



The New Protocol between Cyprus and Russia

On 7 October 2010 the Russian president Dmitry Medvedev visited Cyprus and signed with their respective Cyprus counterparts a Protocol to the Russia-Cyprus double tax treaty that was agreed a year ago. The Protocol amends the existing Treaty which entered into force on 1st January 1998.

The main changes of the protocol are outlined below:

Removal of Cyprus from the Russian “Black List”

This means that dividends received by Russian companies from Cypriot subsidiaries can qualify for the Russian dividend participation exception.

Withholding taxes no changes

The favourable withholding tax rates applying to cross-border payments for dividend, interest and royalties remain unchanged, i.e.

Dividends	5% *
Interest	0%
Royalties	0%
Corporate tax	10%

* If investment in a company is less than €100,000 the withholding tax rate is raised to 10%. This amount was \$100,000 before and has been amended to €100,000 under the protocol

Distributions from Mutual Funds & Depositary Receipts

The Protocol clarifies that distributions from Mutual Funds and similar investment will be subject to the normal withholding tax rates applying to dividends i.e. 5%/10%. This clarifies an uncertainty that existed regarding the withholding tax rates that should apply on such distributions.

The definition of dividends has also been extended to cover distributions from shares held in the form of Depositary Receipts.

Changes relating to Interest

The substantially aligned with the OECD definition of "interest" clarifies, inter alia, that the term "interest" also covers 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.

Any interest reclassified by the Russian tax authorities as dividends (e.g. due to Russian thin capitalization rules) will be subject to the withholding tax rates for dividends.

Capital Gains - The important change: not until at least 2014

The major change to the existing Treaty is the taxation of Capital Gains on the sale of shares in real estate property-rich 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-rich companies). The Protocol moves to the latest OECD Model Treaty principle that such gains should be taxable in the country where the real estate is situated.

To the extent that the shares in a company derive more than 50% of their value from immovable property, the country where such property is located shall have the right to tax Capital Gains on the shares of such company. These changes shall not apply to (i) gains from the sale of shares in listed real estate companies, (ii) gains from the alienation of shares in the course of corporate reorganization, or (iii) any sale where the seller is a Pension Fund, Provident Fund or the Government of Russia or Cyprus.

While this is quite a significant change for the real estate business, the good news are that the Protocol provides for a "grace period" of four years following the enactment of the Protocol during which the new rules shall not apply. We therefore expect these new rules to take effect not earlier than January 2014. Affected clients can contact Globalserve for consultation.

Exchange of Information

The article on "Exchange of Information" is replaced by the latest OECD Model Treaty equivalent and the article on Assistance in collection is replaced by wording almost identical to the latest OECD Model Treaty equivalent. The difference from the current article on exchange of information is understood to be clarifications of existing obligations and powers. It is provided that professional secrecy rules i.e banking secrecy, can not be used as an excuse for refusing to supply information. However, the circumstances under which such banking 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. A fully documented case has to be presented together with the details of the bank account for which information is requested in front of the General Attorney who decides if there are solid grounds justifying banking secrecy to be lifted.

No fishing expeditions will be allowed.

Actually, the matter of Exchanging Information was placed into action in Cyprus since May 2008 based on a relevant law that was approved by the Parliament. Despite the fact that 16 months have passed, since then, only very few requests of this type have been submitted before the Attorney General. The above provision in the Treaty between Cyprus - Russia was necessary so that Cyprus be removed from the "Black List" of Russia as well as that a few days before it was also removed from the list of OECD, and put on the "White List". The new article on Assistance in Collection will apply only once Cyprus has amended its domestic law to allow for certain aspects of such assistance.

Limitation of treaty benefits

The limitation of benefits introduced does not apply to Russia or Cyprus registered companies

Limitation of benefits applies to tax residents of Russia or Cyprus which are not registered companies in either of the two states and only in cases where the tax authorities of the two countries agree that the main purpose or one of the main purposes of the company was to obtain the benefits of the agreement. This affects for example the UK registered companies which are tax residents of Cyprus and are holding companies in Russian companies. Clients who are affected can contact Globalserve for consultation.

The good news is that the denial of Treaty benefits does not apply automatically by virtue of the new article, but rather offers a mechanism to the tax authorities of both Cyprus and Russia to counter certain perceived Treaty abuses and only as a result of consultations between the tax authorities.

The Protocol is expected to enter into effect on 1st January 2011 provided it is ratified by both Russia and Cyprus before the end of 2010, with the provision that the amendments to the capital gains article on Assistance on Collection of Taxes will come into effect at the time when Cyprus amends its domestic tax legislation to allow for the application of such procedures (current Cyprus tax legislation allows such assistance to be extended only to other EU Member States).

The ratification of the Protocol will effectively remove Cyprus from a Russian blacklist of jurisdictions which Russian authorities deemed uncooperative and heralds strengthened ties between the two nations. "Cyprus is perceived by our businessmen as a very convenient platform to make investments", Medvedev commented and continued that "the amendments to the agreement on avoiding double taxation that have just been signed are aimed at making this area more predictable, transparent and understandable for the authorities regulating it."

Contact us

9 Vassili Michaelides, 3026 Limassol-Cyprus
PO BOX 57048, 3311 Limassol-Cyprus
Tel. +357 25 824545 Fax: +357 25 824055