[COMMITTEE PRINT]

PROPOSED INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND POLAND

PREPARED FOR THE USE OF THE

COMMITTEE ON FOREIGN RELATIONS

BY THE STAFF OF THE

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

NOVEMBER 4, 1975

U.S. GOVERNMENT PRINTING OFFICE

60-581 WASHINGTON : 1975 JCS-49-75

INTRODUCTION

There is presently no income tax convention between the United States and Poland. In recent years Poland has substantially increased its involvement in international commerce. As a result, its tax system has become relatively sophisticated in its treatment of foreign investors, thus making a tax treaty useful to obtain consistent tax treatment of foreign investment in both countries. Also, it can be expected that there will be increasing economic as well as cultural contacts between Poland and the United States which will generate an increasing number of tax problems.

The proposed convention follows the model tax convention of the Organization for Economic Cooperation and Development (OECD) and the recent tax conventions of the United States (including the Japanese and Norwegian Conventions). Thus, the proposed convention with Poland, in general, follows the approach of other U.S. income tax treaties.

The most significant feature of the proposed convention is the adoption of the "effectively connected" concept contained in most recent U.S. treaties and embodied in the Foreign Investors Tax Act of 1966. This replaces the so-called "force of attraction" doctrine which appeared in earlier treaties of the United States. Under the newer concept, a resident of one country who derives investment income from the other country is entitled to the reduced rates of tax provided by the proposed convention for such income even though he has a permanent establishment in the other country as long as the income is not effectively connected with the permanent establishment.

Other important features of the proposed convention include the following:

(1) The United States and Poland are defined to include their respective continental shelves for purposes of taxing income arising from the exploration and exploitation of natural resources on the continental shelf. The effect of this provision is to recognize a country's jurisdiction to tax income arising in connection with natural resource activities on that country's continental shelf. A definition of this type is found in other recent income tax conventions (e.g., Belgium and Norway). In addition, a similar provision was added to the Internal Revenue Code by the Tax Reform Act of 1969.

(2) The reciprocal exemption for income from transportation by ship and aircraft is extended to gains arising on the sale of the ships or aircraft and to income from the use of containers in connection with the use of a ship or aircraft.

(3) The tax on dividend income from direct investments is limited to a 5-percent rate, and the tax on any other dividends limited to a 15-percent rate.

(4) Interest income is generally exempt from tax unless that income is effectively connected with a permanent establishment in the country from which the interest is paid.

(5) Income from royalties (including cultural and industrial royalties) is generally limited to a 10-percent rate of tax.

The proposed convention does not include a provision exempting from tax social security payments (and other public pensions) paid by one country to residents of the other country. This provision is contained in most other recent U.S. conventions.

GENERAL EXPLANATION

Article 1. Scope of convention

The proposed convention generally applies to persons who are residents of one or both of the countries involved. However, in certain cases the proposed convention applies to citizens of either country, whether or not they are residents of either country.

Article 2. Taxes covered

The proposed convention applies to the U.S. Federal income tax imposed under the Internal Revenue Code, not including social security taxes. The proposed convention also applies to the income taxes imposed under Polish law, specifically the tax on wages and salaries, the equalization tax and the Polish income tax. The proposed convention also contains a provision generally found in U.S. income tax treaties to the effect that the convention applies to substantially similar taxes which either country may subsequently impose.

Only the nondiscrimination provisions of the proposed convention (Article 21) are to apply to taxes imposed by the States of the United States. However, the United States observes in a note accompanying the convention that generally the States of the United States would not tax a Polish resident where that resident is entitled to a reduced rate or exemption under the convention. The United States agreed that its tax authorities would use their best efforts, if necessary, to secure a tax exemption on ship and air transport profits.

The two countries are to notify each other of amendments to the tax laws covered by the proposed convention and of the adoption of any additional taxes which are covered by the convention by transmitting the text of any amendments or new statutes to the other country at least once a year.

Article 3. General definitions

The standard definitions found in most of our income tax treaties are contained in the proposed convention.

In addition, the proposed convention contains a provision which is contained in the more recent U.S. tax treaties which includes within the definition of the term "United States" the territorial sea of the United States and the continental shelf of the United States insofar as the exploration and exploitation of natural resources on the continental shelf are concerned.

This expanded definition, however, is applicable for purposes of the proposed convention only to the extent that the person, property, or activity of concern is connected with the exploration and expolitation of natural resources. A similar definition of Poland is contained in the proposed convention. The definition of continental shelf areas contained in the proposed convention is similar to that contained in the conventions with Trinidad and Tobago, Belgium, and Norway and to that provided in the Internal Revenue Code (as amended by the Tax

Reform Act of 1969), except that under the Code the continental shelf definitions apply only with respect to mines, oil and gas wells, and other natural deposits. Under the proposed convention, the applicability of the definition is not expressly restricted in this manner since it applies with respect to the exploration for or exploitation of any natural resource. In practical operation, however, the applicability of the provision usually will be similarly restricted. The activity of fishing is not intended to be considered the exploration or exploitation of natural resources of the continental shelf, and thus the definition of continental shelf is not to apply with respect to this activity.

The proposed convention also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the convention. It is further provided, however, that where a term is defined in a different manner by the two countries, the competent authorities of the two countries may establish a common meaning for the term in order to prevent double taxation or to further any other purpose of the convention.

Article 4. Fiscal domicile

The benefits of the proposed convention generally are available only to residents of the two countries. The proposed convention defines "resident of Poland" and "resident of the United States," and in addition provides a set of rules to determine residence for purposes of the convention in the case of an individual with dual residences. This provision of the proposed convention is based on the fiscal domicile article of the OECD model convention and is similar to the provisions found in other U.S. tax treaties.

Under the proposed convention, an individual whom both countries consider to be a resident according to their general rules for determining residence will be deemed for all purposes of the convention to be a resident of the country in which he has his permanent home, his center of vital interests, his habitual abode, or his citizenship. If the residence of an individual cannot be determined by these tests applied in the order stated, the competent authorities of the countries will settle the question by mutual agreement.

Article 5. General rules of taxation

The proposed convention contains the basic general rules of taxation which are found in most of our other tax treaties. It provides that a resident of one country may be taxed by the other country only on income from sources within that other country (which under the source rules of the proposed convention includes any business profits attributable to a permanent establishment of the resident in that other country).

The proposed convention also provides that it is not to be interpreted as denying tax benefits available presently or in the future under the tax laws of the two countries or under any other agreement between the countries.

Additionally, the usual savings clause is contained in the proposed convention providing that with certain exceptions the proposed convention is not to affect the taxation by the United States or Poland of its citizens or residents. The principal exceptions involve the benefits provided under the foreign tax credit, the nondiscrimination, the governmental salary, the teacher, and the student provisions.

Article 6. Definition of permanent establishment

The proposed convention contains a definition of "permanent establishment." The permanent establishment concept is one of the basic devices used in income tax treaties to avoid double taxation. Generally, a resident of one country is not taxable on its business profits by the other country unless those profits are attributable to a permanent establishment of the resident in the other country. In addition, the permanent establishment concept is used to determine whether the reduced rates of, or exemptions from, tax provided by the convention for dividends, interest, and royalties are applicable.

The proposed convention contains an expanded definition of permanent establishment which follows the pattern of the OECD model convention and other recent U.S. income tax treaties. In general, a fixed place of business through which a resident of one country engages in industrial or commercial activities in the other country is considered a permanent establishment. This includes a branch, an office, a factory, a workshop, a warehouse, and any building site, or construction or installation project which lasts for more than 18 months.

This general rule is modified to provide that a fixed place of business which is used for any or all of a number of specified activities will not constitute a permanent establishment. These activities include the use of facilities or maintenance of a stock of goods for storing, displaying, or delivering merchandise belonging to the resident, the maintenance of a stock of goods belonging to the resident for purposes of processing by another person, and the purchase of goods or collection of information for the resident.

The proposed convention also provides that a resident of one country will be deemed to have a permanent establishment in the other country if it maintains an agent in the other country who has, and habitually exercises, a general contracting authority (other than for the purchase of merchandise) in that other country. The proposed convention contains the usual provision that the agency rule will not apply if the agent is a broker, general commission agent, or other agent of independent status acting in the ordinary course of its business.

The proposed convention provides that a resident of one country is not deemed to have a permanent establishment in the other country merely because at the termination of a trade fair or convention in the other country the resident sells goods or merchandise which were displayed at the trade fair or convention.

Article 7. Income from real property

The proposed convention provides that income from real property (not including interest on obligations secured by property or by natural resource royalties) may be taxed in the country where the real property or natural resources are located. Income from real property includes income from the direct use, renting, and gains on the sale, exchange, or other disposition of the property.

Article 8. Business profits

Under the proposed convention, business profits of a resident of one country are taxable in the other country only to the extent they are attributable to a permanent establishment which the resident has in the other country. In computing the taxable business profits, the proposed convention allows the deduction of all expenses, wherever incurred, which are reasonably connected with the business profits.

It is further provided that business profits will not be attributed to a permanent establishment merely by reason of the purchase of merchandise by the permanent establishment, or by the resident of which it is a permanent establishment, for the account of that resident.

In determining the profits of a permanent establishment there is to be attributed to the permanent establishment by both countries the profits which would reasonably be expected to have been derived by it if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing at arm's-length with the related person of which it is a permanent establishment.

While the proposed convention does not set forth examples of the types of income which are considered business profits as does some of our other recent treaties, it is intended that those examples be followed in interpreting the proposed treaty. The proposed convention does include within business profits investment income arising from a right or property which is effectively connected with the permanent establishment as do our more recent treaties and the Internal Revenue Code. The types of passive income included within business profits are income derived from real property and natural resources, dividends, interest, royalties and capital gains.

Article 9. Shipping and air transport

The proposed convention provides that income derived by a resident of the United States from the operation in international traffic of ships or aircraft registered in the United States (and gains from the sale or exchange of ships or aircraft used in international traffic which are registered in the United States) are exempt from tax by Poland. Parallel treatment is provided for Polish residents regardless of where the ships or aircraft of those residents are registered.

Income from the operation of ships or aircraft in international traffic includes the rental income of ships or aircrafts operated in international traffic if the rental income is incidental to income from the actual operation of such ships or aircrafts. This rule permits, for example, an airline which is a resident of one country and which has excess equipment during certain periods to lease that excess equipment during those periods to an airline which is a resident of the other country. In such a case the rental income of the lessor is exempt from tax in the other country whether or not the other airline uses the aircraft in international traffic. The proposed convention also makes clear that income derived from the use, maintenance and lease of containers and related container equipment in connection with the operation in international traffic of ships or aircraft is to be included within the scope of the shipping and air transport provision.

Article 10. Related persons

The proposed convention and most other U.S. tax conventions contain a provision similar to section 482 of the Internal Revenue Code which allows the allocation of income in the case of transactions between related persons if an allocation is necessary to reflect the conditions and arrangements which would have been made between unrelated persons.

In addition, the proposed convention requires when a redetermination has been made by one country with respect to the income of a resident that the other country attempt to reach an agreement with the first country on the redetermination, and if an agreement is achieved, the other country make a corresponding adjustment to the income of persons related to the resident.

Article 11. Dividends

Under the proposed convention, the rate of tax in the source country on dividends received by a resident of the other country is limited to 15 percent of the gross amount of the dividend unless the recipient owns at least 10 percent of the voting stock of the company paying the dividend. In that case, the rate of tax is limited to 5 percent. If the shares of stock with respect to which the dividends are paid are effectively connected with a permanent establishment in the source country, the dividends are to be taxed under the business profits provisions of the proposed convention.

Article 12. Interest

Under the proposed convention interest income derived by a resident of one country from sources within the other country is exempt from tax unless the recipient has a permanent establishment in the other country and the indebtedness giving rise to the interest is effectively connected with that permanent establishment. If the indebtedness is effectively connected with a permanent establishment, the interest is to be taxed under the business profits article of the proposed convention.

A definition of interest is contained in the proposed convention which is substantially identical to that found in the OECD model convention and other recent U.S. income tax treaties. In situations where the payor and recipient of the interest are related, the proposed convention limits the application of the interest article to the amount of interest which would have been paid had the persons not been related.

In addition, rules are provided for the source of interest income which are substantially identical to those found in other recent U.S. income tax treaties.

Article 13. Royalties

The proposed convention provides that royalties derived by residents of one country from sources in the other country may be taxed by the source country, but the rate of tax which may be applied is limited to 10 percent of the gross amount of the royalty.

Royalties are defined as payments of any kind received as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works, including copyrights of motion picture films, or tapes used for radio or television broadcasting, any patents, designs, models, plans, secret processes or formulae, trademarks, or other like property or rights, or information concerning industrial, commercial, or scientific experience or skill (know-how). Royalties include gains derived from the sale or exchange of any property or rights, to the extent that the amounts realized on the sale or exchange are contingent on the productivity, use, or disposition of the property or rights. If the amounts realized are not so contingent, the capital gains provisions may apply.

The reduced rate of tax for royalties is to apply unless the recipient has a permanent establishment in the source country and the royalties are effectively connected with that permanent establishment. This treatment generally follows that provided in the OECD model convention and other recent U.S. tax treaties.

In addition, as in the case of the interest provision, the royalty provision of the proposed convention does not apply to that part of a royalty paid to a related person which is considered excessive.

Article 14. Capital gains

The proposed convention generally provides that capital gains derived by a resident of one country will be exempt from tax by the other country unless the recipient of the gain has a permanent establishment in the other country and the property giving rise to the gain is effectively connected with the permanent establishment. In the case of an individual resident of one country, gains derived from the other country will be exempt from tax in that country unless the individual is present in that country for more than 183 days during the taxable year. This exemption from tax for capital gains does not apply with respect to gains derived from the sale or exchange of real property (or the sale or exchange of royalty interests when the amount realized on the sale or exchange is contingent on the productivity, use or disposition of the interest). The treatment of capital gains contained in the proposed convention is similar to the treatment provided in other recent U.S. tax conventions.

Article 15. Independent personal services

Under the proposed convention, income from the performance of independent personal services in one country by a resident of the other country may be taxed in the source country unless the person performing the personal service is present in the source country for less than 183 days during the taxable year.

As a rule, most U.S. tax treaties have a similar 183-day rule for the taxation of independent services performed by individuals. However, the proposed convention does not contain a provision found in some recent treaties (such as the Norwegian treaty) permitting, under certain circumstances, the taxation of entertainers who are present in the source country for fewer than 183 days during the year.

Article 16. Dependent personal services

Under the proposed convention, income from services performed as an employee in one country by a resident of the other country will not be taxable in the source country if three requirements are met: (1) the individual is present in the source country for less than 183 days during the taxable year; (2) the remuneration is paid by, or on behalf of, an employer who is not a resident of the source country; and (3) the remuneration is not borne by a permanent establishment of the employer in the source country.

Remuneration derived by an individual from the performance of personal services as an employee aboard a ship or aircraft operated by a resident of one country in international traffic is exempt from tax by the other country provided that the individual is a member of the regular complement of the ship or aircraft.

Article 17. Teachers

The proposed convention provides that a teacher or researcher who is a resident of one country will be exempt from tax in the other country on income from teaching in that country if he is present in that country for a period not exceeding two years pursuant to an invitation of the host country or an educational institution of the host country. The exemption is not to apply if the research is undertaken not in the public interest but primarily for the private benefit of a specific person or persons.

Article 18. Students and trainees

Under the proposed convention, residents of one country who become students in the other country will be completely exempt from tax in the host country on gifts from abroad used for maintenance or study and on any grant, allowance or award received from a governmental or charitable organization. In addition, a limited exemption is provided for personal service income derived from sources within the country in which the individual is studying. Under this provision, the host country will exempt from tax $2,000 per year of personal service income (such as income from a part-time job). These exemptions (the complete, as well as the limited one) and the visiting teachers exemption may not be utilized for a period of more than 5 years in total. In addition, the benefits under the teachers article are not available to an individual if during the immediately preceding period the individual received the benefit of the student provision.

In addition to the exemption regarding students, the proposed convention follows the approach of other recent U.S. tax treaties and provides a limited exemption for personal service income of residents of one country who are employees of a resident of that country and who are temporarily present in the other country to study at an educational institution or acquire technical, professional or business experience. This exemption is available for a period of one year and is limited to $5,000. The proposed convention also provides an exemption for income from personal services performed in connection with training, research or study by residents of one country who are temporarily present in the other country as participants in government-sponsored exchange training programs. This exemption is limited to $10,000.

Article 19. Governmental functions

Under the proposed convention, wages, including annuities or similar benefits paid from public funds of one country to a citizen of that country for labor or personal services performed as an employee of the national government of that country or any agency thereof in the discharge of governmental functions, is exempt from tax by the other country. Labor or personal services are to be treated as performed in the discharge of governmental functions if the labor or services would be treated under the internal laws of both countries as so performed. The proposed convention generally follows the approach of other recent income tax conventions except that the exemption in the proposed convention is limited to individuals who are employees of the national government.

Article 20. Relief from double taxation

The proposed convention provides for the avoidance of double taxation by means of the foreign tax credit. Under the proposed convention, a U.S. citizen, resident, or corporation will be allowed a credit against the U.S. tax for the appropriate amount of income taxes paid to Poland.

In addition, a U.S. company owning at least 10 percent of a Polish company will be allowed a credit against any dividend received for the amount of taxes paid to Poland on the profits out of which any dividend is paid. The credit allowed under these provisions is subject to the provisions of U.S. law applicable to the year in question and is limited to the amount of U.S. tax attributable to income from sources within Poland. Since these provisions do not contain a specific formulation of the limitation on the credit allowed, a foreign tax credit claimed by a U.S. taxpayer under these provisions will be subject to the applicable limitations provided by the Internal Revenue Code.

Under the proposed convention, Poland will provide a foreign tax credit to its citizens or residents in a manner parallel to the U.S. tax provision in the proposed convention, except that no provision is made for allowing a credit to any Polish corporation for taxes paid by a U.S. subsidiary corporation from which the Polish corporation receives a dividend.

Article 21. Nondiscrimination

The proposed convention contains a comprehensive nondiscrimination provision similar to provisions which have been embodied in other recent U.S. income tax treaties. It first provides that one country cannot discriminate by imposing more burdensome taxes on its residents who are citizens of the other country than it imposes on its own citizens who are also residents there.

Second, a permanent establishment which a resident of one country has in the other country may not be subject in that other country to more burdensome taxes than are generally imposed in that other country on citizens or permanent establishments of residents of third countries carrying on the same activities. The comparison in the proposed convention is with respect to businesses of third countries rather than residents of the host country because the Polish taxation of other foreign businesses is a more relevant comparison than Polish taxation of domestic businesses, which are frequently State-owned enterprises.

In addition, the proposed convention provides that a corporation of one country which is wholly or partly owned by one or more residents of the other country is not to be subject in the first country to any taxation or requirement connected with taxation which is different or more burdensome than the taxation and requirements to which a corporation of the first country owned by resident of a third country is or may be subject to. As with the provision prohibiting discrimination against permanent establishments, the comparison for this provision is with residents of third countries. However, neither of these two provisions require a country to grant to residents of the other country tax benefits granted by special agreement to the residents of third countries.

This Article, as well as Article 2 (Taxes Covered by the Convention) specify that no provision of the proposed convention applies to the Polish Treasury residence registration fee. This fee is annually required of both Polish citizens and aliens; the amount of the fee is $1 for aliens and approximately 10¢ for Polish citizens. The United States agreed to exclude this fee from the terms of the proposed convention, including the nondiscrimination article, because of its nominal amount.

Articles 22 and 23. Administrative provisions

The proposed convention contains various administrative provisions generally along the lines of the provisions contained in other U.S. tax treaties. In general, the proposed convention provides—

(1) for consultation and negotiation between the two countries to resolve differences arising in the application of the proposed convention and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the terms of proposed convention; and

(2) for the exchange between the countries of information pertinent to carrying out the provisions of the proposed convention or preventing fraud or fiscal evasion with respect to taxes covered by the proposed convention.

However, the proposed convention does not contain a provision which appears in most other U.S. treaties which requires that each country assist the other in collecting taxes imposed by the other country to the extent necessary to insure that the benefits provided by the proposed convention are enjoyed only by persons entitled to those benefits.

Article 24. Diplomatic and Consular Officials

The proposed convention contains the rule found in other U.S. tax treaties that its provisions are not to affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or the provisions of special agreements.

Article 25. Entry into force

The proposed convention will enter into force 30 days following the exchange of the instruments of ratification. It will become effective generally for taxable years (and payments made) beginning on or after January 1, 1974. Reductions in U.S. withholding taxes under the proposed convention generally will apply to amounts received on or after the date the proposed convention enters into force.

Article 26. Termination

The proposed convention will continue in force indefinitely, but either country may terminate it at any time after 5 years from its entry into force by giving notice through diplomatic channels.

O