



NEW PROTOCOL TO CYPRUS RUSSIA DOUBLE TAX TREATY

On 16 April 2009, following a year's intensive meetings and negotiations, representatives from the respective Ministries of the Republic of Cyprus and the Russian Federation signed a final draft Protocol to the Double Tax Treaty of 1998 between the two countries. The Protocol was signed by both countries on 7 October 2010 during Russian President Dmitry Medvedev's official visit to Cyprus. Formal ratification is expected to happen before the end of 2010 so that the Protocol will become **effective from 1 January 2011**. As a result of this development, the Russian government is expected to simultaneously announce the **removal of Cyprus from the Russian Blacklist**.

As from the effective date of the removal from the black list, dividends received by Russian shareholders from eligible equity participations in Cypriot subsidiaries can qualify for the Russian dividend participation exemption.

An eligible subsidiary is a company which fulfils the following conditions as at 1/1/2008:

- The holding company has a minimum participation of 50% in the capital of the subsidiary
- The participation has been held for at least 365 continuous calendar days
- The value of the participation is at least RUR500 million.

Below is a list of the changes that the Protocol will bring upon the relevant Double Tax Treaty once it comes into effect:

1. Withholding taxes: Dividends, Interest and Royalties

No changes to the nil rates of withholding tax on interest and royalties. For dividends, the withholding tax rates of 5% or 10% remain unchanged and the only change is on the conditions for eligibility of the 5% rate, whereby the withholding tax rate of 5% applies if the direct investment in the capital of the Russian Entity exceeds EUR100.000 (currently it is US\$100.000).

2. Dividends

The definition of dividends has been amended to align substantially with the OECD Model Treaty definitions. Dividends now include payments on shares of mutual investment funds and similar collective investment vehicles. This clarifies an uncertainty that existed regarding the withholding tax that should apply on such distributions as currently such distributions, under Russian domestic law are subject to 20% withholding tax. In addition, the definition of shares has been extended to include shares held in the form of Depository Receipts.



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3. Interest

The substantially aligned definition of interest with the OECD definition, has been extended to include 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.

The new definitions of interest and dividends will not prevent the Russian Tax authorities from applying domestic "thin capitalisation rules" to reclassify excessive interest payments as dividends and tax such amounts in Russia at source, albeit at the reduced dividend withholding tax rates under the treaty.

4. Capital Gains

The current treaty provides for the country of residence of the selling entity to have the taxing right, for example, when Cypriot companies sell shares in Russian property holding companies, Cyprus has the taxing right.

The important change to the existing treaty is the taxation of capital gains on the sale of shares in real estate property-holding companies. The Protocol change is in line with the latest OECD Model Tax Convention in that gains should be taxable in the country where the real estate property is situated. More specifically, on the disposal 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, the country in which the immovable property is situated will also have a right to tax the resulting gain.

The following relate to this change:

- The change will apply on 1 January 2015, that is 4 years after the Protocol will come into force
- The exclusive taxing right will remain with the country of residence of the seller if:
 - The disposal is in the course of a corporate reorganisation
 - The disposed shares are listed on a recognised stock exchange
 - The seller is a provident fund, a pension fund or the government of Cyprus or the Russian Federation

5. Limitation of Treaty Benefits

The limitation of benefits introduced does not apply to Companies registered in Cyprus or Russia. The limitation applies to tax residents of Russia or Cyprus which are not registered companies in either of



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the two states and only in cases where, after consultation of the two countries competent tax authorities they agree that, the main purpose or one of the main purposes that the entity was created was to obtain the benefits of the agreement.

6. Exchange of information – Assistance in Collection – Mutual Agreement

The article on exchange of information has been revised in line with the latest OECD Model Treaty equivalent and reflects the changes that have already been introduced during 2008 in Cyprus Tax legislation.

The difference from the current article on exchange of information is largely understood to be clarifications of existing powers and obligation of the tax authorities of the two countries generally aimed to improve the administration through which information can be collected and exchanged between the two countries.

In case where information is requested by one country, the other country shall use its information gathering measures to obtain the requested information, even though it may not need such information for its own tax purposes.

However, it remains clear that information will not be supplied in the case where it cannot be obtained under the laws or in the normal course of the administration of that country. In addition, information will not be supplied if it is required to carry out administrative measures at variance with the laws and administrative practice of that country.

In no case shall a country decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

The circumstances under which the above secrecy rules may be lifted and the process that must be followed are subject to the detailed domestic legislations of the two countries. In Cyprus, the approval of the Attorney General is required before any exchange of information.

The article on assistance in collection is replaced by wording almost identical to the latest OECD Model Treaty equivalent and will come into effect only upon the introduction by Cyprus of the necessary legal framework to allow for certain aspects of such assistance.

The amendments to the article on mutual agreement procedures are made largely to bring the article in line with OECD standard.



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7. Other Amendments

- Under the current treaty, residence is determined by the entity's place of effective management. The Protocol introduces a clarification of the existing "tie-breaker" test in relation to residency so that in cases where the effective management cannot be determined the Russian and Cypriot tax authorities should consult and come to a mutual agreement in this respect.
- The Protocol extends the meaning of permanent establishment to cover for the taxation of profits arising from services performed in one country by an entity of the other country through an individual(s) present in the other country for more than 183 days in a 12-month period in certain circumstances.
- The existing treaty's article regarding taxation of income from international traffic (i.e. shipping and aircraft) is replaced. This type of income according to the existing treaty was only taxed in the country in which the person deriving such income was resident, whereas according to the Protocol, the taxing right of Income from international traffic belongs to the country where the effective place of management of the person deriving the income is situated.
- Income from immovable property is taxed in the country in which the property is situated irrespective of its ownership. The definition of immovable property has been extended so that income of Mutual funds investing only in immovable property would be treated as Income from immovable property and may be subject to tax in the country where the immovable property is situated.