares at a profit, will be dealt with under Article 13 and so probably only taxable in the State where he is resident.
If the shares do not vest irrevocably on exercise of the option (e.g. because they are liable to forfeiture upon certain conditions) then the increase in value of the shares until they do vest irrevocably will also be dealt with as employment income and subject to the same considerations as the benefit arising between grant and exercise.
The method of apportioning stock option benefits recommended by the OECD is by reference to the proportion of the number of days during which the employment was exercised in one State to the total number of days of employment from which the entitlement to the stock option benefits were derived. Thus if an employee was required to work for an employer for 520 days in total during a particular time period to qualify for the benefits of the stock option and was sent to work in the other State for 260 days out of that period, then half of the stock option benefits would be taxable in each State.

Domestic law

China
The extent of the taxation of expatriates depends on whether the stay is more than a year and whether it is more or less than five years. If the stay is for less than 90 days, then Chinese source income is taxable, except that employment income not borne by the Chinese employer is not taxed. (This corresponds to the rules set out in the Treaty, where the period is 183 days.) If the stay is for more than 90 days but less than a year, then Chinese source income, but not foreign income, is taxed in China. If the stay is for less than five years, then foreign income is usually exempt from Chinese tax. Only for stays of more than five years does full Chinese taxation apply.
Employer provided accommodation, travelling expenses, removal costs, and general household costs for expatriates are tax free.
China also permits an enhanced personal tax allowance.
Poland
Generally, there are no special tax provisions for expatriates working in Poland on the employment contract basis.

Article 16 Directors' Fees

See treaty text.
These fees may be taxable in the country in which the company is resident as well as that in which the director is resident.
There are special rules for taxation of expatriates' income from board duties. Income from board duties received by foreign nationals with limited tax liability in Poland may be taxed at the fixed rate of 20 percent. In such cases, no deductions are available.
Income from board duties received by residents of the EU, EEA or Swiss Confederation may also be taxed - under certain conditions - according to the progressive scale. In such cases, certain deductions are available.

Article 17 Artists and Athletes

See treaty text.
The usual OECD Model rule is followed: Income derived by a resident of one State as an entertainer, such as a theatre, motion picture, radio or television artist, or a musician, or as an athlete, from their personal activities as such exercised in the other State may be taxed in the other State. This also applies where the income accrues not to the entertainer or athlete himself, but to another person, e.g. a management company or a troupe, team or orchestra forming a legal entity or to an artist company. This rule does not apply if the activities of the artist or athletes where the visit is made under a cultural or sports exchange between the two States.

Article 18 Pensions

See treaty text.
These are taxable only in the State where the recipient is resident. However, as per the UN Model, pensions paid from a State's social security system are taxable only in the paying State.
Government service pensions are taxable in the State of which the recipient is resident and citizen.

Article 19 Government Service

See treaty text.
This Article contains rules for the taxation of a remuneration paid in respect of government service.

Article 20 Teachers and Researchers

See treaty text.
Teachers and researchers normally resident in one State can work in the other State remain taxable only in the State of residence for period of up to five years. The work must consist of teaching or engaging in research in a university, institute, school or other non-profit making teaching institution, or government recognised research institution.

Article 21 Students, Apprentices and Trainees

See treaty text.
Payments which a student, business apprentice or trainee, who is, or was immediately before visiting a Contracting State, a resident of the other Contracting State and who is present in the visited State solely for the purpose of his education or training will not be taxed in the visited State on:

- All remittances from abroad for the purpose of is maintenance, education, or training; and

- All scholarships, grants, allowances and awards from governmental, charitable, scientific, literary or educational organisations for the purposes of his maintenance, education or training.

There is no exemption from taxation on remuneration from employment in the visited State, but such remuneration will enjoy the same exemptions, reliefs or reductions in taxes that are available to residents of the visited State.

Article 22 Other Income

See treaty text.

Any income not dealt with in the preceding Articles is taxable only in the State of residence but if it arises in the other State then the other State may tax it according to domestic law. Thus the default position regarding the two States is that the State of source has primary taxing rights. Income not arising in either State may only be taxed by the State of residence. These rules follow the UN Model Treaty.

There is an express provision that income in respect of rights or property which is connected to a permanent establishment is taxed under Article 7 as the income of that permanent establishment. Income from immovable property remains taxable under Article 6 in the State in which the property is located.

Article 23 Methods for the Elimination of Double Taxation

See treaty text.

China

The credit method is used, but with credit for underlying tax on Polish dividends where the dividend is received by a Chinese company owning at least 10 percent of the shares of the paying company.

Poland

Poland uses the exemption method for all income and gains except dividends, interest and royalties. The method used is exemption with progression, so that any income exempted is taken into account when determining the rates of tax on income remaining in charge to Polish tax.

Credit method (without relief for underlying Chinese tax on dividends) is used for dividends, interest and royalties.

Such deduction will not exceed that part of the tax computed before deduction in accordance with Chinese income tax.

Tax sparing

Whatever the actual rate of Chinese tax, Poland will give credit as if the rate used had been a minimum of 10 percent of the gross amount of the dividends, interest or royalties. There is no time limit on this provision.

According to Polish court decisions, the phrase “may be taxed” used in conventions on preventing double taxation is not intended to give the taxpayer an option to choose the country in which his income should be taxed. Conversely, this phrase should be construed as meaning that such income is taxed in the country of origin and in accordance with the laws of that country, and at the same time this income is also taxable in the country where the taxpayer has his tax residency (see the judgment of the Supreme Administrative Court dated August 12, 2008, case no. II FSK 782/2007, passed in relation to the Polish-Dutch DTT).

Article 24 Non-discrimination

See treaty text.

The usual OECD provisions, that nationals of one of the States shall not be subjected in the other State to any taxation or any requirement connected with tax, which is other or more burdensome than the taxation and connected requirements to which nationals of the other State in the same circumstances are or may be subjected.

There is an extension so that the principle of non-discrimination also applies to persons not residents of either Poland or China. It applies to all taxes, not merely those listed in Article 2.

Article 25 Mutual Agreement Procedure

See treaty text.

The usual provision founding the OECD Model is used but with different time limits. Where a person considers that the actions of one or both of the States result or will result for him in taxation not in accordance with the provisions of this Treaty, he may present his case to the competent authority of the State of which he is resident or if not resident in either Poland or China, to the competent authority of which he is a national. This is so irrespective of the remedies provided by domestic law. The time limit for bringing a claim is three years from the date of first notification of the disputed tax liability.

The two tax authorities will try to resolve the case by mutual agreement. They will also try to agree on definitions of terms not specifically defined in the Treaty and on general matters of interpretation of the Treaty.

Thus this Article removes the need for the tax authorities in each State to go through diplomatic channels, they may simply contact each other directly. The mutual agreement procedure is commonly used to decide matters concerning income and expense allocations and transfer pricing.

Article 26 Exchange of Information

See treaty text.

The scope of this Article is quite wide ranging in that it provides for exchange of such information as is "necessary for carrying out the provisions of this Agreement", for the purposes of domestic law of the two States and also for the prevention of tax evasion. The exchange of information is not limited to that only concerning persons who are residents of one of the States.

The Article includes the usual provisos relieving the States from any obligation to:

- Carry out administrative measures at variance with the laws or administrative practices of either State;

- Supply information which is not obtainable under the laws or in the normal course of the administration of either State; and

- Supply information which would disclose any trade, business, industrial commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (*ordre public*).

There is no requirement to supply any information that the requested State would not need for its own tax purposes. Neither is there any bar on declining a request solely due to secrecy concerns.

Article 27 Diplomatic Agents and Consular Officers

See treaty text.

The provisions of this Convention shall not affect the fiscal privileges of diplomatic agents or consular officers under the general rules of international law.

Article 28 Entry into Force

See treaty text.

This Article contains the rules for bringing the Convention into force and giving effect to its provisions.

Article 29 Termination

See treaty text.

This Convention shall remain in force so long as it is not terminated by one of the two States.