US Inbound Newsalert

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Luxembourg-Poland protocol eliminates PE exemption, affecting US investments in Poland

On June 7, 2012, Luxembourg and Poland signed a protocol amending the treaty signed between these countries in June 1995 (the 2012 Protocol). The 2012 Protocol contains numerous revisions. The most significant impact from a US federal income tax perspective is with respect to structures involving Luxembourg branches of Polish companies. This structure has applied to inbound and outbound structures, and has been commonly used to finance a group's US and non-US subsidiaries.

Pursuant to Article 5 of the 2012 Protocol, which revises Article 24 (Elimination of Double Taxation) of the treaty, a Luxembourg branch's profits will no longer be exempt from Polish taxation, which may result in substantially higher Polish tax exposure. As a result, companies with a Polish/Luxembourg structure in place that relies on the current exemption system should review their current structures.

This recent development has potential relevance for companies that claim benefits under the United States-Poland income tax treaty. The current United States-Poland income tax treaty is one of the few US income tax treaties that does not contain a limitation on benefits (LOB) article, which is an anti-treaty shopping provision that restricts the ability of third country residents to access the benefits of a treaty. Poland and the United States have initialled, but not yet implemented, a new treaty that includes a modern LOB article.

The 2012 Protocol generally is applicable from the first of January of the year following the year in which it enters into force. However, the provisions of the Protocol impacting withholding taxes will apply to income derived on the first day of the second month following the date on which the Protocol enters into force. For example, if the diplomatic notes are exchanged in September 2012, the provisions of the 2012 Protocol will apply to US-source income of a Polish company attributable to a PE in Luxembourg as of January 1, 2013.

***Observation*:** Since the 2012 Protocol does not contain a provision to grandfather or otherwise protect existing structures, companies with a Polish/Luxembourg structure in place that relies on the current exemption system should review their current structures.

The new treaty between the United States and Poland is being translated and prepared for signature; once the agreement is signed, both parties must ratify it in order to enter into force. In the case of the United States, the ratification process requires the treaty to be sent to the US Senate for advice and consent. As previously noted in several of PwC's US Tax Treaty Newsalerts (June 18, 2012 and May 22, 2012), Senator Rand Paul (R-KY) has placed a hold on three bilateral tax agreements that were sent to the full Senate for approval last year (agreements with Hungary, Switzerland and Luxembourg). Senator Paul's action leaves the tax treaty ratification process in a state of flux, and as such, it is not known whether Senator Paul's hold will impact the ratification of the new United States-Poland treaty once it is signed. As a result, it is unclear as to the period of time that structures reliant on the current United States-Poland treaty will continue to be effective.

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