



AMENDMENTS TO THE DOUBLE TAX TREATY BETWEEN CYPRUS AND RUSSIA

Russia and Cyprus have on 16 April 2009 initialed an agreement to avoid double taxation between the two countries paving the way for Cyprus's removal from the Russian tax black list. The protocol was signed in Nicosia by Finance Minister Charilaos Stavrakis and the Director of the Department of Tax and Customs Tariffs Policy at the Russian Ministry of Finance Ilya Trunin. The Protocol is expected to be ratified by both countries in 2009 so that it will become effective as from 1 January 2010.

The breakthrough was achieved after Cyprus passed legislation recently facilitating the exchange of information between the authorities of the two nations. In addition, the Protocol revises several other provisions which will impact on all Russia-Cyprus corporate structures used for real estate investment vehicles, joint ventures or otherwise.

Most important amendments:

Dividends, interest and royalties

No changes in the Nil rates of withholding tax for interest and royalties. For dividends, the withholding tax of 5% and 10% remained unchanged. The only change is that in order to benefit for the lower rate of 5% the minimum investment in capital of the company must be €100,000 instead of \$100,000 as it used to be before. The definitions of dividends and interest have been amended in accordance with the new OECD Model Treaty. It is possible under the rules for the Russian Authorities to apply "thin capitalization"

rules, which may reclassify excessive interest payments as dividends resulting in withholding tax being deducted at source.

Abolition of Capital Gains Tax Exemption for real estate companies

Currently, the existing DTT exempts all capital gains derived by a Cypriot shareholder from the sale of shares in a Russian subsidiary from Russian taxation, whether or not that subsidiary owns immovable property in Russia. Under Cypriot domestic law such capital gains are exempt from taxation.

Article 7, of the Protocol now provides that gains derived by a resident of the contracting state from the sale of shares of a company which has more than 50% of their value from immovable property situated in another contracting state may be taxed in that country. This provision is planned to come into effect 4 years after the Protocol takes effect and is expected to be applicable in the year 2014.

Limitation of benefits (LoB)

The inclusion in the Protocol of the LoB article introduces the limitation of benefits which aims in preventing any potential treaty abuses from existing or newly incorporated companies whose purpose is to obtain the tax benefits granted by the Treaty. Such limitation does not apply to Russian or Cypriot companies and therefore one can conclude from this that the intention is to apply to companies which have been registered outside Cyprus, but are tax resident in Cyprus by virtue of the exercise of management and control.

Exchange of information

Article 26 of the Protocol based on the exchange of information between the two States and provides that:

- Information exchange can be extended not only to taxes covered by the tax Treaty, but also with regard to any other indirect taxes (e.g. Vat)
- Banking secrecy does not form grounds for refusal to exchange information with a competent authority of the other state
- The fact that the required information is not necessary or valuable for the purposes of collecting taxes for a competent authority can not serve as grounds for refusal to exchange the information with a competent authority of other state

Permanent establishment

- may be deemed to be in Russia if an individual who is present there for a period or periods exceeding 183 days in any 12-month period, and more than 50% of the gross revenues attributable to active business activities of the company are derived from such services or
- for a period or periods exceeding in the aggregate 183 days in any 12 month period, and these services are performed for the same project or for connected projects through one or more individuals who are present and performing such services in Russia
- As a result if a foreign company is deemed to have a Russian PE, is liable to 15% withholding tax on dividends. In addition, Russian withholding tax may apply to other passive income such as interest and royalties to the extent that this income is received by a foreign company from a Russian source and is attributable to its PE created in Russia.

Conclusion

In order for these amendments to take effect, the Protocol will need to be ratified by both Russia and Cyprus in

accordance with their applicable domestic laws. It is expected that, in line with intensifying global pressure against tax evasion and the decisions made at the recent G-20 Summit in London, the two countries will sign the final version of the new DTT by the end of the year.

It is advisable that clients who may be affected by the changes, take appropriate action to circumvent any negative implications of the provisions of the new Treaty. Midland Consult is always available to advice clients who consider that the new provisions may impact on the existing structures.

**Vassos Maratheftis FCCA
6 May 2009**