Amendment of the Cyprus-Poland double taxation agreement

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The protocol amending the double taxation agreement between Cyprus and Poland was signed on behalf of the two countries in March 2012. When ratified, the protocol will make a number of changes to the existing agreement, which dates back to 1992. The principal changes are outlined below.

I. Taxes covered

The taxes covered by the 1992 agreement were, for Poland, income tax, corporate income tax and agriculture tax. The protocol removes any specific reference to the agriculture tax.

II. Reduction of withholding tax on dividends

Article 4 of the protocol provides that maximum rate of withholding tax on dividends will be reduced from ten percent to zero if the beneficial owner is a company (other than a partnership) resident in the other contracting state which has directly held at least ten percent of the capital of the company paying the dividends for an uninterrupted period of 24 months, and to five percent otherwise. As well as the reduction in rate, there is a significant conceptual change: the 1992 agreement refers to the recipient of the dividends being a resident of the other contracting state: the protocol requires that the beneficial owner of the dividends should be a resident of the other contracting state. This change in emphasis, from the recipient to the beneficial owner, is in line with the latest OECD Model Convention and is designed to forestall artificial avoidance schemes.

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III. Reduction of withholding tax on interest

The maximum rate of withholding tax on interest will be reduced from ten percent to five percent. As in the case of dividends, the determining factor is now the country of residence of the beneficial owner, not the recipient.

IV. Withholding tax on royalties

The maximum rate of withholding tax on royalties remains unchanged at five percent but, as in the case of dividends and interest, the determining factor is now the country of residence of the beneficial owner, not the recipient.

V. Personal services

Articles 7 and 8 of the protocol correct some loose drafting in Articles 14 and 15 of the 1992 agreement, which deal respectively with independent and dependent personal services. They make clear that income from services may be taxed in the source country if the taxpayer stays in that country for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned (the 1992 agreement merely referred to "any twelve month period").

VI. Directors' fees

Article 16 of the 1992 agreement provides that directors' fees paid to a resident of one contracting state (A) by a company resident in the other contracting state (B) may be taxed in the state (B) in which the company is resident. The ambiguity of the wording led some to argue that Polish-resident directors of Cyprus companies should not be liable to Polish income tax on directors' fees from those companies. However, since the top rate of Cyprus personal tax is now 35 percent, compared to the top Polish rate of 32 percent, this apparent loophole had become of little benefit.

The protocol removes any ambiguity. It provides simply that directors' fees and other similar payments paid to a resident of a contracting state (A) by a company resident in the other contracting state (B) are subject to tax only in the state (A) in which the recipient is resident.

VII. Elimination of double taxation

The amount allowed as a deduction from tax on income or capital gains in Poland will be based on the tax paid in Cyprus, limited to the amount attributable to such income or capital gains derived from Cyprus. The protocol explicitly includes tax on capital gains, which was not included in the 1992 agreement.

Paragraph 3 of Article 24 of the 1992 agreement allows Polish taxpayers to obtain credit against their Polish tax liability for tax that would have been payable in Cyprus but for the other provisions of that agreement. For example, taxpayers are currently allowed credit for a ten percent withholding tax on dividends, regardless of the fact that no tax has been withheld. This allows investors to reduce the 19 percent Polish tax rate on dividends to nine percent.

The protocol allows credit against Polish tax for "an amount equal to the tax paid in Cyprus". Accordingly, if no tax has been paid in Cyprus, no reduction of Polish tax will be allowed once the protocol takes effect.

VIII. Exchange of information

The protocol replaces Article 27 of the 1992 agreement with a new article, which reproduces the information exchange article of the OECD Model Convention verbatim and supplements it with details of the information to be supplied by a state when making a request for information to demonstrate the foreseeable relevance of the information to the request. This prevents tax authorities embarking on speculative enquiries and safeguards the interests of taxpayers.

IX. Entry into force and effective date

The protocol will enter into force when both states have exchanged notifications that the necessary ratification procedures have been completed. The changes it introduces will have effect from the beginning of the following calendar year.

X. The effect of the protocol

It is widely expected that ratification procedures will be completed before the end of 2012 and that the changes introduced by the protocol will take effect from the beginning of 2013. However, with Cyprus being preoccupied with the Presidency of the EU Council in the second half of 2012 this timetable could easily slip.

The Polish tax authorities have been reviewing double tax agreements over the past few years with the objective of closing loopholes and removing outdated provisions. The agreements with Switzerland, the Czech Republic and Malta have already been amended and changes to several others are awaiting ratification.

The changes to the Cyprus agreement are principally of a "housekeeping" nature, and will not fundamentally affect Cyprus's relative competitiveness as a portal for investment into or from Poland. The reduction in tax on dividends and interest balances the abolition of the tax-sparing provisions and the removal of the ambiguity on taxation of directors' fees should have little practical effect, given that there was nothing to be gained by exploiting it.

Much has been made of the new exchange of information regime, with fears being expressed that it will be used as the basis for "fishing expeditions" based on little more than envy and suspicion. These fears are unfounded: Cyprus has robust safeguards, established by Law 72(I) of 2008 amending the Assessment and Collection of Taxes Law, against abuse of any exchange of information provisions. Requests for exchange of information are dealt with solely by the International Tax Relations Unit ("ITRU") of the Department of Inland Revenue of the Ministry of Finance. Exchange of information may only take place via the ITRU: direct informal exchange of information between tax officers bypassing the competent authority is prohibited. A request must be much more than a brief email containing the name and identifying information of the individual concerned. Instead, a detailed case must be made, with the criteria set out in a lengthy legal document. In effect, this means that the authorities requesting the information must already have a strong case even before they request the information. Accordingly, it will not be possible to follow up a suspicion without first gathering significant evidence. As a final safeguard, Cyprus's Assessment and Collection of Taxes Law requires the written consent of the Attorney General to be obtained before any information is released to an overseas tax authority.

Cyprus offers substantial benefits as a portal for investment to and from Poland. Following recent changes to the Polish regulatory regime regarding promotion of pharmaceutical products there has been an increase in the use of Cyprus structures in order to achieve maximum effectiveness of marketing expenditure in compliance with the regulations. Cyprus's attractiveness in this regard has been enhanced by recent changes to the rules for taxation of intellectual property, including an 80 percent tax exemption for income earned from intellectual property or profits on the disposal of intellectual property. Cyprus will continue to be one of the most beneficial jurisdictions for investment to and from Poland after the protocol takes effect.

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