

“Cyprus–Russia tax treaty”

Protocol to tax treaty signed

1. Background

On Thursday 7 October 2010 during the official visit of the Russian president Mr Dmitry Medvedev to Cyprus, 15 agreements were signed boosting bilateral ties with Cyprus. The final version of the long awaited Protocol to the Russia/Cyprus Double Tax Treaty was also signed.

The economic relations between the two countries are gaining even greater momentum as the joint declaration signed by the two presidents in late 2008 in Moscow has now been converted into a three year action plan aimed at enhancing the cooperation between the two countries at all levels.

The Russian president said that the overall investment from Cyprus to Russia has exceeded US\$50 billion and that the signing of the protocol to the double tax treaty agreement between Russia and Cyprus would further enhance economic cooperation.

**“Overall investment from
Cyprus into Russia has
exceeded US\$50 billion”**

**Russian President
Dmitry Medvedev**

Cyprus is a major conduit of investment into Russia with many Russian-owned offshore companies operating on the island, and the accord removes a long-standing thorn in bilateral relations.

Russia had blacklisted Cyprus in early 2008 on claims that it was not cooperating enough in exchanging information on bank assets, leading to tax evasion.

Mr Medvedev also said that the new accord makes such business activity more transparent, allowing for better monitoring. He said Cyprus would be removed from the Russian Central Bank’s black list.

The removal from the Russian black list will come into effect simultaneously with the provisions of the Protocol. Formal ratification is expected to happen before the end of 2010 so that the Protocol could come into effect on 1 January 2011.

Contact Us

Address:

Centaur House
2 Apostolos Varnavas
2571 Nisou, Nicosia,
Cyprus

Tel: +357 22 499 994
Fax: +357 22 499 984

Email:

cyprus@centaurtrust.com

Website:

www.centaurtrust.com

**“Removal of
Cyprus from the
Russian Black List”**

**Russian President
Dmitry Medvedev**

“Features of Protocol”

No change in the withholding tax rates

2. No change in withholding tax rates

The withholding tax rates for payments of dividends, interest and royalties from Russia to Cyprus, remain the same:

- **Dividends – 5%**
(subject to a minimum direct investment of €100,000 – previously \$100,000)
- **Interest – 0%**
- **Royalties – 0%**

This development was very important and it was very positively welcomed by the business community.

New definition for dividends

The protocol amends the definition of dividends to align it with the wording of the latest version of the OECD Model Treaty.

To this effect the protocol clarifies that the new definition of dividends includes:

- distributions from mutual investment funds and similar collective investment vehicles (other than real estate investment trusts or real estate investment funds or similar vehicles primarily investing in immovable property).

No changes in withholding tax rates

- **Dividends–5%**
- **Interest-0%**
- **Royalties-0%**

- The definition of dividends has also been extended to cover distributions from shares held in the form of depository receipts (GDRS and ADRS).

- Lastly, the definition also includes the reclassification by the Russian tax authorities of excessive interest due to thin capitalisation rules.

In all, the above situations, payments will now be subject to the normal withholding tax rate applying to dividends i.e. 5%.

New definition for interest

The protocol amends the definition of interest to align it with the wording of the latest version of the OECD Model Treaty.

To this effect the protocol clarifies that the new definition of interest includes:

- income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, but it does not include penalty charges for late payment or interest which is reclassified as dividends by virtue of other provisions.

Contact Us

Address:

Centaur House
2 Apostolos Varnavas
2571 Nisou, Nicosia,
Cyprus

Tel: +357 22 499 994
Fax: +357 22 499 984

Email:

cyprus@centaurtrust.com

Website:

www.centaurtrust.com

Broadened definition for:

- **Dividends &**
- **Interest**

“Features of Protocol”

Changes in the taxation of capital gains

3. Changes in the taxation of capital gains

The major change to the existing treaty made by the protocol relates to disposals by a resident of one country of shares of companies which derive a substantial part of their value (more than 50%) from immovable property situated in the other country.

This change is in line with article 13 of the latest OECD model treaty principle that provides that such gains should be taxable in the country where the real estate is situated (provided that “more than 50% of the value of shares is represented by immovable property situated in the other state.

To this effect any income from these operations will be taxable in Russia at the rate of 20%. The same will apply to income paid by Russian mutual investment funds whose assets consist mostly of immovable property, in favor of participants who are Cyprus tax residents. This income will be subject to Russian withholding tax at the rate of 20%.

“The change to the treaty expected to be applicable from 2015”.

Currently, the treaty grants the taxing right to the country of residence of the selling entity.

This change will come into effect four years after the date the Protocol will come into force i.e. it is expected to be applicable from 2015.

Certain exemptions will apply to the application of this provision:

- concerning disposals in shares which qualify as a reorganization,
- shares listed on a recognized stock exchange,
- where the seller is a pension/provident fund or the government of either of the two countries.

The Russian Federation has undertaken that, by the time the Protocol will come into force, it will have adopted the OECD Model Tax Convention on Income and Capital provision for capital gains in its tax treaties with all States which are regarded as main investors in the Russian Federation.

Contact Us

Address:

Centaur House
2 Apostolos Varnavas
2571 Nisou, Nicosia,
Cyprus

Tel: +357 22 499 994
Fax: +357 22 499 984

Email:

cyprus@centaurtrust.com

Website:

www.centaurtrust.com

“Gains on immovable property

Now are taxable

in Russia at the

rate of 20%.”

“Features of Protocol”

Exchange of information

4. Exchange of information

The changes introduced to articles 25, 26 and 27 of the Agreement generally concern administrative matters and have been revised in line with article 26 of the latest OECD Model.

More clarity has been introduced in relation to the powers and obligations of the tax authorities of the two countries which are generally aimed at improving the administrative procedures through which information can be collected and exchanged between the tax authorities of Russia and Cyprus.

It should be noted that the changes introduced do not assume the automatic exchange of information. To obtain information from the Cypriot tax authorities the Russian tax authorities will have to follow certain procedures, and in particular, in considering the possibility of information provision, the requirements of Cyprus legislation have to be taken into account.

“Expanded exchange
of information
provision”.

However, it is further clearly provided that professional secrecy rules (e.g. by a bank or a person acting in an agency or fiduciary capacity) cannot be used as an excuse for refusing to supply information.

The circumstances under which such professional secrecy rules can be lifted and the process that must be followed in this respect are subject to the detailed provisions of the domestic legislations of the two countries.

In the case of Cyprus, the approval of the Attorney General is needed before any information is exchanged.

Contact Us

Address:

*Centaur House
2 Apostolos Varnavas
2571 Nisou, Nicosia,
Cyprus*

*Tel: +357 22 499 994
Fax: +357 22 499 984*

Email:

cyprus@centaurtrust.com

Website:

www.centaurtrust.com

“In the case of Cyprus the approval of the Attorney General is needed before any information is exchanged”

“Features of Protocol”

Other changes

5. Other amendments

Limitation of treaty benefits

The protocol introduces a new limitation of benefits article to an entity that was created with the main purpose of obtaining such benefits.

It should be noted that the limitation has a very narrow scope as it will not be applied to companies incorporated in Russia or Cyprus.

This provision applies mainly to companies incorporated outside Cyprus but which are tax resident in Cyprus by virtue of the exercise of their management and control in Cyprus.

Also the denial of treaty benefits does not apply automatically but only as a result of consultations between the tax authorities of Russia and Cyprus.

“Limitation of treaty benefits

It does not apply to Cyprus and Russian registered companies.”

Extension of definition of permanent establishment

The meaning of permanent establishment is extended by a new paragraph 4, according to which : provision of services by a resident of one State in the other State might lead to the recognition of a permanent establishment in that other State, provided certain conditions are met.

Introduction of a tie-breaker clause

In case of a dispute on residency issues, the competent tax authorities should consult with each other to reach a mutually agreeable conclusion.

Income from international traffic of ships, aircraft or road vehicles

This income will be subject to tax in the country where the effective place of management of the person deriving the income is situated.

Contact Us

Address:

Centaur House
2 Apostolos Varnavas
2571 Nisou, Nicosia,
Cyprus

Tel: +357 22 499 994
Fax: +357 22 499 984

Email:

cyprus@centaurtrust.com

Website:

www.centaurtrust.com

Contact Us

Address:

*Centaur House
2 Apostolos Varnavas
2571 Nisou, Nicosia,
Cyprus*

*Tel: +357 22 499 994
Fax: +357 22 499 984*

Email:

cyprus@centaurtrust.com

Website:

www.centaurtrust.com

Contributed by:

**Demetris Papaprodromou (BA, MSc, ACA, CPA)
Managing Director**

The contents of this publication are for information purposes only and can not be construed as providing any advice on matters including, but not restricted to, financial, accounting, tax or legal advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, Centaur Trust, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

As such, the reader should not use this publication as a substitute for professional consultation with competent accounting, tax, legal or other advisors.