

### **CYPRUS- RUSSIA PROTOCOL RATIFIED BY THE RUSSIAN DUMA**

The Russian State Duma ratified the new version of the agreement for avoidance of double taxation between Russia and Cyprus on 15/02/2012 that was signed on the 7 of October 2010, during the Russian President's official visit to Cyprus.

Most importantly the protocol changes go into force on January 1, 2013 and Cyprus is to be removed from the Russian black list for dividend participation exemption. The much talked about article about the property – will apply in 2017. Russia has agreed to accept the delay in order to introduce a similar article in the agreements with other countries - "competitors" of Cyprus in the financial markets: Switzerland, Luxembourg, the Netherlands.

#### **A recap on the main provisions as included in our Bulletin 31:**

The changes to the treaty will become effective from the 1<sup>st</sup> of January of the year following the year of ratification.

The Protocol keeps Cyprus as the country with the most competitive and favorable Double Tax Treaty with Russia and removes it from the Russian black list for dividend participation exemption. This releases the Russian parent companies from the burden of being taxed on dividends received from Cypriot subsidiaries. Most of the changes adopt international practice and most importantly the OECD recommendations.

#### **Dividends, Interest and Royalties – No changes**

The favorable withholding tax rates applying to payments of dividends, interest and royalties from the one contracting state to the other remain intact.

Interest	- 0%
Royalties	- 0%
Dividends	- 5%

This has been a very important achievement for the business world in general as this was and will continue to be the cornerstone of the Double Tax Treaty. The threshold for the 10% withholding tax on dividends has changed from below US\$100,000 to below EURO 100,000.

The definition of dividends will now include payments on shares of mutual investment funds and similar collective investment vehicles as well as depository receipts over shares.

### **Residency**

A new paragraph is added to Article 4 to allow the two tax authorities to determine the residency of an entity, by mutual agreement, if the place of effective management cannot be determined. The definition of "resident" remains unaffected.

### **Permanent Establishment**

The OECD recommendations were adopted in Article 5 where a business activity carried out by a resident of one contracting state in the other contracting state can create a permanent establishment in the other contracting state even if there is no fixed place of business. The meaning of permanent establishment is extended to include profits from services performed in one country by an entity of the other country through an individual or individuals present in the other country. The individual must be present for more than 183 days in a 12-month period and more than 50% of aggregate revenues attributable to active business are derived through the individual.

In essence a permanent establishment in Russia may be created even in the absence of a "fixed place of business" through services provided by individuals who spend a long period of time in Russia.

### **Real Estate Mutual Investment Funds**

One of the important changes introduced is included in Article 6 where the income received from Cyprus companies that are participants in property rich mutual investment funds is taxed where the immovable property is situated. This income if earned in Russia will result in 20% withholding tax.

There are no parameters however how a mutual investment fund will be determined as being property rich and no indication of how the participants will be taxed when the fund is dissolved or the shares redeemed.

The uncertainty though under the existing treaty on whether such distributions could be classified as "other income" is now eliminated.

### **International Traffic**

The article regarding taxation of income from international traffic (i.e. shipping, aircraft, rental of containers) is effectively replaced. The taxing of these activities is where the place of effective management of such entities is situated and not where the person resides as it was in the previous Article 8. The OECD model is again followed.

## **Investment in Property Holdings**

The major change to the existing treaty's Article 13 is the taxation of capital gains on the sale of shares in real estate companies.

The treaty currently provides for the country of residence of the selling entity to have the taxing right (e.g. Cyprus for Cypriot companies selling shares in Russian property companies). The Protocol aligns to the latest OECD Model Treaty principle whereby such gains should be taxable in the country where the real estate is situated. The change affects sales of shares of companies deriving more than 50% of their value from immovable property. The exemption from the above provisions is where the selling entity is a pension fund, a provident fund, the government of Cyprus or the Russian Federation, or the gains are from the disposal of shares in a listed company or in the course of a corporate reorganization. The taxing right will remain with the country of residence of the selling entity.

The above provision is expected to apply after 1 January 2017. The Russian Federation Ministry of Finance was committed to include similar provisions in jurisdictions like Switzerland, Luxembourg, Austria, Netherlands and Malta.

The period to 2017 allows plenty of time for the tax planning strategies to be reviewed and consider ways of reducing and even eliminating the effects of this change and keeping the property under the ownership of Cyprus company.

## **Exchange of Information**

This article has been revised in line with the article 26 of the OECD Model Tax Convention on Income and Capital and reflects the changes that have already been introduced in the Cypriot tax legislation since 2008.

The changes are towards alignment to OECD policy standards on fiscal transparency and exchange of information on taxation matters.

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 is now clearly provided that the fact that one country may not need information for its own purposes should not prevent it from collecting this information in reply to a request from the other country.

At the same time, it also remains clear that information cannot be supplied which is not obtainable under the laws or in the normal course of the administration of a contracting state.

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. However, 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.

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 Russia 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.

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

The proposed changes follow international practice and are aimed at expanding the exchange of information between the Russia and Cypriot tax authorities. Similar changes have been introduced in several double tax treaties concluded by Russia, in particular, with Germany and the Czech Republic and will be added to treaties with other states in future.

#### **Assistance in Collection**

The article on "Assistance in Collection" has also been aligned to the OECD Model Tax Convention on Income and Capital. This will come into effect only upon the introduction by Cyprus of the necessary legal framework necessary to provide the Assistance in Collection.

#### **Mutual Agreement**

The amendments to the article on Mutual Assistance procedures are also towards bringing this article in line with the OECD standard. The changes basically clarify the existing powers and obligations of the treaty countries and broadens the spectrum to cover all taxes.

#### **Limitation of treaty benefits**

An article that limits the treaty benefits is introduced (Article 29) with the purpose of disallowing treaty benefits that would otherwise provide a reduction or exemption in tax to an entity that was created with the main purpose of obtaining such benefits and the entity is not registered in Russia or Cyprus . **Companies incorporated in Russia or Cyprus will therefore not be affected by this article.** The limitation will apply only to companies incorporated outside Cyprus but are tax resident in Cyprus by virtue of the exercise of their management and control in Cyprus, since Russian resident companies are considered only the ones incorporated in Russia.

**Please contact a member of our staff for further information and/or clarifications.**