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Article

Permanent establishment as a foreign direct investment in Poland: Identification of tax barriers in the context of new tax development

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Empirical Paper

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Permanent establishment as a foreign direct investment in Poland: identification of tax barriers in the context of new tax development

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Abstract: The paper aims to identify the significant tax barriers to foreign direct investment (FDI) in Poland, in particular in the form of a permanent establishment (PE), in the context of new developments in international tax law. Due to the recommendations of the Base Erosion and Profit Shifting (BEPS) project, launched by Organisation for Economic Co-operation and Development (OECD) to prevent international tax avoidance, the understanding of PE has changed, which could lead to changes in business models. The purpose of the research is also to identify the significant tax barriers to economic activity in Poland, in particular in the form of PE, against the international tax law context. The study conducted by the authors relies on the most current tax rulings and judgments of administrative courts issued between 2017 and 2020. It is concluded that not so much the effective tax burdens but the regulatory ambiguity surrounding the tax obligations may contribute to the reduction of Poland's attractiveness as a location for FDI.

Keywords: BEPS, foreign direct investment, permanent establishment

JEL Classification: F65, F21, H26, K34

1 Introduction

Many arguments, such as easier access to the host country market or resources, avoiding barriers to imports, lower transaction costs, or reduction of the cost of production, transport, and distribution, can be put forward in favor of launching business operations outside of an enterprise home country. On the other hand, high tax rates and the so-called double taxation are among the major barriers to the growth of foreign direct investment (FDI) in developing countries [Egger et al., 2004, p. 901]. At the same time, however, one needs to bear in mind that the tax system currently binding in Poland is not neutral across time periods or sectors. This means that when taking business decisions, entrepreneurs should not ignore tax effects which, if taken into account, may trigger changes in the ranking order of the considered business options. For example, differences in taxes that apply to alternative legal forms of business organization can impact tax performance of investment projects [Jamroży, 2014, p. 257]. Business decisions are taken at institutional (choice of legal form, business location, and restructuring option) and functional (choice of an investment project to be carried out or choice of the sources of its funding, revenue, and expense recognition policy, transfer pricing policy, etc.) levels.

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A permanent establishment (PE) is one of the forms of FDI. In principle, a PE is a fixed place of business through which the business of an enterprise is carried out wholly or partly.¹ Specific forms of PE include a transparent partnership, dependent agent, server,² and construction (installation) works. As a rule, the definition of a PE on grounds of national legislation³ overlaps with the definition contained in bilateral agreements based on Art. 5 of the Organisation for Economic Co-operation and Development (OECD) Model Convention (hereinafter “OECD-MC”), with the exception of the delineation of the scope of works leading to the creation of a PE.

According to current principles, a Contracting State has the right to tax the profits of an enterprise, resident of the other Contracting State only when operations exercised by this enterprise remain in sufficiently intense connection with the state where its profits originate from. The extension of the concept of a PE observed in recent years is a reflection of enhanced relevance of source-based taxation.⁴ The aforesaid statement stems from the implementation of recommendations of the Base Erosion and Profit Shifting (BEPS) project launched by the Organization for Economic Cooperation and Development to prevent international tax avoidance which results, among others, from harmful tax competition between countries interested in attracting FDI and from the avoidance of PE status by the fragmentation of activities and by creating structures based on formally independent foreign agents [Pleijssier, 2015; Dos Santos et al., 2016; Jamróży, 2016]. In many instances, the change in the understanding of a PE and the resultant increased relevance of source taxation will force out changes in business models.

The paper primarily aims to identify the significant tax barriers to economic activity in Poland, in particular in the form of PE, against the context of changes occurring in international tax law. Author discusses the findings of his study that consisted the examination of individual tax rulings issued in this area by the Head of the National Revenue Administration and administrative court decisions. In order to capture the most current and relevant issues, the author focused on tax rulings issued by the tax authorities and judgments of administrative courts between 2017 and 2020. For the purpose of the study, 65 tax rulings and 25 judgments of administrative courts were investigated. Due to the pandemic of COVID-19 and general unwillingness to sharing confidential tax data, the author decided that a survey research would produce less reliable and meaningful results.

2 The residence and source principle

International tax law recognizes two fundamental principles that delineate the scope of taxation: the residence and the source principles [Vogel, 1988, p. 393; Gross et al., 2020, p. 2; Litwińczuk, 2020, p. 105]. Based on the source principle, states apply limited tax liability, irrespective of the residence of the subject earning the income, and tax all revenue (income) generated within their territories and at the same time exempt all residents' income earned abroad [Gomułowicz, 2007, p. 34]. Hence, it is possible to determine the scope of tax jurisdiction by identifying an objective tax link. It is crucial to find out whether the income in question was generated within the territory of a given state [Budesz and Komer, 2012, p. 12]. The source principle is therefore in line with the principle of sovereignty, which implies the priority of the tax authorities of the source state in levying tax on income generated on its territory [Schindel and Atchabahian, 2005, p. 29] by which it eliminates the need to sign double tax agreements.

On the other hand, the residence principle is underpinned by the so-called unlimited tax liability applied by the state. The tax link here has a subjective character. For natural persons, it may be the place of residence, habitual abode, or citizenship; and for legal persons, it may be the place of effective management or the place of registered office. According to the residence principle, the state has the right to tax all the

¹ See, Art. 5 para. 1 OECD-MC.

² For details about tax systems that apply to e-trade see J. Warniela, *Międzynarodowe aspekty opodatkowania gospodarki cyfrowej*, chapter 2 para. 2.

³ Since 1 January 2007, the definition of a PE can be found in Art. 5a para. 22 of the PIT Act and in Art. 4a para. 11 of the CIT Act.

⁴ *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD 2015.

resident's income, regardless of the place where it is earned. In view of this statement, the place where income was generated is not of primary importance in this case [Budesz and Komer, 2012, p. 12], which is why it is assumed that the application of this principle neutralizes the effects of harmful tax competition [Genschel and Schwarz, 2011, p. 343; Jamróży, 2018, p. 106]. Double taxation occurs through the overlap of a limited tax liability based on the source principle and an unlimited tax liability based on the residence principle. It is important that there is an adequate convergence of the taxed income, subject, and type of tax, as well as the period for which the tax is due [Koreń, 2013, p. 23].

Source-based taxation is more beneficial for developing countries, which depend on foreign capital and investment flows. A vast majority of double tax agreements are based on the model proposed by the OECD [Quak and Timmis, 2018, p. 2], which reduces the application of source-based taxation. The OECD-MC favors taxation in the country of residence, thus offering benefits to developed countries investing in developing countries. In nearly every case, the country of residence is a developed country, while the source country is a developing country, which leads to the so-called “distributional implications” [Rixen and Schwarz, 2009, p. 446].

In the case of an asymmetric investment position, the reduction of withholding tax rates leads to the transfer of revenue from capital importers to capital exporters, thus favoring the interests of the latter. The eagerness to attract FDI by countries importing foreign capital has triggered the harmful tax competition, resulting in tax base erosion and profit shifting to tax jurisdictions offering more favorable tax rules. These actions undermined the integrity of the international tax system leading to the intervention of international organizations.⁵

One of the actions against tax avoidance is the tightening of regulations on the taxation of PEs seeking to secure source-based taxation. The main principle underpinning the BEPS project is the taxation of income at the place where it was generated, which means that the source principle is gaining in importance.

3 PE as a form of FDI

Along with a subsidiary, PE is one of the basic forms of FDI [Schmidt, 2019, p. 16; Jamróży, 2014, p. 256]. The advantage of doing business by creating a PE consists of taxation of entrepreneur's income only once, which tax-wise makes it an extremely attractive solution. According to Art. 7, para. 1 of the OECD-MC (the so-called PE principle), a Contracting State has the right to tax the income from business activity of an enterprise that is a resident of another state only if there is a sufficiently intensive connection between the activity that the enterprise pursues and the state where the source of income is located.

The term “permanent establishment” was first introduced as a tax concept in the eastern part of Prussia in the 19th century to prevent double taxation between its municipalities [Avery Jones et al, 2006, p. 233]. Since that time, the concept of PE has been pivotal in the distribution of taxing rights between states by determining situations where the source state possesses the right to tax the business profits of a nonresident entity [Reimer, 2015, p. 297]. As explained by Vogel, the PE rules were designed to ensure taxation for the source state when the foreign entity possessed strong economic bonds therein [Vogel, 1997, p. 280]. As Skaar put it, a PE presupposed that the activities of a foreign entity in the source state had grown to the extent that the benefits from this country's expenditure networks justify taxation in that country [Skaar, 1991, p. 559]. The PE concept thus operated as a benchmark for allocating taxing rights between the residence and source states, being mostly successful at fulfilling this goal in times of nonglobalization [Dhuldhoya, 2018, p. 10]. However, globalization and e-commerce opened the door to business models that have challenged the applicability of the PE definition by allowing foreign entities to have a substantial economic involvement in the source country without triggering a PE in its traditional form [Pinto, 2006, p. 266]. The change in the *modus operandi* of businesses globally adds to this complexity and raises new

⁵ The most recent initiative adopted to combat international tax avoidance is the Base Erosion and Profit Shifting (BEPS) project launched by the OECD, see the note no. 4.

questions, which, in many instances, were not even contemplated when international law concepts were being developed.

Foreign investment in the form of a PE may bring higher tax benefits connected mainly with the use of the exemption method in the country of residence and a greater scope of freedom when allocating revenues/costs and assets between the company and the headquarter. On the other hand, what can be considered a benefit (greater flexibility of the PE) is associated with a higher tax risk, e.g., with regard to the establishment of the PE and the allocation of profits. It may lead to tax arrears in the resident country and, as a result, to additional costs [Peretiatkowicz, 2016, p. 126].

Case law has also shown that some tax authorities apply the PE concept in circumstances where others would never do it.⁶ The challenge for multinationals is that the definition and tests for what triggers a PE differ between countries, and there is no universal standard that is applied. This leads to a situation where a taxpayer cannot be sure about the legal grounds and rules, which as a result creates a barrier to growth and further development of business environment.

Consequently, despite the tax attractiveness of PEs, the number of businesses that avail themselves of it is not significant. In fact, it has been regularly decreasing for several years already (see the data of the Ministry of Finance in Figure 1). The trend that unrolls in Poland coincides with what was observed abroad also before the BEPS and Anti-Tax Avoidance Directive (ATAD) recommendations have been put in place, among others, in Norway [Engsig, 2014] and Germany, where the population of foreign affiliates has been decreasing since 2006 [Ringe, 2013].

In the study carried out by the PwC on a sample of over 200 enterprises, mainly multinationals based in 11 European countries and in the USA, only 33% respondents declared that they treated a PE as a better alternative to a related entity. Moreover, as many as 47% of respondents agreed with the statement that the current OECD commentaries on the creation of a PE involve a considerable tax risk [PwC, 2013, p. 6]. In addition, a significant proportion of respondents (78%) decided that the approach of tax authorities for

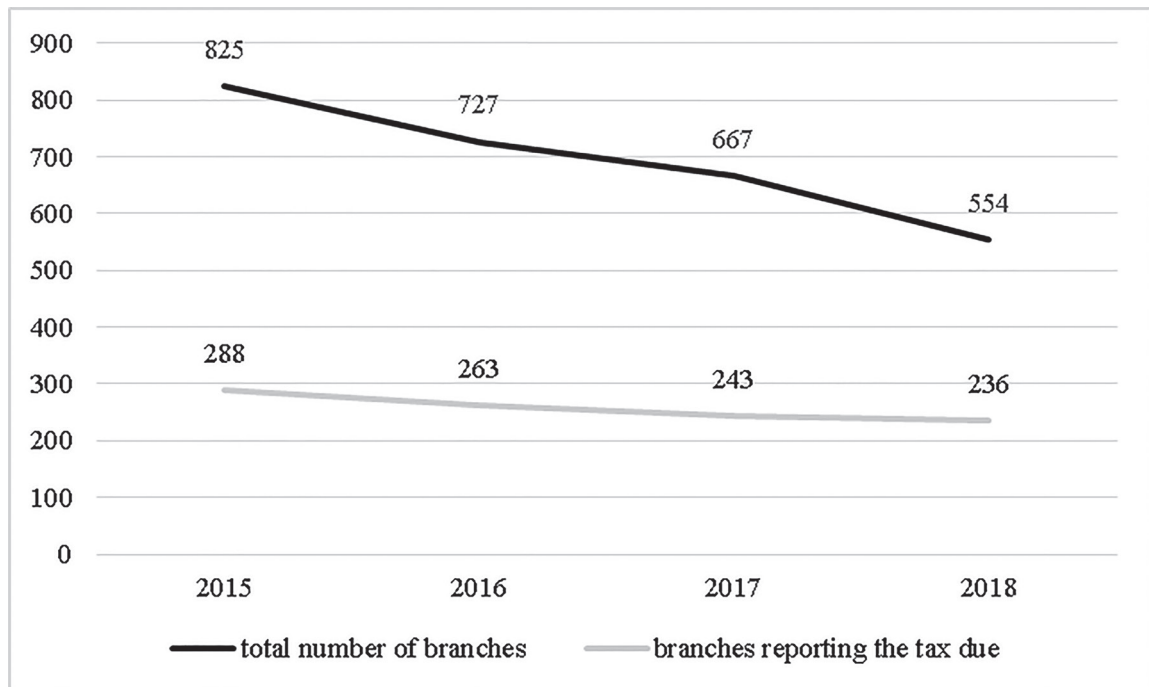


Figure 1. Foreign branches in Poland over the period 2015–2018.

Source: Ministry of Finance.

⁶ See case of *Dell Spain v. Spain*, June 2016, Supreme Court (Case No. 1475/2016).

the creation of a PE differs across countries and that they are more aggressive toward the creation of a PE than that in previous years (63% of respondents). Special attention was paid to the mobility of corporation employees which, according to 86% of respondents, involves the risk of creating a PE in the form of a dependent agent.

One of the real challenges involved in tax planning in the context of a PE is that each country has the authority to create its own standards and criteria for a PE creation. Therefore, there is nothing like a reliable “general” approach that would work to predict the creation of a PE status, although some global regions are beginning to target any revenue generated within a host country. Some markets, such as Europe, are aggressive in pursuing PE claims and the associated revenue, and even tax treaties fail to offer much relief. Successful legal PE cases against large hi-tech companies have emboldened European countries to continue along these lines. In Asia-Pacific, China as a popular business market has one of the most generous approaches to PE for foreign companies but also has tax treaties with major trading partners that grant some relaxed criteria and tax rates. A drop in the interest in European countries as a destination of FDI reflected in the size of FDI inflow can be seen in the diagram below (Figure 2).

On the other hand, the amount of income tax levied on branches in 2015–2018 has increased significantly, even though it dropped in 2018 compared with 2017 (see the data provided by the Ministry of Finance in Figure 3).

Increased tax revenue from the branches of foreign companies may be attributed to the increased value of investment, as well as to the narrowing Corporate Income Tax (CIT) gap [NBP, 2018]. According to the data from the National Bank of Poland (NBP), reinvested revenue and dividends represented the major proportion of revenue generated by the FDI [NBP, 2018]. That, in turn, increases the revenue to the state budget for two reasons. On the one hand, such increases can be stimulated by good economic situation, which reduces the propensity to engage in illegal or quasi-legal arrangements [Elgin, 2013, p. 478]. On the other hand, increased tax revenue may result from improved tax collection, an effect of measures adopted to tighten the tax system [Janiszewska, 2020, p. 19].

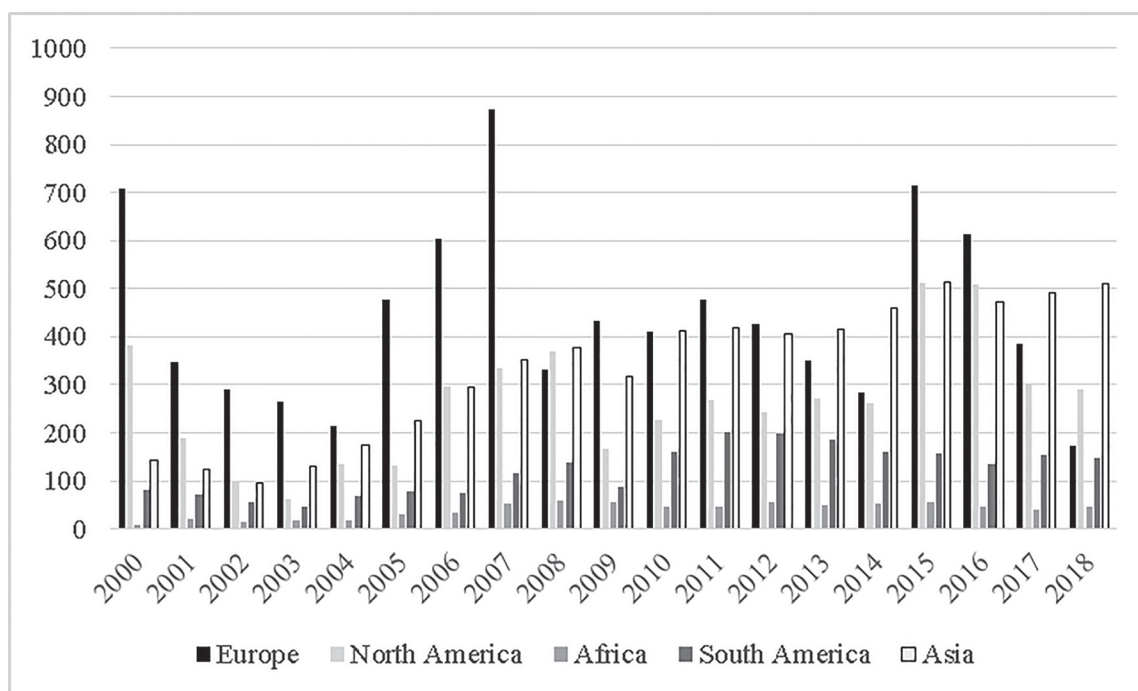


Figure 2. Geographic structure of FDI inflows in the period 2000–2018 (in billion of USD).

Source: own collaboration based on UNCTAD (2000–2019). World Investment Report for years 2000–2018, New York and Geneva.

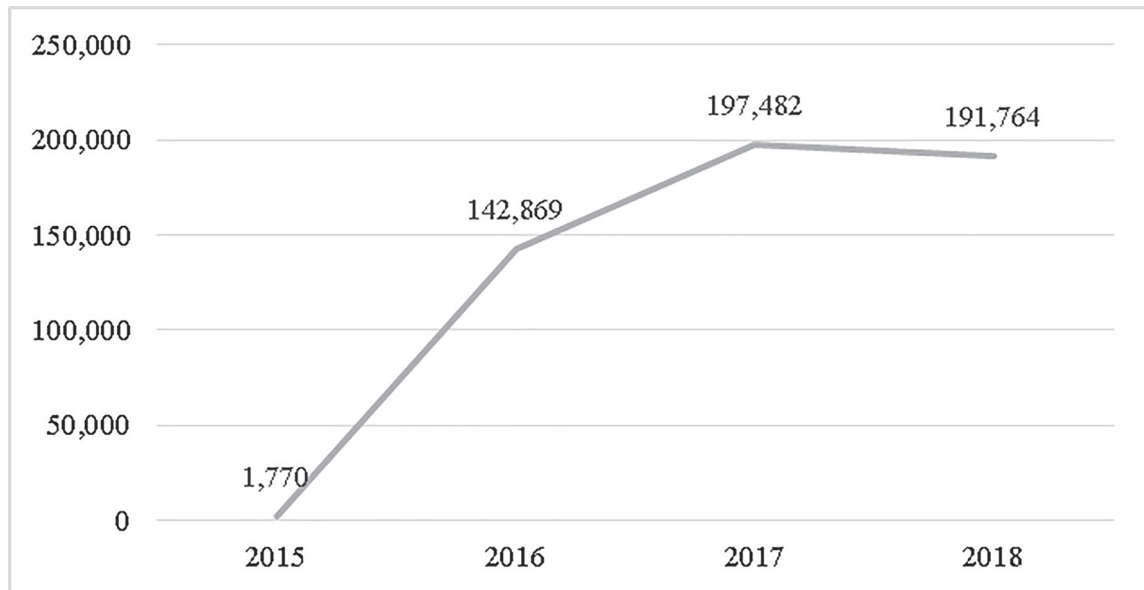


Figure 3. Income tax levied on branches in 2015–2018 (in thousands of PLN).

Source: Ministry of Finance.

4 Creation of PE

PE is created when the business of an enterprise meets criteria such as having a stable and ongoing presence in a foreign country and carrying out business operations through it. Importantly, these business activities should not be of preparatory or auxiliary character [Skaar, 2020, p. 9; Jamróży, 2016, p. 61]. Therefore, taxation of the enterprise's profits generated in the source state depends on its physical presence in this state. The willingness to limit withholding tax, especially in jurisdictions with a high level of taxation, may be achieved by limiting the so-called taxable presence in overseas markets. This can be done by developing business models in such a way that the above mentioned taxable presence conditions are not fulfilled. Among them one can mention, inter alia, acting through formally independent agents and fragmentation of business activities, which were to be combated by selected measures adopted under the BEPS project. This, however, does not apply to the so-called digital PEs. For them, the OECD recommendations highlight the need to expand the definition of a PE to cover cases of maintaining significant digital presence in a given country [OECD, 2017, p. 16]. According to the previous definition, a PE occurs in the place where the server is located, thus in isolation from the economic presence of the enterprise in a given foreign market [Warnieło, 2016, p. 115].

Past experience has taught us that PE and criteria applied to assess whether a PE should be created would trigger mechanisms leading to tax avoidance. First of all, the practices exercised so far have boiled down to an artificial fragmentation of activities pursued by a dependent agent in such a way as to present his activities as preparatory or auxiliary. In accordance with the current approach, agent offices are not viewed as PEs, especially when their activities are of preparatory or auxiliary character. The list of the latter includes, among others, advertising, information, or supervisory activities. A relatively wide range of activities of preparatory or auxiliary character triggered optimization possibilities for multinational enterprises interested in artificial avoidance of a PE status through the fragmentation of activities [Hongler and Pistone, 2015, p. 12]. Multinational groups are often engaged in a seamless range of functions within which they perform integrated services. Hence, it is difficult to draw a distinction between “core” functions and other functions that are somehow related to core function. In this case, the problem lies in identifying when the interaction of those functions may amount to a PE. Within the framework of the BEPS project, the OECD recommends preventing avoidance of the PE status by, inter alia, changing the catalog of exemptions listed in Art. 5(4) of the OECD MC (Action 7 of the BEPS Action Plan, BEPS 7).

The changes to the definitions resulting from BEPS were integrated in the 2017 OECD Model Tax Convention and in Part IV of the Multilateral Instrument (MLI) (Arts 12–15). The MLI is a flexible tool that allows jurisdictions to adopt BEPS treaty-related measures to counter BEPS and strengthen their treaty network. The MLI was signed by nearly 90 jurisdictions, and almost half of them have so far adopted the MLI articles that implement changes to the PE definition. However, Poland failed to approve the package of solutions proposed in the MLI, meaning it will be possible to change their content in the future based on bilateral agreements.

Second, for many distribution models, acting through formally independent representatives has led to avoiding withholding taxes. A PE is created as a result of business activities carried out through the so-called dependent agent duly authorized to habitually conclude contracts on behalf of an enterprise (Art. 5(5) of the OECD MC), even in the absence of a fixed place of business maintained by the enterprise in the state where the agent acts on its behalf. So far, an agent has not been considered dependent when he had the status of an independent agent, acting within the framework of his usual activities or when his activities were confined to auxiliary and preparatory ones. According to the recommendations resulting from BEPS 7, a dependent agent should create a PE of its principal also when the conclusion of a contract results directly from the agent's activities performed for the principal which have been crucial for negotiating the contract even if the contract is signed by another person. To multinational enterprises, it means changes in their distribution structures (models), especially to commissionaires and other limited risk distributors [Eisenbeiss, 2016; Pleijsier, 2015; Uslu, 2018]. Importantly, expanding the scope of regulations involves recognizing that an agent is not dependent when acting exclusively or almost exclusively on behalf of an entity closely related to him. An entity that holds at least 50% of the voting rights or has effective control over the agent should be considered a closely related entity, while an “exclusive or almost exclusive” activity refers to sales of the agent amounting to at least 90% of total sales to an affiliated entity [OECD, 2015, p. 26]. This means that an independent agent should have the status of a so-called “multi-agent,” acting on behalf of several entrepreneurs. Consequently, the changes should ensure that where the activities pursued by an intermediary in a given jurisdiction are designed to result in the regular conclusion of contracts to be performed by a foreign enterprise, the latter will be considered to have a taxable presence in that jurisdiction unless we are dealing with an intermediary performing these activities in the course of an independent business. For example, Spanish case law has already taken quite an aggressive stance on commissionaire structures which has been very controversial and may have also had a relevant impact on the approach of BEPS Action 7 with regard to Art. 5(5) [Jiménez, 2016].

Third, tax avoidance has also been observed in the construction sector. The BEPS 7 report identified the problem of artificial avoidance of the PE status by splitting up of contracts carried out within one construction project [Jamroży and Krysiak, 2018, p. 435]. Creating a PE for a building site defined as a construction site, construction, assembly, or installation depends on the duration of the works. To avoid paying taxes, enterprises would split up contracts so that for each contract the specific time limit for creating a PE is not exceeded. The BEPS 7 report indicated that one of the regulations that should prevent and counteract such practices is the Principal Purpose Test (PPT)⁷ clause included in double tax treaties.

Several authors have come to the conclusion that the new rules, at least to some extent, provide solutions to problems created by the strategies detected by the OECD [Oguttu, 2018; Wettersten, 2016]. However, the new changes appear to be less predictable [Dhuldhoya, 2016, p. 61; Barbier, 2016, p. 16] most probably due to the substance over form (SOF) approach of the rules themselves, given the existence of subjective elements (e.g., determining whether an agent has a principal role in the negotiation of contracts with clients) as well as the challenges of controlling substance, consequently

⁷ Principal Purpose Test clause is intended to counteract awarding undue benefits stemming from double taxation treaties. In accordance with the OECD assumptions, the clause should ensure benefits relating to the exchange of goods and services made in good faith, as well as to the movement of capital and persons. It is also expected to counterbalance the arrangements made primarily to ensure more favorable tax treatment. For more, see M. Boniecka, P. Sołtysiak (2018), *Wybrane aspekty prawne i podatkowe dotyczące klauzuli PPT*, *Przegląd Podatkowy*, Vol. 10, pp. 41–51.

requiring a case-by-case analysis [Dhuldhoya, 2016, p. 13]. As indicated by Skaar, a PE should be viewed as the evidence that the income derived from it should be taxed where it arises and not as the reason why source taxation is applied. Therefore, we need to determine what a PE stands for prior to understanding the constituents of its existence [Skaar, 2020, p. 560].

Effects of implementation of the new rules in Poland in respect to PE cases are reflected in tax rulings of the tax authorities and judgments of administrative courts.

5 Findings and conclusions

To start with, we validated the research question regarding the intensity with which cases concerning taxation of a PE featured in the decisions of administrative courts and tax rulings between 2017 and 2020, i.e., in the period following the implementation into the Polish tax law of OECD recommendations under the BEPS Project and ATAD Directive. Next, we investigated the frequency with which the Head of the National Revenue Administration Information Centre (Head of KIS) and Polish administrative courts dealt with the PE in the context of CIT. Finally, we determined decisions and tax rulings devoted *strictly* to PE-related issues.

To conduct the own PE study (hereinafter “the study”), we selected and examined all tax rulings issued between 2017 and 2020 and published on the Polish Ministry of Finance website sip.mf.gov.pl that appeared in response to the “permanent establishment” keyword.

For the above mentioned time limit, 86,965 interpretations and 1,525 court rulings were found. Having included selection criteria “permanent establishment” as the search term and selected legal acts (corporate income tax law), we obtained 1,847 interpretations and 250 court rulings. Manual (qualitative) selection conducted as part of the study helped in eliminating interpretations not strictly related to its subject.

Sixty-five tax rulings were chosen for the study. The study also covered the selection and examination of Polish administrative court judgments concerning PEs of 25 non-resident enterprises. Factors identified in our research study were broken down into five following main problem areas (Figure 4):

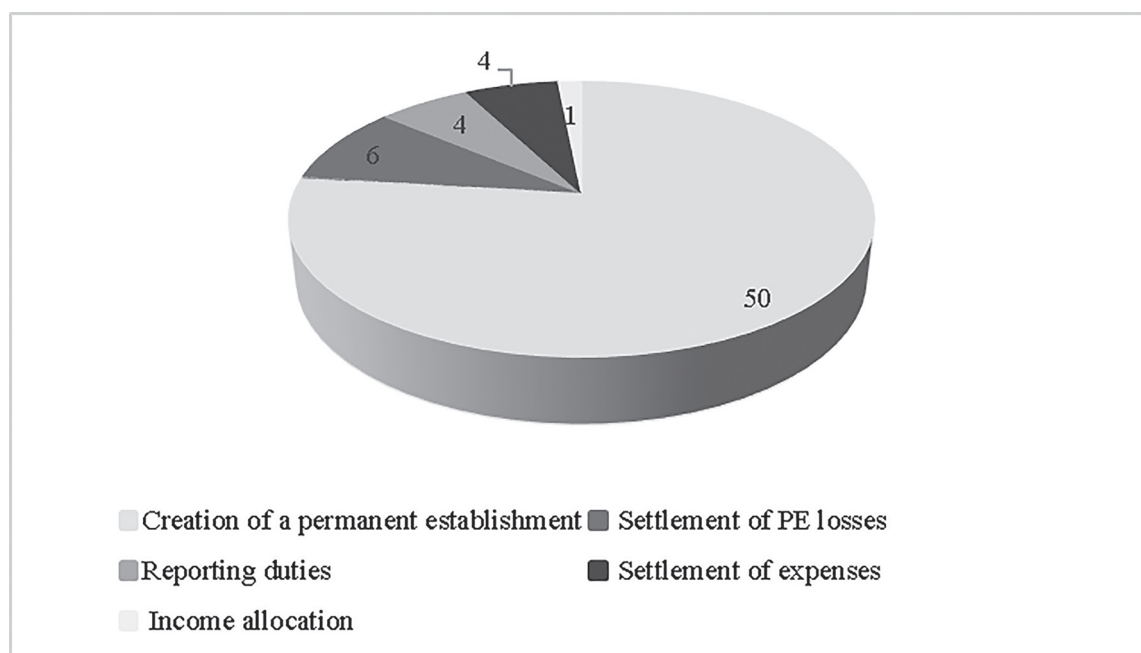


Figure 4. The main PE problem areas addressed in tax rulings.

Source: own elaboration. PE, permanent establishment.

- 1) Creation of a PE,
- 2) Reporting duties,
- 3) Income allocation,
- 4) Settlement of PE losses, and
- 5) Settlement of expenses.

Frequency with which the above factors were addressed is presented in the bar chart below (in %) (Figure 5).

As a next step, we investigated issues addressed in the judgments of administrative courts. It turned out that the most frequently tackled problem is the settlement of PE losses by the head office (10 decisions representing 40% of all examined judgments). On the pie chart below, we show the frequency with which the above listed problems are reflected in court judgments (Figure 6).

This has led us to the conclusion that problem areas addressed by the administrative courts are exactly the same. Besides the settlement of tax losses, investigated court decisions are related to the creation of eight PEs. Issues, such as the allocation of income (four decisions) or settlement of expenses (two decisions) to a PE, are tackled slightly less frequently. The frequency with which the above issues feature in the judgments of administrative courts is shown on the bar chart below (in %) (Figure 7).

In most instances, tax rulings covered by the study concerned a PE in the form of a fixed place of business (32 tax rulings). Often, the tax rulings refer to PEs as dependent agents (25 tax rulings). Cases where a PE was not created because the activity in question was of preparatory or auxiliary character were slightly more rare (20 tax rulings). There were also tax rulings that explained circumstances in which a PE could be created for a building site (a building and assembly business); however, only five such tax rulings were identified (Figure 8).

The findings of the research suggest that Polish tax authorities apply an extended understanding of PE proposed by the BEPS 7 approach. The mere fact that an enterprise, which uses the services of an agent, reviews and approves trade contracts while his activities involve low risk and his remuneration depends on costs he has incurred provide evidence for considering him as a dependent agent.⁸ Moreover, tax authorities

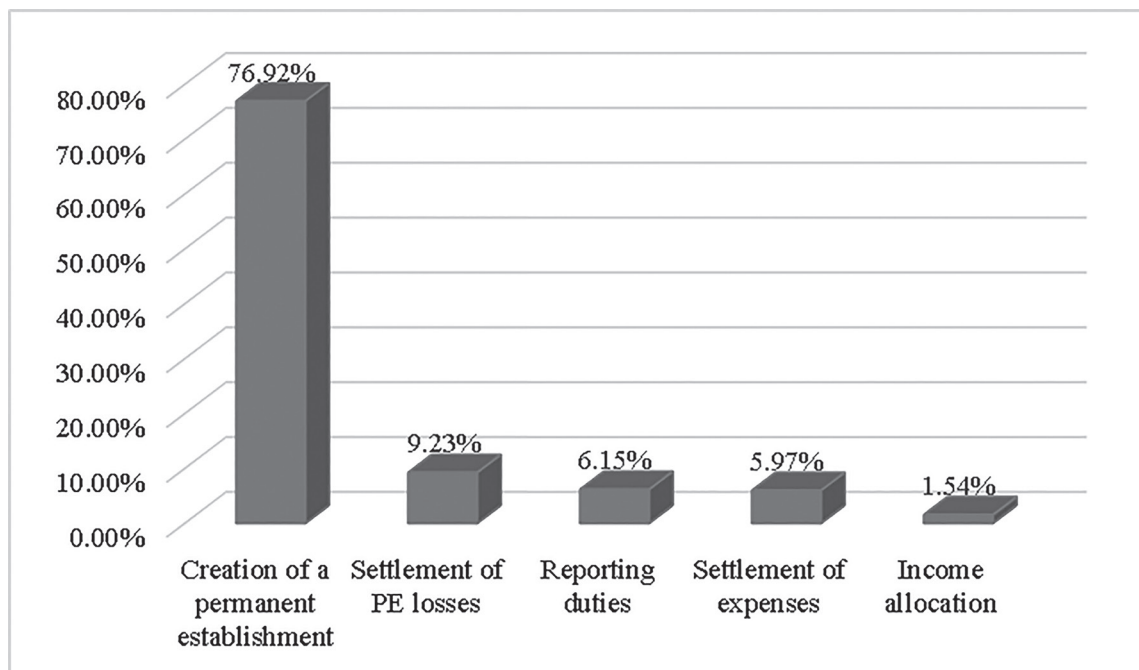


Figure 5. Frequency of main PE problem areas (in %).

Source: own elaboration. PE, permanent establishment.

⁸ Such arguments were put forward in tax rulings of the Head of the National Revenue Administration Information Centre [Polish abbr. KIS] of 24 August 2018 (Ref. 0114-KDIP2-1.4010.227.2018.2.AJ) and 22 August 2018 (Ref. 0114-KDIP2-1.4010.253.2018.1.AJ).

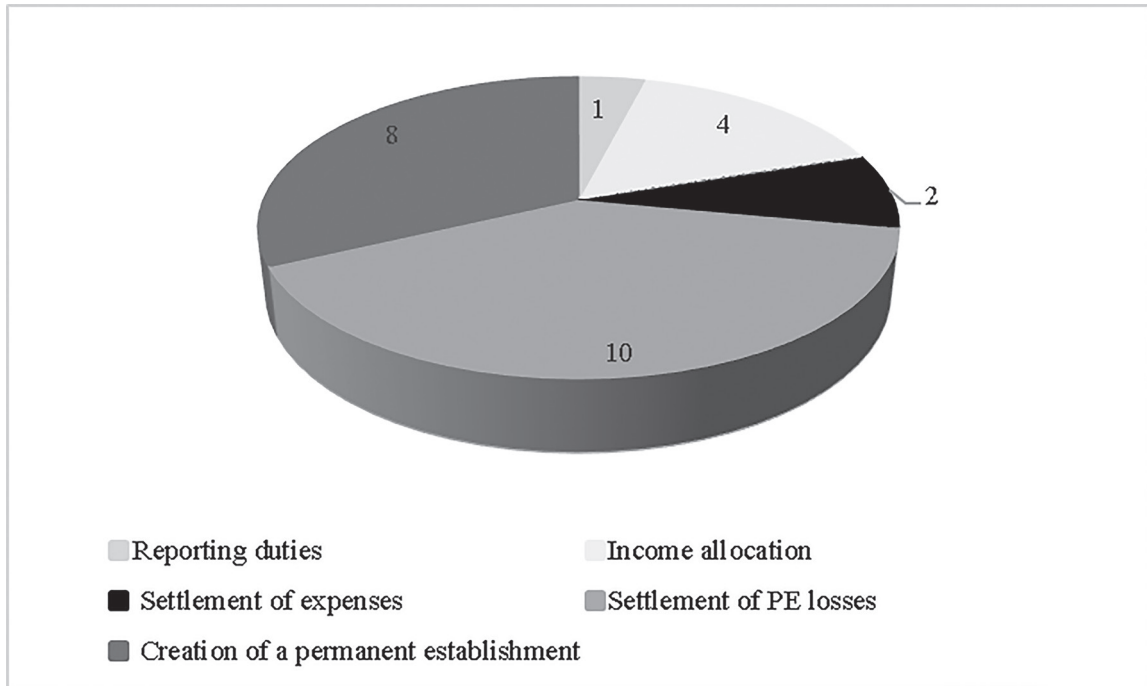


Figure 6. Problem areas addressed in the judgments of administrative courts.

Source: own elaboration.

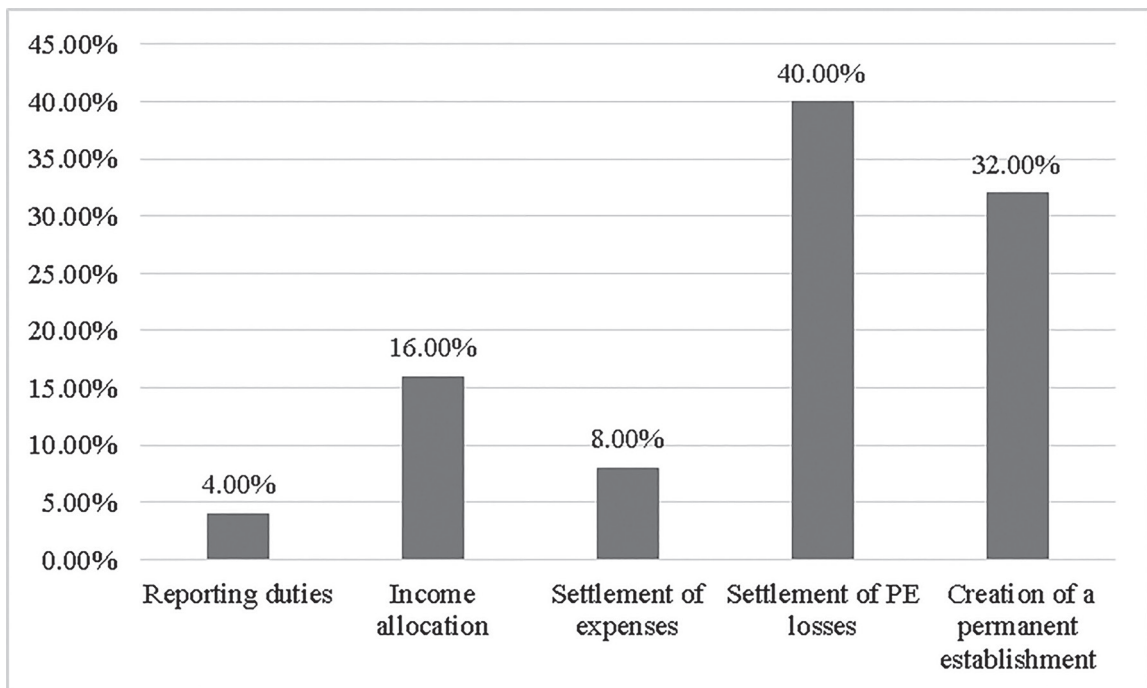


Figure 7. Frequency with which problem areas are addressed in judgments of administrative courts (in %).

Source: own elaboration.

are of the opinion that the processing of inquiries and orders and communicating with the client are sufficient conditions for creating a PE as they provide evidence that the agent “solicits and receives orders” (see para. 32.1 of the Commentary to Art. 5), meaning his role is critical for the conclusion of contracts

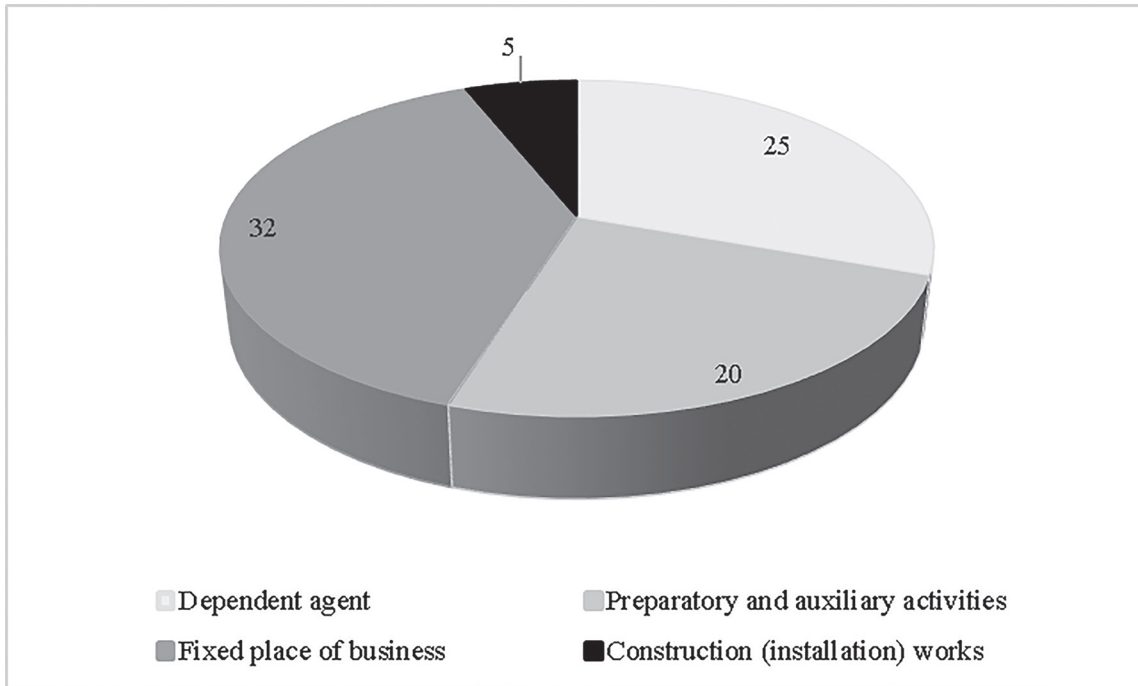


Figure 8. Forms of permanent establishments featuring in tax rulings.

Source: own elaboration.

and his activities are neither auxiliary nor preparatory.⁹ The principal role leading to the conclusion of the contract was also derived from being able to “convince” a third party (client) about the agent’s relevance for the conclusion of the contract.¹⁰ Moreover, in the opinion of tax authority, it suffices when an agent informs a client about the product and available discounts as it testifies to his principal role in the conclusion of a contract, irrespectively of the fact that formally he (the agent) is not authorized to conclude contracts or make binding offers.

Polish tax administration also looks very closely at cases when an agent renders services exclusively to one enterprise. This aspect was highlighted, among others, in the tax ruling of the Head of KIS of 17 August 2018.¹¹ In the facts of the case at hand, the activities undertaken by the recipient of the service (a daughter company of the applicant) were limited to warehousing and logistics operations carried out in his own name. Tax authorities argued that his activities led to the creation of a PE because services were rendered exclusively to the applicant suggesting an intention to act in somebody else’s interest rather than his own. Thus, in the opinion of tax administration, the service provider was dependent (mainly at the economic level) on the applicant. A similar position was presented by the Head of KIS in the interpretation of 22 January 2018.¹² The above cases suggest that when services are rendered to only one enterprise, which is a related enterprise, the Polish tax administration interprets such an arrangement as the absence of economic independence.

We can come across similar approaches in administrative court decisions. For example, in the decision of the Voivodeship Administrative Court in Warsaw of 28 January 2020,¹³ which refers to the case of 2019, i.e., decided after BEPS and ATAD had been implemented, the court stated that the absence of an active involvement of an enterprise in the conclusion of contracts may mean that the enterprise has already authorized an agent to take care of it. The real power to conclude contracts is reflected in seeking

⁹ The stance was presented, e.g., in the tax ruling of the Head of KIS of 24 August 2018 (Ref. 0114-KDIP2-1.4010.227.2018.2.AJ).

¹⁰ See para. 88 of the Commentary to Art. 5 in the Update to the OECD Model Convention.

¹¹ See the tax rulings of the Head of KIS of 17 August 2018 (Ref. 0114-KDIP2-1.4010.255.2018.1.PW).

¹² See the tax rulings of the Head of KIS of 22 January 2018 (Ref. 0114-KDIP2-1.4010.351.2017.1.JC).

¹³ See the decision of the Voivodeship Administrative Court in Warsaw of 28 January 2020 (Case No. III SA/Wa 696/19).

orders and securing them, as well as in holding day-to-day communication with clients that is crucial for winning and keeping them while a foreign enterprise only approves contracts in a routine way. Under such circumstances, it does not matter whether the contract is finally signed by a person acting in the name of an enterprise or by an enterprise as the decisive criterion lies in legal linkages between the enterprise and the activities performed by the agent.

Examples of similar solutions dating back before the implementation of the OECD recommendations can be traced in decisions issued by administrative courts in other countries. For example, a Belgian court case concerning NethCo, a company resident in the Netherlands which was conducting business in Belgium, owned by two related individuals who lived in Belgium. One of them was a representative of NethCo and concluded contracts on behalf of NethCo but not in the name of it. Nevertheless, the Court held that the individual constituted an agency PE of NethCo in Belgium because it was the carrying out of the core business activity in Belgium by NethCo through an agent substantially bound with NethCo that mattered, rather than the legal formality of the conclusion of the contracts not in the name of NethCo by a representative.¹⁴

A change in the position of tax administration is also seen in the approach to preparatory and auxiliary activities. According to tax authorities, marketing activities are not of such character because they represent operations that are crucial for investor's business.¹⁵ A similar approach applies to support services, such as IT, accounting, and loading, performed for entities operating in the area of international maritime transport.¹⁶ Activities carried out by an agent exhibiting signs of being significantly related with the income received by the enterprise are not considered auxiliary or preparatory by nature.¹⁷ Tax authorities describe preparatory and auxiliary activities as operations generating outcomes that are little attributable (distant) to profits obtained by an overseas enterprise, which means allocating them to these activities becomes next to impossible.

In the tax ruling of 22 February 2019,¹⁸ the Head of KIS stated that “the decisive criterion consists in determining whether activities of a fixed place of business represent a relevant and significant part of overall activities of an enterprise. (...) Beyond any doubt, a fixed place of business whose goal is identical with the goal of the whole enterprise does not perform preparatory or auxiliary activities.” A similar view was repeated in a tax ruling of 30 August 2019¹⁹ issued for a company engaged in international maritime transport and exploitation of sea shipping vessels. Activities performed for the company in Poland were limited to services related to the loading of sea vessels (cargo loading and control, including dangerous cargo), acting as an internal IT unit (IT Service Centre), and financial and accounting operations. In this case, the Head of KIS decided that what the applicant was doing in Poland was not of preparatory or auxiliary character in the meaning of Art. 5 para. 4 of the Double Tax Treaty because these activities (especially cargo loading and control, load optimization) belong to a critical and indispensable part of transport services that the company renders for clients who are tax residents in Poland by which it strives to accomplish the same goals as the entire enterprise.

Moreover, the Head of KIS in the tax ruling of 22 February 2018²⁰ highlighted that the activities performed in the fixed place of business were neither preparatory nor auxiliary, and there was a significant relationship between these activities and revenue obtained by the enterprise. In this case, tax authorities provided a description of preparatory and auxiliary activities identifying them as operations that generate outcomes that are little attributable (distant) to profits obtained by a foreign enterprise, which means allocating them to these activities becomes next to impossible. Thus, they decided that activities outlined

¹⁴ See the decision of CA Bruxelles (Cour d'Appel Bruxelles, Court of Appeal Brussels) of 18 Feb. 1992, *Algemeen Fiscaal Tijdschrift*.

¹⁵ See the tax ruling of the Head of KIS of 24 August 2018 (Ref. 0114-KDIP2-1.4010.227.2018.2.AJ) and 22 February 2019 (Ref. 0114-KDIP2-1.4010.9.2019.1.AJ).

¹⁶ The tax ruling of 30 August 2019 (Ref. 114-KDIP2-1.4010.288.2019.1.AJ).

¹⁷ Head of KIS in the tax ruling of 22 February 2018 (Ref. 0114-KDIP2-1.4010.391.2017.1.PW).

¹⁸ The tax ruling of 22 February 2019, (Ref. 0114-KDIP2-1.4010.9.2019.1.AJ).

¹⁹ The tax ruling of 30 August 2019 (Ref. 114-KDIP2-1.4010.288.2019.1.AJ).

²⁰ Head of KIS in the tax ruling of 22 February 2018 (Ref. 0114-KDIP2-1.4010.391.2017.1.PW).

in the facts of the case, which basically consist in the supervision over the works carried out by business partners against their compliance with concluded contracts, shall not be deemed as preparatory or auxiliary as they may actively impact production by, e.g., eliminating the shortcomings. In addition, in the tax ruling of 24 August 2018,²¹ the Head of KIS came to the conclusion that activities carried out by a fixed place of business may not be seen as having preparatory or auxiliary character because they include marketing activities representing a relevant part of the applicant's activities as a manufacturer and seller of specialist products and a distributor of standard products.

When deciding whether given activities are solely of preparatory or auxiliary character, administrative courts also seek to find out if these activities represent a relevant part of the overall business of an enterprise and what they actually cover. For instance, in the decision of 8 November 2019, the Supreme Administrative Court ruled that the creation of a PE in Poland is triggered by an active involvement of a company in production. Core activities carried on by the applicant in Poland suggested that what the court was dealing with in this case was production (current) rather than storage services. The scope of performed works included, *inter alia*, quality control which would not have been possible without production taking place there. In the court opinion, the above suggests that company's activities in Poland were not auxiliary or preparatory by nature as they covered a relevant part of applicant's operations.

The Voivodeship Administrative Court in Warsaw presented an identical stance in the ruling of 15 May 2017 in which it stressed that the supervision over production and quality control, as well as having the right to perform machine changeover and reject the final product if it does not comply with quality standards, suggests an active interference with the production process. Thus, since the activities at hand make a relevant and significant proportion of all economic activities and an obvious link can be drawn between activities undertaken in an establishment and revenue obtained by the company, they are not of preparatory or auxiliary character.

When it comes to the case law of other countries, there are some notable examples of the new OECD approach that predate 2017. For example, a classic storage space, which typically is not a PE, was viewed differently by the Spanish court. FinCo, a company resident in Finland, carried on its marketing and distribution business in Spain where it merchandized goods of other Finnish companies. FinCo did not have any premises in Spain but used the storage and distribution facilities of third-party service providers in Spain. FinCo also had a Spanish subsidiary that acted as its sales agent engaged in marketing of the said merchandise and goods in Spain, in accordance with FinCo's instructions, but was not able to conclude contracts in the name of FinCo. The Court held that storage and distribution facilities were essential parts of FinCo business and as such belonged to the core business activity of the enterprise even if, in principle, they were auxiliary or preparatory in nature.²²

Along the lines of judicial reasoning, one could think that core activities inevitably "attract" preparatory/auxiliary activities so that a distinction cannot be readily drawn. For example, a taxpayer, resident in Belgium, was engaged in the business of selling gems in Belgium but did not have a fixed place of business there; he did, however, have a habitual abode in Germany where he kept the bank statements of the profits from his business, which were deposited in a bank account at a German bank. The Court held that there was a PE in Germany, arguing that an auxiliary or minor activity which supports the core business constitutes a PE in itself also in the light of the fact that the greater the extent of the business activities performed without a PE, the more this "activity threshold" is lowered to constitute a PE.²³

Tax authorities attach a great deal of attention to whether an agent renders services exclusively to one enterprise.²⁴ In their opinion, an arrangement where services are performed to one entity only automatically triggers the creation of a PE as it reveals an intention to act on the other entity's behalf rather than in the

²¹ See the tax ruling of the Head of KIS of 24 August 2018 (Ref. 0114-KDIP2-1.4010.227.2018.2.AJ).

²² See the judgment of Tribunal Económico Administrativo Central (TEAC, Central Economic-Administrative Court) of 2 March 2006 (Case No. 0657/2003).

²³ See the judgment of Bundesfinanzhof (BFH) of 18 December 1986 (Case No. IR 130/83), 119.

²⁴ Such stance was presented, e.g., in tax rulings of 17 August 2018 (Ref. 0114-KDIP2-1.4010.255.2018.1.PW) and 30 August 2019 (Ref. 114-KDIP2-1.4010.288.2019.1.AJ).

agent's own name and is indicative of the latter being economically dependent on the principal.²⁵ The above suggests that rendering services to only one company are viewed by tax authorities as a sign of absence of economic independence.

In addition, serious investors' doubts are voiced about the conditions that must be met to decide that a non-resident enterprise has got a fixed place of business in Poland. This is because, in recent years, tax authorities have been of the opinion that, to decide that foreign investors have a fixed place of business in Poland, they do not have to own or rent (formally or informally) any facilities or space while the employees can work from home (teleworking).²⁶

The artificial splitting up of contracts is also addressed by the Polish tax administration. For example, from an individual interpretation issued by the Head of the Treasury Office in Warsaw on 21 June 2016,²⁷ we can learn that the economic and organizational relationship between the works performed is of primary importance. To consider a construction site, assembly, or installation works a homogenous fixed place of business (one PE), there must be economic and geographic cohesion between them. To assess whether a construction site (construction works) or assembly works constitute a PE, we need to take account of the timeline of the construction or assembly works. To calculate the time of construction works, these works should not be considered separately as they are carried out in the same place although under two different contracts. Moreover, Polish tax administration excludes the possibility to artificially avoid a PE status through the splitting up of contracts motivated by geographic location of the construction sites or assembly works. They believe that it does not matter whether workers involved in carrying out the contract stay for 12 months in the same place. What does matter, however, is whether activities taking place in different locations make up an integral part of a single project and then such a project must be considered a PE if it lasts for >12 months. This approach was adopted, for example, in the interpretation of the Head of KIS of 11 December 2017.²⁸

6 PEs of Polish resident enterprises abroad

The inconsistency of the position of Polish tax authorities is surprising as to the creation of PEs of Polish resident enterprises in overseas markets. Polish tax authorities argue that a PE is not created abroad even though employees of a foreign affiliate act on behalf of the Polish investor, are authorized to represent him, and habitually conclude contracts on his behalf.²⁹ There was even one case in which the employees of the foreign affiliate could engage in a number of other activities, such as advertising and promoting the Company, transmitting information to and from the Company, organizing business meetings and promoting the Company at fairs and conferences, correspondence management, providing supplementary transport documentation, translation of documents, as well as receiving and transmitting complaints. Nevertheless, the Polish tax administration decided that these activities were of fully preparatory and auxiliary character and their goal was only to streamline Company's operations by, e.g., ensuring efficient customer service in the foreign market, as well as attracting new clients through promotion and advertising. Consequently, advertising and promotional activities carried out for the Polish resident investor abroad are treated as preparatory and auxiliary and do not lead to the creation of a PE in another country, even though under different facts of the case when the issue concerned the creation of a PE in Germany, a similar scope of activities were indicative of overlapping operations performed by the affiliate and the German company.³⁰

Apparently, criteria for the creation of a PE in other tax jurisdictions applied by Polish tax authorities substantially differ from those applied to PEs created in Poland. In order to create a PE in Poland, it suffices to perform activities little related with the business pursued by the principal company through people

²⁵ Similar position was presented by the Head of KIS in the tax ruling of 22 January 2018 (Ref. 0114-KDIP2-1.4010.351.2017.1.JC).

²⁶ For instance, the tax ruling of 10 January 2018 (Ref. 0114-KDIP2-1.4010.304.2017.2.PW).

²⁷ Tax Chamber in Warsaw in the tax ruling of 21 June 2016 (Ref. IPPB5/4510-459/16-4/RS).

²⁸ Head of KIS in the tax ruling of 21 December 2017 (Ref. 0115-KDIT2-3.4010.261.2017.2.MJ).

²⁹ For instance, Head of KIS in the tax ruling of 24 October 2018 (Ref. 0111-KDIB1-2.4010.350.2018.1.BG).

³⁰ For instance, Head of KIS in the tax ruling of 22 January 2018 (Ref. 0114-KDIP2-1.4010.351.2017.1.JC).

who establish contacts with clients but are not formally authorized to conclude contracts on behalf of the principal. On the other hand, to create a PE of a Polish company in another tax jurisdiction, activities of trade agents are not enough even when they are formally authorized to perform them.³¹ The above creates substantial uncertainty when it comes to launching activities abroad. If the stance of tax authorities as to the creation of a PE abroad is different than that of the taxpayer, domestic investor may be taxed twice in the home country and in the country where a PE is located.

7 Summary

To prevent further proliferation of certain common tax avoidance strategies used to circumvent the definition of a PE provided in the OECD-MC, the BEPS Action Plan called for a review of this definition. Unfortunately, in the BEPS era, global capital and profits are inherently mobile so that sourcing net profits appears to be a difficult exercise that can be referred to as the “source conundrum” [Garbarino, 2020, p. 3]. Since the PE definition failed to fulfill its historical purpose [Eisenbeiss, 2016, p. 481], the BEPS package introduced several changes to it in line with the SOF approach. However, the application of the SOF doctrine varies across countries [Zimmer, 2002, p. 61, Rosenblatt, 2015, p. 138].

Obviously, changes made to the OECD Model and Commentary in 2017 raise different issues with regard to the future application of the existing tax treaties (or of new treaties) which do not include the BEPS changes. Under such circumstances, the question is whether the interpretive position added to the Commentary in 2017 may have any legal impact on the interpretation of those treaties. This poses a problem that is typical in tax treaty interpretation, namely whether the change to the Commentary has a retroactive effect. The evidence provided in this paper demonstrates that decisions issued by Polish administrative courts and tax administration are based on BEPS 7 even though the provisions of double tax treaties and domestic regulations have not been amended. That is because Polish administrative courts follow the dynamic interpretation of the tax treaties [Janiszewska et al., 2019, p. 54].

Based on the study, most doubts surrounding the launching of business in Poland in the form of a PE consists in the delineation of exact conditions that trigger the creation of a PE (almost 77% of tax rulings). The creation of a PE is crucial for taxable presence in Poland and for identifying the scope of the allocated revenues and expenses (taxable income). One of most important problem areas is also the recognition of PE losses by the head office (almost 10% of the tax rulings) if such losses cannot be settled in the PE country. Factors such as reporting duties, income allocation, or settlement of expenses were addressed slightly less frequently. This means that there is a substantial level of uncertainty among investors in respect to the creation of a PE, as well as correct identification and allocation of taxable revenues and expenses that a PE generates. When it comes to the limitations of the study, we need to stress that a systematic analysis of all PE-related court rulings and individual interpretations would be the source of more valuable knowledge; however, the exercise does not seem necessary owing to the extensive research sample and individual factual states.

The lack of transparent tax regulations and the absence of legal certainty in respect to PE's may be also reasons why the inflow of FDI to Poland decreases. That, in turn, translates into a smaller number of PEs, even though a PE is a form of investment beneficial from tax point of view. The aforesaid means that not so much the effective tax burdens but the regulatory ambiguity surrounding the tax obligations may contribute to the reduction of Poland's attractiveness as a location for FDI. Officially, Poland has not adopted the MLI within the scope of preventing artificial avoidance of PE status. Hence, Poland has not adopted solutions related to the anti-abusive clauses preventing, i.e., artificial avoidance of PE status through agency agreements, by exploiting the exclusion of certain activities from the definition of a PE (anti-fragmentation rule), as well as the splitting up of contracts. Hence, as far as a PE of a non-resident enterprise is concerned, Polish double tax treaties will remain unchanged. Since clear divergences between how tax authorities approach the problem and what is provided for in double tax treaties lead to numerous

³¹ For instance, Head of KIS in the tax ruling of 14 March 2018 (Ref. 0111-KDIB2-1.4010.373.2017.2.BKD).

doubts and enhance the risk involved in foreign investors' business operations, such a position should be critically reassessed.

In addition, further concerns arise with regard to using digital economy business models to which the current definitions of a PE do not fit. Putting the existing definitions in order and their practical application is a huge challenge not only to tax administration and legislators but also to entrepreneurs engaged in foreign investment. It holds also a great potential for future research.

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