RUCH PRAWNICZY, EKONOMICZNY I SOCJOLOGICZNY
Rok LXXXV – zeszyt 1 – 2023
https://doi.org/10.14746/rpeis.2023.85.1.18

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HOLDING COMPANY LOCATION: A POLISH TAX PERSPECTIVE

LOKALIZACJA SPÓŁKI HOLDINGOWEJ: PERSPEKTYWA PODATKOWA POLSKI

This paper aims to present the size and structure of passive income payments, such as dividends, interest, royalty payments, and fees for intangible services, made by companies domiciled in Poland belonging to a multinational enterprises (MNE) group. The authors formulate a hypothesis that tax jurisdictions offering extensive legal and tax incentives for holding structures, in particular concerning the tax treatment of dividends and other withholding tax payments, are the preferred location of holding companies. A review of the literature and legal sources precedes empirical research. The empirical analysis shows that passive income flows, including dividends, interest, royalties, and fees for intangible services, which constitute the dominant type of payments to holding companies, are directed from Poland primarily to countries with tax and regulatory solutions that are friendly to holding companies, including in particular the so-called intra-EU tax havens, namely Luxembourg, Cyprus, the Netherlands, Malta and Ireland. Real trade with these countries is neither significant nor proportional to the scale of passive income.

Keywords: passive income; holding companies; tax haven; tax competition; withholding tax
JEL: H26, K34, F36, F38

Celem artykułu jest przedstawienie wielkości i struktury płatności pasywnych, takich jak dywidendy, odsetki, opłaty licencyjne oraz należności za usługi niematerialne, dokonywanych przez spółki holdingowe mające siedzibę w Polsce. W artykule sformułowano hipotezę, że jurysdykcje podatkowe oferujące rozbudowane zachęty prawno-podatkowe dla struktur holdingowych, w szczególności dotyczące podatkowego traktowania dywidend i innych płatności opodatkowanych u źródła, są preferowanym miejscem lokalizacji holdingów. Przegląd literatury oraz analiza źródeł prawa poprzedzają analizę empiryczną. Z przeprowadzonej analizy empirycznej wynika, że płatności pasywne, w tym dywidendy, odsetki, opłaty licencyjne czy za usługi niematerialne, które stanowią dominujący typ płatności do spółek holdingowych, kierowane są z Polski przede wszystkim do krajów o „przyjaznych" rozwiązaniach podatkowych i regulacyjnych dla holdingów,

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RPEiS 85(1), 2023: 239–260. © WPiA UAM, 2023. ISSN (Online) 2543-9170 ISSN (Print) 0035-9629

w tym w szczególności do tzw. wewnątrzunijnych rajów podatkowych, czyli Luksemburga, Cypru, Niderlandów, Malty i Irlandii. Realna wymiana handlowa z tymi krajami nie jest ani znacząca, ani współmierna do skali płatności pasywnych.

Słowa kluczowe: płatności pasywne, spółki holdingowe, raje podatkowe, konkurencja podatkowa, opodatkowanie u źródła
JEL: H26, K34, F36, F38

I. INTRODUCTION

The attractiveness of tax jurisdictions for holding activities can be assessed from the perspective of individual countries in which holding companies operate through subsidiaries. One of the key features of a holding company is the capital commitment and the resulting subordination of some entities to others that exercise managerial, coordination, management or control functions.[1]

The UK was one of the first tax jurisdictions with developed holding activities to opt for income taxation. From the adoption of the first Income Tax Act in 1799 until 1965 capital gains were excluded from taxation altogether.[2] It was only in 1965 that a decision was taken to tax capital gains. Similarly, in other Anglo-Saxon countries, including Canada, Australia and South Africa, capital gains were initially not taxed at all. A notable exception was the United States of America, where income taxation was extended to capital gains from the beginning of 1913.

One of the actions the Polish legislator has undertaken to make the country's tax system more attractive was the introduction of a new form of a holding company with preferential rules of taxation from the year 2022. The preferences include full CIT exemption for profits from the transfer of shares in subsidiaries (with exceptions) to unrelated entities, as well as a 95% exemption for dividends received from subsidiaries, including entities from outside the European Union. Starting from 2023, the tax exemption for dividends received from qualified subsidiaries amounts to 100. A company which applies tax exemptions resulting from the EU Parent-Subsidiary Directive, the EU Interest and Royalties Directive, the special economic zones, or the so-called Polish Investment Zone, is also entitled to benefit from the new holding regime. In addition, the catalogue of legal forms in which a holding company may operate will be extended by a Simple Public Limited Company. Moreover, the subsidiary will be allowed to participate in partnerships and to hold more than 5% of shares in the capital of other companies.

The conduct of business by a multinational enterprise comprising entities with differing legal and tax autonomy requires the division of functions per-

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[1] Pyzio (2015): 1.
[2] Littlewood, Elliffe (2017): 1–3.

formed, including management and organizational functions. The division of functions in a multinational enterprise can lead to multifaceted tax implications, for example with regard to withholding tax, permanent establishment, or transfer pricing. At the same time, there is a challenging discussion in response to unfair tax competition, for example with respect to Luxleaks or to recent tax law changes in the Netherlands, Hungary and Romania aimed at increasing tax attractiveness.

Passive income, such as dividends, interest, and royalties, as well as fees for providing services, are the predominant type of payments to holding companies. The hypothesis is that tax jurisdictions offering extensive legal and tax incentives for holding structures, in particular concerning the tax treatment of dividends and other withholding tax payments, are the preferred location of holding companies. In order to verify this hypothesis, an analysis of passive income payments is made in terms of the extent to which they are directed to countries with favourable tax and regulatory arrangements for holding companies. In addition, the level of passive income payments is compared to the GDP of the recipient country. A literature review as well as a legal sources review precede the empirical research focused on the financial flows towards foreign holding companies. The results of the research are presented from the Polish perspective.

II. HOLDING STRUCTURES AND FINANCIAL FLOWS

A widely accepted definition of a holding company has yet to be developed. The concept is interdisciplinary in nature,[3] with the way in which a holding company is defined depending on whether it is considered in legal, tax, or economic contexts. According to the approach advocated by Cárdenas and Gamez, a holding company should be understood as an intermediary company with legal capacity, whose purpose is to own and manage the shares of other national and foreign companies, which can benefit from tax preferences when they meet the requirements of local law.[4] On the other hand, Maners compared a holding company to a corporation whose assets consist of shares and stocks, and whose primary function is to manage these companies.[5] A holding company is also understood as 'a hierarchical organizational form of cooperation between companies, based on capital ties and enabling the concentration of economic potentials in order to use them in a cooperative manner within the framework of a jointly determined operational strategy'. Another definition of a holding company relies on the joint management of a group of companies, geographically dispersed, conducting similar activities or, in order to minimize risk, different types of activities.[6]

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[3] Vlachy (2008): 656–668.
[4] Cárdenas, Gamez (2015): 218–237.
[5] Maners (1988): 459–460.
[6] Toborek-Mazur (2005): 13–14 and the literature cited therein.

As a rule, entities forming multinational enterprise (MNE) groups are separate legal and tax entities. Most often these are capital companies, but the group may also include other entities, including partnerships, investment funds, or foundations.[7] A group may, however, be a taxpayer separate from the companies comprising the group (e.g. a tax capital group on the basis of the Polish Corporate Income Tax Act[8]), which is associated, among other things, with preferential tax loss settlement. Holding structures may potentially be constructions conducive to the lowering of tax burdens. Among the holding structures used to reduce the tax burden the companies below can be distinguished:[9]

– holding companies that manage and administer holdings or carry out acquisitions or mergers on behalf of the parent company,

– licensing companies, which exploit copyrights, patents, or licenses on behalf of parent companies or their owners,

– financing companies, raising funds from international markets, offshore financial centres, or capital group funding and then lending them to subsidiaries.

Fiscal policy shaped by individual countries based on selected tax concepts is crucial for how holding companies are taxed. The economic unity approach implies treating the holding company as a single economic entity, which entails taxing the combined financial result. Next, the separation approach involves taxing holding companies as if they were independent taxpayers, with transactions between them being tax-neutral.[10] The third concept of holding company taxation, the so-called mixed approach, combines elements of both concepts mentioned above. Poland, along with countries such as Denmark and Germany, decided to opt for the mixed approach.[11]

The capital commitment and the resulting subordination of the parent company to others (subsidiaries) translates into a specific structure of financial flows within the MNE groups. Often within the MNE groups, there are entities that perform the function of a group treasurer, which optimizes the group financial management process.[12] The centralization of the financial function for the MNE group allows for a number of benefits, including primarily a reduction in the cost of raising capital, wider access to financial markets, specialization of staff and tax optimization.[13]

The pursuit of common economic objectives causes these entities to enter into various transactions with each other, by providing services or selling goods, as if they were independent entities.[14] Equity involvement implies that

[7] Gajewski (2005): 460.

[8] Act of 15 February 1992 on Corporate Income Tax, consolidated text Journal of Laws of the Republic of Poland [JL] 2021, item 1800 as amended; hereinafter: CIT Act.

[9] Van Dijk, Weyzig, Murphy (2006): 49–55.

[10] Gajewski (2016): 460.

[11] Litwińczuk (1995): 18–20.

[12] Szumielewicz (2004): 225–237.

[13] Mioduchowska-Jaroszewicz (2011): 153–164.

[14] Rudowski (2019): 13–17.

related benefits are realized between the entities in the group, in particular the payment of dividends, interest, royalties, or payments related to the assets provided. Such payments are referred to as passive ones, as they do not require the other party to the transaction to organize and provide goods or perform services: some complex activity involving the need to engage in production and logistics operations or to provide personnel, equipment, or materials. At the same time, specific instruments are emerging within capital groups, such as cash pooling or netting – a form of benefit resulting from financial management within the capital group.[15]

III. IMPACT OF TAXATION ON PASSIVE FLOWS IN THE LIGHT OF EXISTING STUDIES

According to Chen and Lehmer, entities having the ability to shift profits are more likely to report zero income in their country of tax residence than those without such ability.[16] Hence, it is not without reason that researchers are striving to identify factors that have a significant impact on the size and direction of passive flows and profit shifting. For example, Albertus, Glover and Levine showed that a factor contributing to lower FDI inflows and passive flows is the likelihood of tax reform.[17] The role of tax law changes, particularly in tax rates, is also evidenced by the results of a study by Alexander, de Vito and Jacob.[18] Moreover, based on data from 1,084 parent companies domiciled in 24 countries and 9,497 subsidiaries based in 54 countries around the world, Delis, Hasan and Karavitis showed that the propensity to shift profits is higher when subsidiaries are located in jurisdictions offering stable tax rates.[19] Thus, the study has demonstrated the significant role of tax rate uncertainty in decisions to shift profits to other jurisdictions. In another study on profit shifting Janský and Palanský showed that the higher the share of direct investments from tax havens in a particular country, the lower their rate of return. They attributed the reasons for this trend to artificial profit shifting.[20]

Other in-depth studies relate to the impact of the implementation of selected tax regulations on the volume of passive flows and the location of subsidiaries. An example is the study by Clifford, who, using data on the international operations of multinational corporations, has shown the impact of the implementation of the controlled foreign corporations tax rules on the redirection of capital from low-tax to higher-tax countries.[21] In turn, Buettner, Overesch and Wamser (2018) looked at how thin capitalisation regulations

[15] Majdowski (2014): 24–33.
[16] Chen, Lehmer (2021): 181–206.
[17] Albertus, Glover, Levine (2021): 298–327.
[18] Alexander, de Vito, Jacob (2020): 309–341.
[19] Delis, Hasan, Karavitis (2020): 645–676.
[20] Janský, Palanský (2019): 1048–1103.
[21] Clifford (2019): 44–71.

and transfer pricing rules affect the level of investment and employment in foreign subsidiaries.[22] From their research it can be concluded that the introduction or tightening of thin capitalization regulations has a significant negative impact on the level of direct investment and employment in high-tax countries. Moreover, in countries that have introduced thin capitalization rules, the sensitivity of direct investment to tax rates has increased. However, such relationships were not found in relation to transfer pricing regulations. Yet, the role of transfer pricing in profit shifting was presented by Hopland et al. based on empirical results.[23] They showed, using data on direct transfers and internal debt of subsidiaries of Norwegian companies, that transfer pricing provides ex-post flexibility in profit shifting.

The role of tax rules on the direction of passive flows is also evidenced by the results of an empirical study by Goldbach et al. conducted on a group of German multinational corporations. The study found a significant impact of tax incentives on the choice of financing sources and the direction of debt capital flows.[24] On the other hand, the results obtained by Xing after the tax reform in Japan, indicated a decrease in the level of foreign equity financing in favour of profit repatriation. However, no evidence was found that the tax reform contributed to the repatriation of capital inflows to the dominant company's home country in comparison with the pre-reform period.[25]

There is also empirical evidence that tax rules do matter for the location of royalty earners. The results of a study conducted on a sample of US companies indicated that the level of taxation is a factor affecting the number of patents protecting intangible assets.[26] In fact, regulations leading to a reduction in tax benefits for the creation of intangible assets contributed to a decrease in the number of patents filed, while in countries where no such changes were made, the number of patents filed did not change.

IV. SOURCES OF DATA ON CROSS-BORDER FINANCIAL FLOWS

Multinational enterprise (MNE) groups can operate locally, but most often holding structures extend beyond the boundaries of a single jurisdiction. It follows that financial flows within the MNE group are visible in the various payment statistics between jurisdictions. Information on the scale of passive income transferred to individual countries can be used to identify jurisdictions that are attractive for the MNE group entities, in particular a holding company.

The primary record of economic transactions between residents of two economies is the balance of payments. The balance of payments provides in particular information on exports and imports of goods and services, as well as on direct and portfolio investment. Direct investment is related to the efficient

[22] Buettner, Overesch, Wamser (2018): 553–580.

[23] Hopland et al. (2018): 163–183.

[24] Goldbach et al. (2021): 102119.

[25] Xing (2018): 252–282.

[26] Li, Ma, Shevlin (2021): 101382.

management of an entity and often takes the form of greenfield investment. Portfolio investment can be both asset-based, concerning equity involvement in entities, and debt-based, which means financing in particular through the issue of bonds. In the balance of payments, in addition to direct and portfolio investment, there is also a separate category ‘other investment’, which primarily includes foreign loans.[27]

Tax administrations collect data from payers on payments of a certain type made by them to non-residents. The main tool for providing this data in Poland is the Information on Revenue (Income) Derived by Nonresident (IFT Forms). Payers of lump-sum withholding tax include in the IFT Forms summary information on payments and tax withheld by the end of the third month of the year following the tax year in which they made the payments. From an analytical point of view, a major advantage of such data is that they do not depend on the amount of tax that has actually been collected.[28] The withholding tax payer (WHT payer) reports the payments made to a non-resident, even when no tax is due on the payments because, for example, they are covered by an exemption under a relevant double taxation treaty or provisions resulting from the implementation of EU directives.[29]

The payments that are included in the IFT Forms provided to the tax authorities, pursuant to Articles 21(1) and 22(1) of the CIT Act, correspond to:

– interest, copyrights or related rights, rights to invention designs, trademarks and ornamental designs, including the sale of such rights, making available the secret of a formula or of a production process, the use of or the right to use an industrial facility, including a means of transport, a commercial or scientific facility, information relating to acquired industrial, commercial or scientific expertise (know-how);

– fees for services rendered in the field of performing arts, entertainment, or sports activities, performed by legal persons established abroad, organized through natural persons or legal persons conducting activity in the field of artistic, entertainment, or sports events on the territory of Poland;

– services such as consultancy, accounting, market research, legal services, advertising, management and control, data processing, employee recruitment and acquisition services, guarantees and warranties and services of a similar nature;

– fees due for the export of cargo and passengers accepted for carriage in Polish ports by foreign commercial maritime shipping enterprises, with the exception of transit cargo and passengers;

– revenues obtained in the territory of Poland by foreign air navigation enterprises, excluding revenue obtained from scheduled passenger air transport, the use of which requires the possession of an air ticket by the passenger;

– dividends and other revenues (income) from participation in the profits of legal persons with their registered office or board headquarters in Po-

[27] Bernaś (2006): 228–232.
[28] Sekita (2017): 126–131.
[29] Jamroży (2016): 177.

land. This category also includes dozens of different similar payments, such as income from the withdrawal or liquidation of a company, various income received as part of merger and acquisition processes, interest on an equity share, or income from participation in investment funds.

WHT payers indicate the amount of exempt income, the amount of taxable income, the tax rate and the amount of tax collected. The taxable income and the tax withheld are indicated on a monthly basis. The information contained in the specific form IFT-2R includes, in addition to data on the payments themselves, data on the payer, data on the payee, including their tax identification number, full and abbreviated name, date of the commencement of activity, and a registered office address.

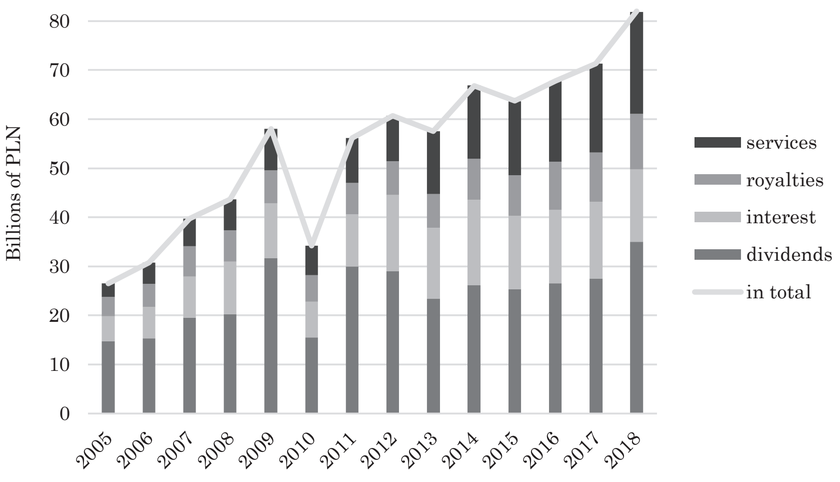
V. ANALYSIS OF PASSIVE INCOME FLOWS

1. Total passive income flows

The value of passive income flows from Poland to the EU Member States between 2005 and 2018 is presented in Graph 1. This income has been steadily increasing, despite a decrease in dividends paid in 2010, from a total of PLN26.5 billion in 2005 to PLN82 billion in 2018. This means that streams of passive income from Poland to other EU countries have more than tripled over the last 13 years. The share of passive income is also growing relatively to gross domestic product. In 2018, passive income transferred to the EU Member States accounted for 3.86% of Poland's GDP, compared to 2.7% in 2005.

Graph 1

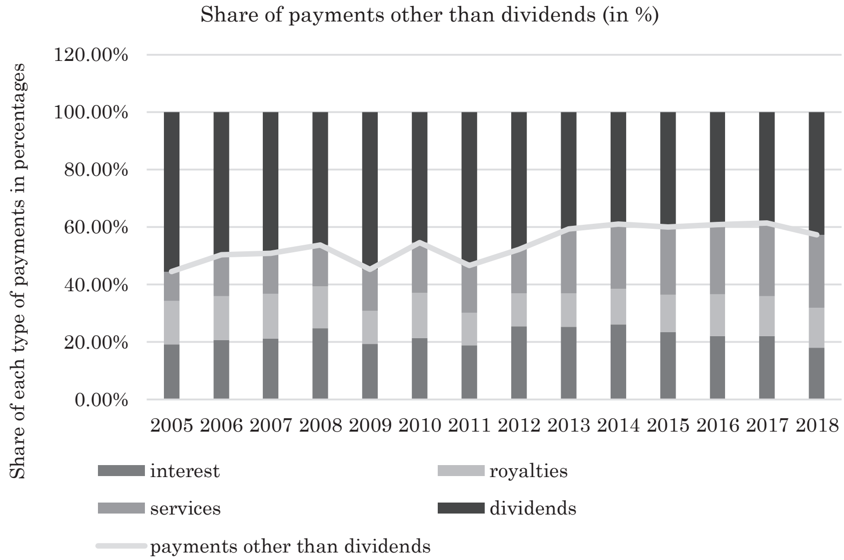
Payments transferred from Poland to the EU Member States from 2005 to 2018
(in billions of PLN)



Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

Graph 2 shows the distribution of the different types of passive flows from Poland to the EU Member States. Dividend payments have the largest share in outgoing passive payments from Poland, but the share of other payments, especially for intangible services, is steadily increasing. In 2005, payments other than dividends amounted to 44.5% of all outward passive payments, while in 2018 they already amounted to 57.3%.

Graph 2

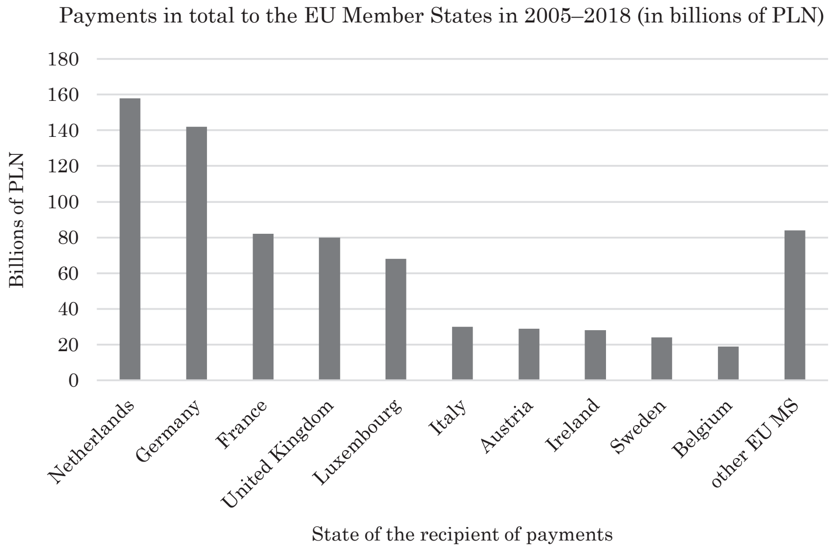


Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

When examining the attractiveness of individual countries in terms of tax regimes designed for the MNE groups, payments made to each jurisdiction have to be analysed separately. A summary of payments to individual countries is presented in Graph 3. The highest passive income was paid out by Polish taxpayers to entities based in the Netherlands, Germany, France, the United Kingdom, Luxembourg, Italy, Austria, Ireland, Sweden and Belgium. In comparison, Poland's largest EU partners in terms of imported goods (by country of origin, as of 2018) are:[30] Germany (PLN215.3 billion), Italy (PLN48.2 billion), France (PLN35 billion), the Netherlands (PLN34.6 billion), the Czech Republic (PLN32.8 billion), Belgium (PLN23.8 billion) and the United Kingdom (PLN23.3 billion). The amount of passive income payments to some countries is thus far out of proportion with the imports of goods. The rationale for the high share of passive income streams going to some countries can be found in non-economic conditions, in particular those linked with holding structure-friendly legislation.

[30] Główny Urząd Statystyczny (2019): 3–5.

Graph 3



Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

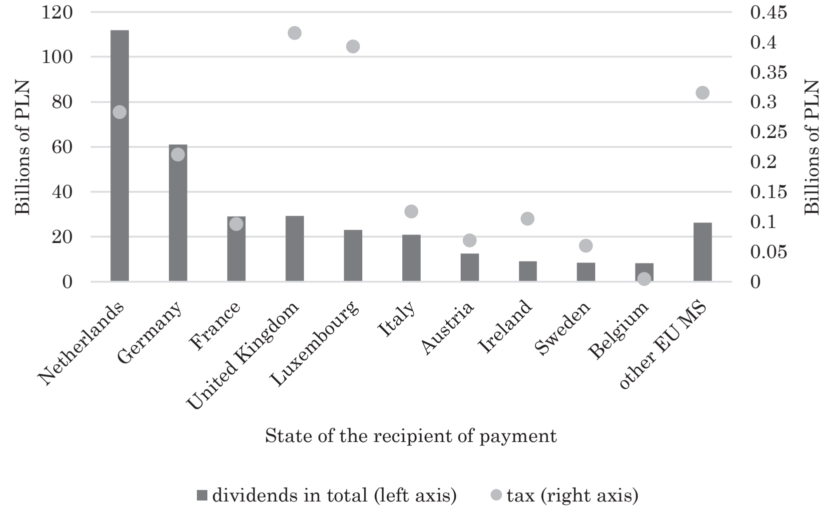
2. Dividends

The most important type of passive income are dividend payments, which are directly linked to the tax residence of the parent entity in a specific tax jurisdiction. The Netherlands is the leader in receiving dividend payments from Polish entities. Almost twice as many dividend payments were transferred to Dutch residents than to Poland's largest economic partner, Germany. Dividend outflows from Poland to Luxembourg are at a similar level to those transferred to France. The top ten EU countries ranked by dividend payments also include Cyprus.

In order to find out whether dividend payments are associated with membership of the MNE group, the level of dividend taxation resulting from the application of the so-called participation exemption among corporate income taxpayers will be analysed. To put it in a simplified way, the participation exemption for dividends is applicable in Poland on condition that the dividend is paid to a shareholder company residing in another EU Member State, which for at least two years has had an equity exposure of at least 10% (Article 22 para 4 of the CIT Act). In most cases, the participation exemption applies to the MNE groups. As shown in Graph 5, almost all of the dividends paid concerned payments between entities whose equity exposure exceeds 10%.

Graph 4

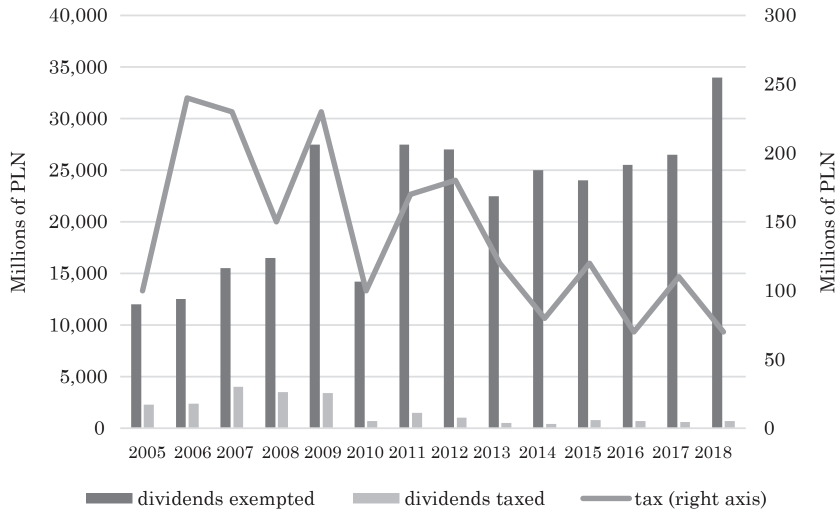
Dividends in total paid to the recipients residing in the EU Member States in 2005–2018
(in billions of PLN)



Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

Graph 5

Dividends transferred to the recipients residing in the EU Member States in 2005–2018
(in millions of PLN)



Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

3. Interest

The MNE groups use various instruments to finance the operations of group entities. Debt financing can take different forms, such as corporate loans or bonds, financial derivatives or joint liquidity management tools (cash pooling, netting). It is possible to obtain tax benefits if the sources of intra-group financing are appropriately planned, depending on the legal and factual situation in the country where the business is conducted and the country of residence of the financing party. Hence, the choice of funding sources can impact the effective level of taxation on a global, group-wide basis. While dividends paid are not tax deductible, subject to limitations on the deductibility of borrowing costs, interest paid is tax deductible and as such reduces taxable income. In the absence of withholding tax at the time of interest payments, which is the rule for holding structures operating in the EU (participation exemption), the significant factors include the taxation of interest income in the country of residence of the payee and the costs incurred by the financing party. Debt financing costs may reduce taxable income in the source country, but in general generate income in the payee's country of residence. If interest income in the payee's country of residence is exempt from taxation or taxed preferentially, total tax savings are possible.

Luxembourg is the leading recipient of interest payments from Poland (see Graph 6). Remarkably, in the case of interest on bank loans and borrowings, withholding tax in Poland is excluded by virtue of a specific provision provided for in the double taxation agreement between Poland and Luxembourg.[31] The participation exemption among holding companies is also widely applicable. Apart from Luxembourg, interest payments were made to entities resident in Germany, France, the Netherlands, the United Kingdom, Austria, Sweden, Belgium, Spain, Ireland, Finland, Denmark, Cyprus and Italy. A particularly high position, compared to trading relationships, was achieved by Cyprus and Sweden.[32]

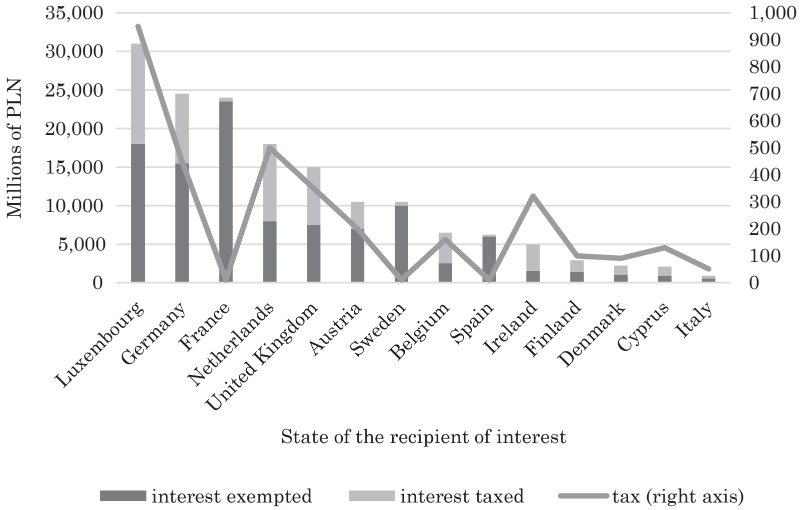
In total, interest payments transferred from Poland to other EU member states tripled in the year 2018 in comparison with 2005 (see Graph 7). Despite the increase in interest payments, the share of transactions effectively taxed remained constant. This means that the growth of interest transfer was rather almost exclusively due to exempted payments, in particular intra-group payments.

[31] Convention between the Republic of Poland and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital done at Luxembourg on 14 June 1995, JL 2019, item 1244.

[32] Główny Urząd Statystyczny (2019): 3–5.

Graph 6

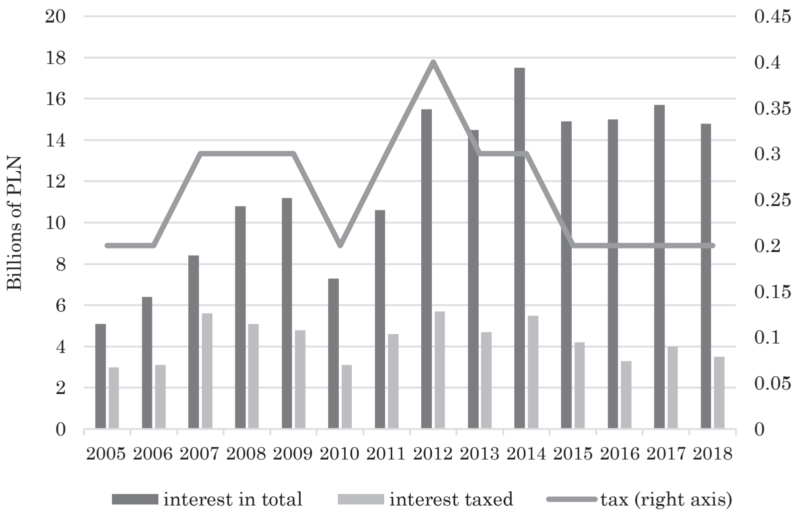
Interest transferred to recipients residing in the EU Member States in 2005–2018 (in millions of PLN)



Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

Graph 7

Interest transferred to recipients residing in the EU Member States in 2005–2018 (in millions of PLN)



Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

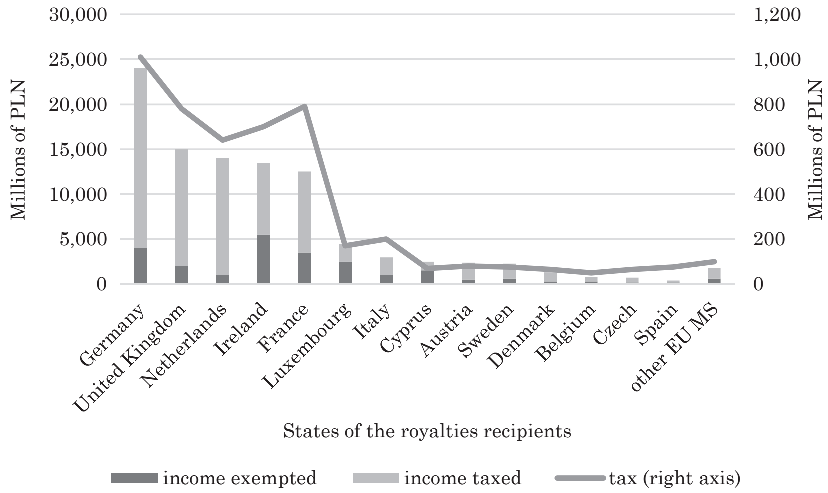
4. Royalties

How the individual MNE group entities use ‘group’ intellectual property rights is normally the subject of strategic management. Intangible assets are difficult to clearly define and value, and often relate to crucial assets for the MNE groups, determining their market position, business strategy, innovation and profitability. The correct split of the return generated by intangibles may be difficult when many related entities are involved in their development, enhancement and exploitation. In many cases, intangible assets are unique and create a synergy effect, which makes their valuation more difficult.[33]

The location of the IP rights holder within the MNE group may be dictated by tax considerations. The flow of royalty payments may indicate arrangements that are favourable to the holding entities in a particular tax jurisdiction. The highest value royalty payments were made to Germany, the UK, the Netherlands, Ireland, France, Luxembourg, Italy and Cyprus. Unlike dividends and interest, royalties were overwhelmingly subject to withholding tax. There has been a noticeable increase in the share of withholding tax exempt royalties among all outgoing royalty payments from Poland. In 2012, the value of exempt royalties represented only 11.69%, while in 2018 it accounted for 42.35% of the total value of payments (see Graph 10).

Graph 8

Royalties in total transferred to recipients residing in the EU Member States in 2005–2018 (in millions of PLN)

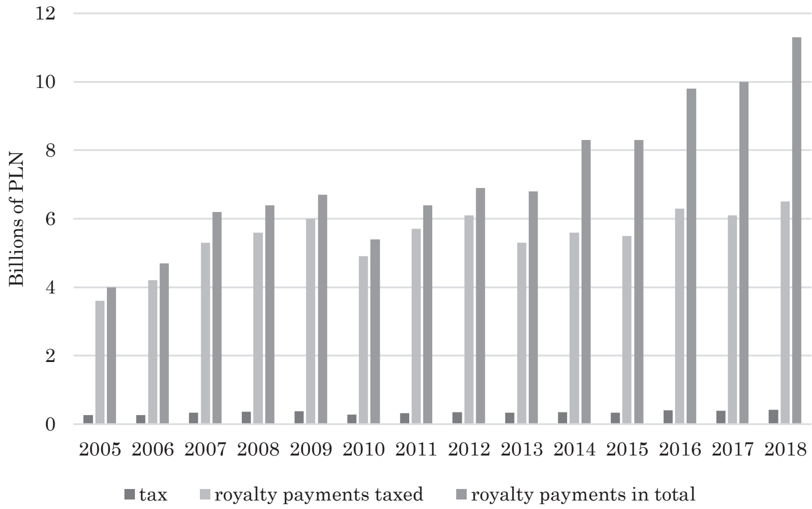


Source: the authors’ own elaboration based on non-published data from the Ministry of Finance.

[33] Jamroży, Sarnowski, Tonia (2021): 87.

Graph 9

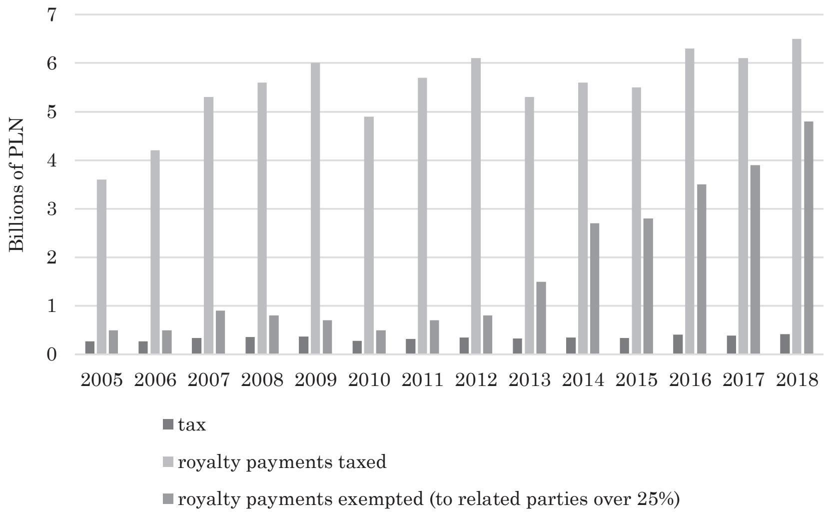
Royalty payments transferred to recipients residing in the EU Member States in 2005–2018
(in billions of PLN)



Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

Graph 10

Royalty payments transferred to recipients residing in the EU Member States in 2005–2018,
including transactions with related parties (in billions of PLN)



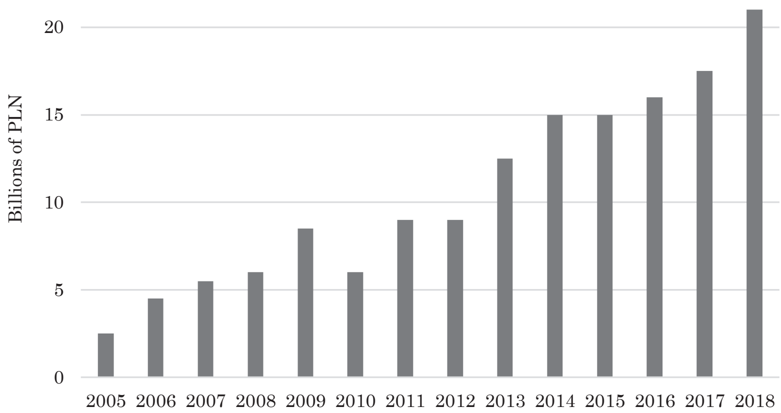
Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

5. Remuneration for specific types of services

The last group of passive income payments includes various fees paid for certain 'intangible' services such as advisory services, advertising, management services and many others. The remuneration for such services was in most cases not taxed at source in Poland. Payments of the highest value were made to residents of Germany, the United Kingdom, France, the Netherlands, Ireland and Italy (Graph 11). Between 2005 and 2018, a clear increase in the value of such services performed for Polish taxpayers can be observed as in the year 2018 the amount of PLN20.8 billion was paid out under this category.

Graph 11

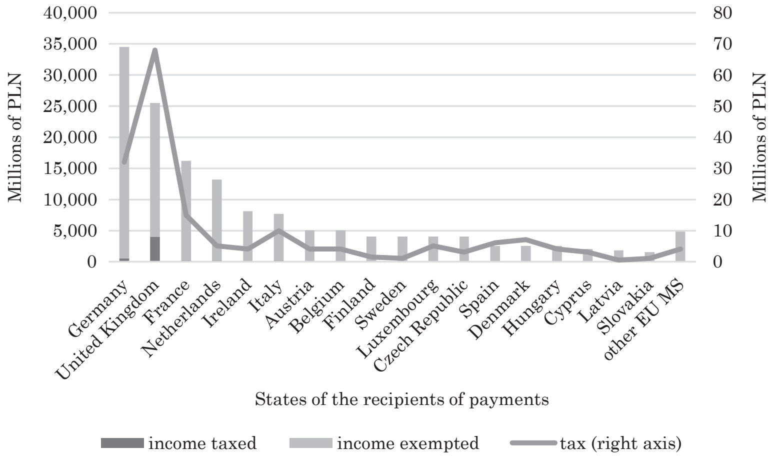
Remuneration for specific services in total paid to the recipients residing in the EU Member States in 2005–2018 (in billions of PLN)



Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

Graph 12

Remuneration for specific services transferred to recipients residing in the EU Member States in 2005–2018 (in millions of PLN)



Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

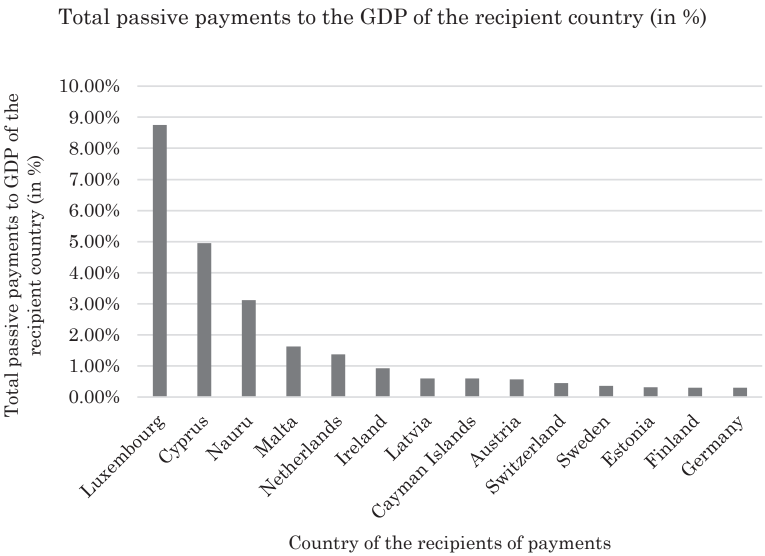
VI. PASSIVE INCOME INDEX

In the next step, the level of passive payments was compared to the GDP of the recipient country. Account was taken of the total value of passive income payments made from Poland in 2005–2019 to individual countries (data in PLN), relative to the GDP of the recipient country in those years (in USD). The purpose of the index is to show the share of passive payments from Poland to individual foreign jurisdictions in the GDP, the basic indicator of the country's economic development.

The analysis shows that among countries having intensive trade links with Poland (e.g. Germany, Italy, France), the index oscillates around 0.1%–0.3%. Among countries whose trade with Poland is less intensive, it is around 0.01%–0.1%, while in the case of countries for which trade with Poland is negligible, the index is close to zero.

There is a number of jurisdictions for which the index reaches above-average values, despite the lack of adequate trade exchange with Poland. The highest values of the index were recorded for Luxembourg, Cyprus, Nauru, Malta, the Netherlands, Ireland, Latvia, the Cayman Islands, Austria and Switzerland, respectively (Graph 13). For Luxembourg, the index assumes a value that is approximately thirty times higher (8.76%) than for neighbouring Belgium. Similarly, Cyprus and Nauru have index values over a dozen times higher than those of Belgium, while Malta, the Netherlands and Ireland have index values several times higher. The values of the index cannot be

Graph 13

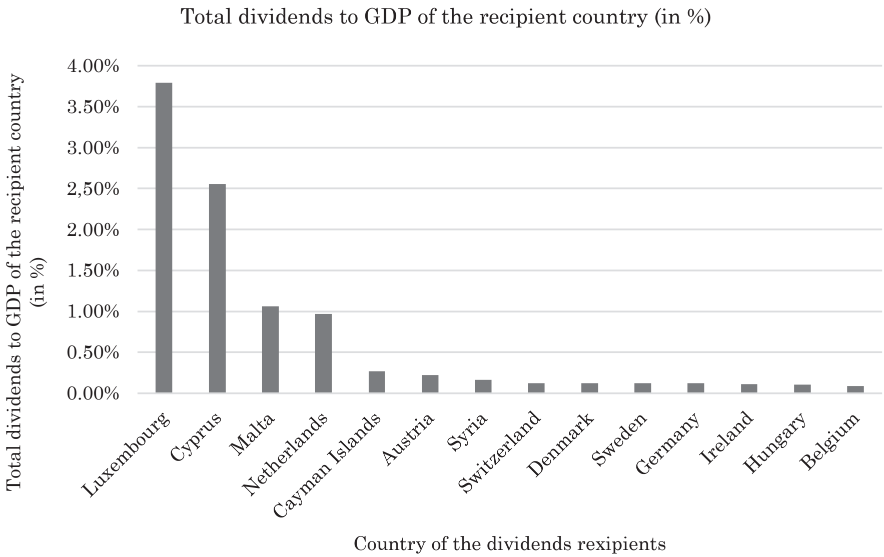


Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

explained by trade flows with these countries. The only common denominator of the countries mentioned, determining the divergent value of the index, observed by the authors, is the favourable regulatory and tax regime for multinational groups. All countries for which the value of the index deviates significantly from the standard have adopted favourable tax arrangements and are often referred to in the literature as tax havens.[34]

Similar conclusions can be drawn from the breakdown of the index by type of passive income. For dividend payments, the highest five values of the index have been found for Luxembourg, Cyprus, Malta, the Netherlands and the Cayman Islands, respectively (Graph 14).

Graph 14

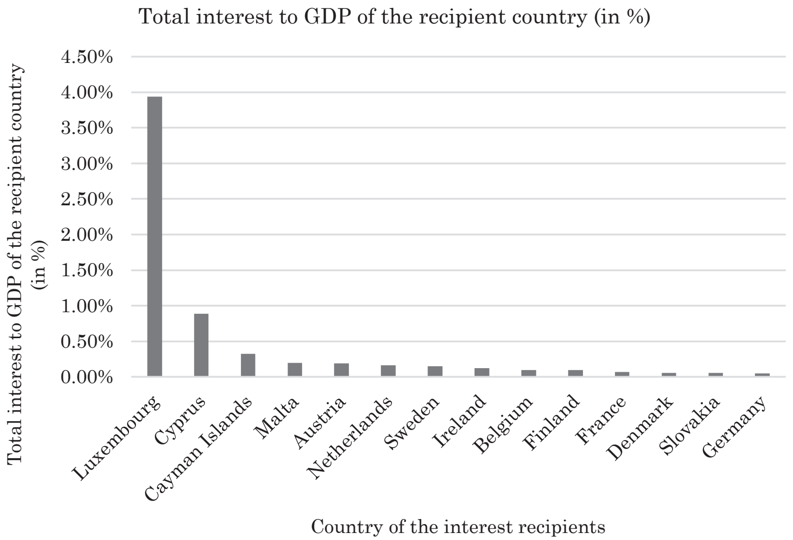


Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

Luxembourg and Cyprus, the Cayman Islands, Malta, Austria, and the Netherlands are also the leaders when looking at debt financing payments (Graph 15). Taking into account both debt and equity financing, Luxembourg presents itself as a primary foreign financial hub for Polish companies.

[34] Tørsløv, Wier, Zucman (2021): 8.

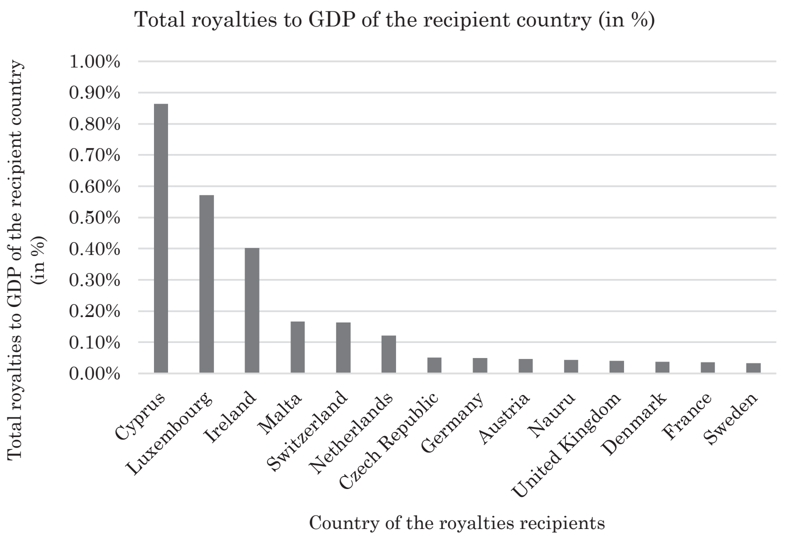
Graph 15



Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

Luxembourg loses its first position to Cyprus for the index based on royalties (Graph 16). The significantly higher position of Ireland, whose tax system takes a particularly preferential approach to this type of income, is evident. The use of various Irish IP-based incentives and capital allowances for intangible assets combined with a web of international treaties gives multinationals an opportunity to shelter profits globally.

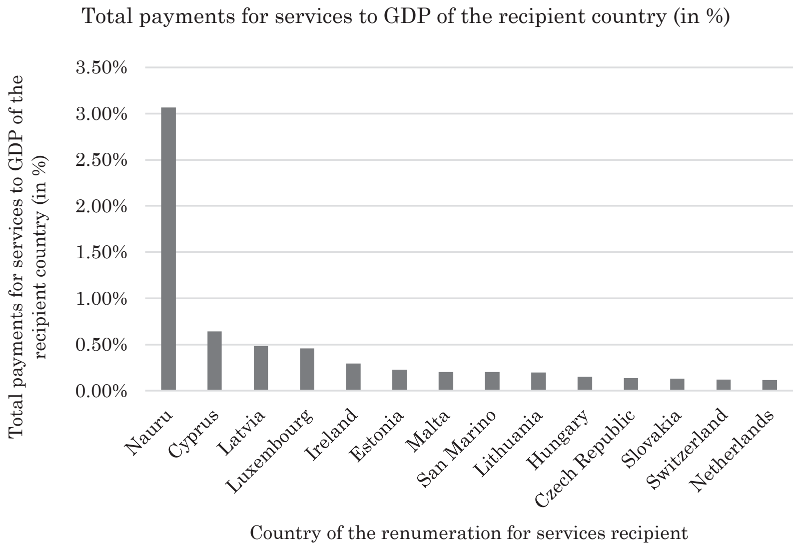
Graph 16



Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

In the case of payments for certain 'intangible' services, the first position is held by the Republic of Nauru, a jurisdiction that is classified directly as a tax haven by the Minister of Finance of Poland[35] (Graph 17). Other countries at the top of the ranking for the index based on the value of remuneration for such services are Cyprus, Latvia, Luxembourg and Ireland.

Graph 17



Source: the authors' own elaboration based on non-published data from the Ministry of Finance.

VII. CONCLUSION

The high share of passive income: dividends, interest and royalties, exempt from withholding tax, implies that most payments are made within the MNE groups. An analysis of passive income outflows from Polish entities to entities within the MNE groups showed that among the jurisdictions with the highest volume of passive income payments are countries with which trade is not significant and far from proportionate as to the scale of passive income. These are countries such as Luxembourg, Ireland, Malta and Cyprus – countries with much smaller populations and negligible trade in goods with Poland. In a ranking compiled using the share of passive income in the GDP of the recipient country, the leaders are also countries that qualify explicitly as tax havens, such as Nauru or the Cayman Islands.

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[35] Regulation of the Minister of Finance of 28 March 2019 on the identification of countries and territories that apply harmful tax competition with respect to corporate income tax, JL 2019, item 600.

The example of passive income flowing from Polish entities to foreign entities supports the thesis that tax jurisdictions offering extensive legal and tax incentives for holding structures, including the tax treatment of dividends and other passive income, are the preferred location of holding companies. The analysis shows that passive income payments, including dividends, interest, license fees or fees for intangible services, which constitute the dominant type of payments to holding companies, are directed from Poland primarily to countries with the so-called friendly tax and regulatory solutions for holding companies, including, in particular, the so-called intra-EU tax havens: Luxembourg, Cyprus, the Netherlands, Malta, or Ireland. The results obtained remain largely consistent with those obtained by van 't Riet and Lejour.[36] This study confirms that Luxembourg and the Netherlands are among the countries most frequently chosen by international groups, if only for the implementation of tax regulations favouring the reduction of dividend taxation.

The above indicates also how important the cost-effectiveness of ongoing and planned investments in choosing an investment location for taxpayers may be. The new Polish holding company related tax legislation makes the holding regime in Poland more attractive internationally and domestically. The question of whether it will bring the expected results and thus contribute to the changes in the flow of passive income payments may be the subject of further research.

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[36] Van 't Riet, Lejour (2018): 1321.

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