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The U.S. – Poland Income Tax Treaty

1. Introduction

During the 1990's and the early 2000's, the United States Treasury Department (hereafter: the "Treasury") undertook a program of renegotiating all of the U.S. income tax treaties that did not contain a limitation on benefits ("LOB") provision. By 2010, this effort was virtually complete: the two outstanding treaties that the Treasury was concerned about were the treaties with Hungary and Poland, both of which dated back to the 1970's and were concluded during the era of the Soviet Union's domination of Eastern Europe.[2] The Treasury, wielding the threat of abrogating these treaties entirely, negotiated new tax treaties with Hungary (signed in February 2010)[3] and Poland (signed in February 2013).[4] The new treaty with Hungary was submitted to the United States Senate for ratification

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[2] United States – Poland Income Tax Convention, https://www.irs.gov/pub/irs-trty/poland.pdf (accessed: 21.03.2021); Tax Convention with the Hungarian People's Republic, https://www.irs.gov/pub/irs-trty/hungary.pdf (accessed: 21.03.2021).

[3] Convention between the Government of the United States of America and the Government of the Republic of Hungary for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Hungary-2-4-2010.pdf (accessed: 21.03.2021).

[4] Convention between the United States of America and the Republic of Poland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Poland-2-13-2013.pdf (accessed: 21.03.2021).

in November 2010[5] and the new treaty with Poland was submitted to the Senate in May 2014.[6] Almost a decade later, neither of these treaties has been ratified by the Senate.

2. The 2006 U.S. Model Convention

The starting point for the negotiations between the Treasury and Poland was the U.S. Model Income Tax Convention published by the Treasury in 2006 (hereafter: the "2006 U.S. Model Treaty").[7] A comparison of the text of the new U.S. tax treaty with Poland (hereafter: U.S. – PL DTC) with the text of the 2006 U.S. Model Treaty shows that the majority of the provisions of the Polish Treaty have been lifted verbatim from the 2006 U.S. Model Treaty.

Critically, the 2006 U.S. Model Treaty contained the Treasury's latest version of its LOB provision. This provision, embodied in Art. 22 of the 2006 U.S. Model Treaty, limits the benefits of the Treaty to taxpayers that are not only residents of the treaty partner, but "qualified" residents of the treaty partner. Thus, under Art. 22 of the U.S. – PL DTC, only Polish resident taxpayers that have an adequate economic connection to Poland are entitled to claim benefits from the United States. For example, a publicly traded corporation tax resident in Poland may claim benefits under the tax treaty if it is publicly traded on the Warsaw Stock Exchange or is managed and controlled from Poland. Also, a corporation tax resident in Poland may claim benefits under the tax treaty if it is owned and controlled by a limited number of Polish resident corporations which are themselves qualified to claim benefits from the United States under the tax treaty.

Treasury experience in negotiating treaties under the 2006 U.S. Model Treaty had led to three additional provisions that extended the definition of "qualified taxpayer" under the 2006 U.S. Model Treaty. All three of these provisions are included in the U.S. – PL DTC.

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[5] Message from the President of the United States transmitting Convention between the Government of the United States and the Government of the Republic of Hungary for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Treaty Doc. 111-7, 111th Congress, 2nd Session.

[6] Message from the President of the United States transmitting the Convention between the United States of America and the Republic of Poland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Treaty Doc. 113-5, 113th Congress, 2nd Session.

[7] United States Model Income Tax Convention of 15 November 2006, https://www.irs.gov/pub/irs-trty/model006.pdf (accessed: 21.03.2021).

First, the U.S. – PL DTC introduces the concept of "equivalent beneficiaries," that is, taxpayers who are entitled to benefits under another U.S. tax treaty with a European Union Member State that are at least as favorable as the benefits under the U.S. – PL DTC.[8] If a Polish resident corporation is owned and controlled by a limited number of equivalent beneficiaries, and if less than 50 of its gross income is paid to persons who are not equivalent beneficiaries, then the corporation is entitled to claim benefits from the United States under the tax treaty.

Second, the U.S. – PL DTC introduces the concept of a "headquarters company."[9] Under the U.S. – PL DTC, a corporation tax resident in Poland may claim benefits from the United States if the company owns and actively manages businesses in at least five different countries and earns less than 25% of its gross income in the United States.

Finally, the U.S. – PL DTC includes a rule that prohibits a Polish tax resident corporation from claiming benefits from the United States for income earned through a permanent establishment in a third country if the combined rate of tax in Poland and the third country is less than 60% of the Polish rate of tax that would apply if the income were earned in Poland.[10]

3. Variations from the 2006 U.S. Model Treaty

The most obvious difference between the U.S. – Poland DTC and the 2006 U.S. Model Treaty relates to the rate of withholding tax levied on interest and royalties. Under the U.S. – PL DTC, the country of residence may tax interest and royalties, but the country of source is limited to a withholding tax rate of 5%.[11] The 2006 U.S. Model Treaty prohibits the source country from imposing any withholding tax at all.

Interestingly, the U.S. – PL DTC does not adopt a related provision that has appeared in some recent U.S. tax treaties but was not included in the 2006 U.S. Model Treaty: namely, the elimination of the withholding tax on dividends paid by a subsidiary in one treaty country to its parent in the other treaty country. Under the U.S. – PL DTC, such dividends are subject to a 5% withholding tax comparable to the tax on interest and royalties.[12]

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[8] United States – Poland Income Tax Convention, Art. 22, sec. 3, see: supra note 2.

[9] United States – Poland Income Tax Convention, Art. 22, sec. 5, see: supra note 2.

[10] United States – Poland Income Tax Convention, Art. 22, sec. 6, see: supra note 2.

[11] United States – Poland Income Tax Convention, Art. 11, sec. 2, and Art. 12, sec. 2, see: supra note 2.

[12] United States – Poland Income Tax Convention, Art. 10, sec. 2, see: supra note 2.

A variation of a different sort appears in Art. 7 of the U.S. – PL DTC, which adopts not the language of the 2006 U.S. Model Treaty, but, rather, the language of the OECD Model Convention on Income and Capital (hereafter: OECD MC) most recently issued by the Organization for Economic Cooperation and Development. The OECD MC language firmly establishes the principle that a branch of a company located in one treaty country must be treated AS IF it were a separate corporation from its home office in the other treaty country, and the arm's length principle applied to the two deemed corporations as it would between a parent company and its subsidiary. This probably does not mean a substantial change in U.S. treaty policy, but it puts in the past U.S. arguments that you cannot recognize transactions between a home office and its branch for purposes of applying the arm's length principle.

Finally, the U.S. – PL DTC does not adopt another provision that has been added to the OECD MC in a number of recent treaties, namely, a provision for binding arbitration of tax disputes between competent authorities. The U.S. – PL DTC maintains the competent authority provisions of Art. 25 of the OECD MC largely intact.

4. Information Exchange

Article 26 of the 2006 U.S. Model Treaty provides for information exchange between the competent authorities of the two treaty partners. Article 26 of the U.S. – PL DTC largely follows the 2006 U.S. Model Treaty. One change of note relates to the standard of what information is subject to exchange. The U.S. – PL DTC moves from the 2006 U.S. Model Treaty standard of "information as may be relevant" to the OECD MC language of "information foreseeably relevant" to the administration of the tax system of the requesting tax authority.[13] This does not appear to be a substantive change of any magnitude and was intended merely to bring the U.S. standard into line with the international practice as evidenced by the latest OECD pronouncement.

While information exchange is a long-standing element of all U.S. tax treaties, it is critical to note that the provisions of the U.S.'s existing treaties have to some extent been superseded by developments following the enactment of the Foreign Account Tax Compliance Act ("FATCA") in 2010. Specifically, the United States and Poland have entered into an

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[13] United States – Poland Income Tax Convention, Art. 26, sec. 1, see: supra note 2.

intergovernmental agreement under FATCA under which the Polish tax authorities have agreed to provide the U.S. tax authorities with information of the type that would be deliverable under Art. 26 of the Model Treaty.[14] The United States and Poland have also entered into an agreement providing for exchange of their respective Country by Country reports as envisaged by the OECD Base Erosion and Profit Shifting ("BEPS") project.[15]

5. Efforts at Ratification

Poland completed the steps necessary to ratify the U.S. – PL DTC before the end of the calendar year 2013.

The history of the U.S. – PL DTC in the United States has been quite different. The Department of the Treasury published its Technical Explanation of the U.S. – PL DTC (the "Technical Explanation") in June 2014.[16] Meanwhile, the President had submitted the Treaty to the Senate for ratification and the Joint Committee on Taxation had prepared its Report on the Treaty for the Senate (the "JCT Report").[17] The Treaty was referred to the Senate Committee on Foreign Affairs, which held hearings on the Treaty in June 2014 and reported it out to the full Senate, with a favorable recommendation, in July 2014.[18] The Senate did not act on the Treaty before the end of the then-current session of Congress in December 2014. The Senate Foreign Relations Committee again held hearings on the Treaty in late 2015 and reported it out again to the full Senate with

[14] Agreement between the Government of the United States of America and the Government of the Republic of Poland to Improve International Tax Compliance and to Implement FATCA, https://home.treasury.gov/system/files/131/FATCA-Agreement-Poland-10-7-2014.pdf (accessed: 21.03.2021).

[15] Arrangement between the Competent Authority of the United States of America and the Competent Authority of the Republic of Poland on the Exchange of Country-by-Country Reports, https://www.irs.gov/pub/fatca/poland_competent_authority_arrangement_cbc.pdf (accessed: 21.03.2021).

[16] Department of the Treasury Technical Explanation of the Convention between the United States of America and the Republic of Poland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-Technical-Explanation-Poland-6-19-2014.pdf (accessed: 21.03.2021).

[17] Joint Committee on Taxation, Explanation of Proposed Income Tax Treaty between the United States and Poland, JCX-68-14 (17 June 2014).

[18] Tax Convention with Poland, Exec. Report 113-11, 113th Congress, 2nd Session.

a favorable recommendation in April 2016.[19] Again, the Senate did not act on the Treaty before the end of the then-current session of Congress in December 2016.

The reason for the failure of the Senate to act on the U.S. – PL DTC is a simple one: Senate procedures require unanimous consent to proceed to consideration of a treaty on an expedited basis, and Senator Rand Paul of Kentucky has objected to the consideration of any treaty that includes exchange of information provisions such as those found in the 2006 Model and the U.S. – PL DTC. Moreover, the Republican leadership of the Senate has been unwilling to devote effort and time to moving treaties through the ratification process required in the absence of unanimous consent.

6. Ratification and the BEAT

After the failure of the U.S. – PL DTC to gain ratification during the session of Congress that ended in 2016, neither the Trump Administration nor the Senate Foreign Relations Committee moved to bring the Treaty before the Congress in the years 2017–2019. The U.S. – PL DTC, and tax treaties with Switzerland, Luxembourg, Spain, Japan, Chile and Hungary, remained in legislative limbo.

The situation changed in mid-2019, reportedly because a Kentucky corporation owned by a Spanish parent corporation pressed the Senate Majority Leader Mitch McConnell of Kentucky, to facilitate ratification of the Spanish treaty that had been signed in 2013. At this time, at a meeting between officials of the Department of the Treasury and the Senate Foreign Relations Committee, the Trump Administration agreed to support the ratification of the four tax protocols that had been previously considered – those with Switzerland, Luxembourg, Spain and Japan – but declined to support ratification of the three treaties that were entirely new – those with Chile, Hungary and Poland.[20] The Trump Administration took the position that it would only support those three treaties if the ratification resolutions contained explicit statements that the ratification of the treaties would not override any inconsistent provisions of the Tax Cuts and Jobs Act of 2017 (the "TCJA") – the Trump Administration's signature tax cut.

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[19] Tax Convention with Poland, Exec. Report 114-3, 114th Congress, 2nd Session.

[20] Foreign Relations Committee, *Menendez Asks Sec. Mnuchin to Explain Attempts at Changing International Tax Treaties*, 2019, https://www.foreign.senate.gov/press/ranking/release/menendez-asks-sec-mnuchin-to-explain-attempts-at-changing-international-tax-treaties (accessed: 21.03.2021).

The Trump Administration's primary concern was with the so-called BEAT provision, the Base Erosion and Anti-Abuse Tax, which has been widely criticized as inconsistent with the anti-discrimination provisions present in all U.S. tax treaties, including the U.S. – PL DTC. Under the U.S. rule that statutes and treaties are of equal status, and that the last in time prevails, ratification of these three treaties without such an explicit reservation could have had the effect of repealing anything in the TCJA inconsistent with the treaties and, arguably, preventing the enforcement of the BEAT against Chilean, Hungarian and Polish taxpayers.

Senator McConnell moved the four tax protocols to ratification by the Senate in July 2019, with the final ratification votes being almost unanimous in favor, excepting only Senator Paul and Senator Lee of Utah. The protocols with Switzerland, Luxembourg, Spain, and Japan have now entered into force. But the treaties with Chile, Hungary and Poland remain in legislative limbo due to the arcane procedural rules of the United States Senate.

7. The Biden Administration

The expiration of the 116th Congress on 3 January 2021, means that the process of ratifying the Polish and Hungarian treaties must begin again in the 117th Congress. The Biden Administration has indicated that it would like to move forward with the tax treaties with Poland, Hungary and Chile that remain pending in the Senate.[21] But Senator Paul remains in the Senate and retains his veto over the expedited process of obtaining Senate ratification of the treaties. So as of the date of this writing, February 2021, the status of the tax treaties with Poland and Hungary remains in limbo.

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[21] See question 24 at *Finance Committee Questions for the Record*, 2021, https://www.finance.senate.gov/imo/media/doc/Dr%20Janet%20Yellen%20Senate%20Finance%20Committee%20QFRs%2001%2021%202021.pdf (accessed: 21.03.2021).

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Abstract

The article deals with the U.S. program of renegotiating all the U.S. income tax treaties including the 2013 tax treaty between the U.S. and Poland. The Author discusses reasons why almost a decade later, neither of these treaties has been ratified by the U.S. Senate.

Keywords: tax treaties, ratification, U.S. Model