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Tax Update Newsletter

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Cyprus Russia Double Tax Treaty

Russia and Cyprus signed a tax treaty on Thursday that is expected to boost and reaffirm Cyprus' status as the primary source of foreign investment to Russia.

The protocol of the tax treaty which was agreed in April 2009, was signed on 7th of October in Nicosia. The signing of the treaty will have as an immediate effect the removal of Cyprus from the Russian so called "black list" and at the same time dispel any uncertainty in this area.

Formal ratification is expected to happen before the end of 2010 so that the Protocol could come into effect on 1 January 2011.

The signing of the treaty gives a positive boost on the existing Cyprus Russian business relationships

1. “Black List” Removal

Following the signing of the treaty, the Russian tax authorities are expected to remove Cyprus from the Russian “Black List” with such removal coming into effect at the same date as the Protocol.

As from the date of the removal from the black list, dividends received by Russian shareholders from Cyprus subsidiaries will be able to claim the Russian participation exemption.

Russia and Cyprus signed a tax treaty on 07 October 2010 that is expected to boost and reaffirm Cyprus's status as the primary source of foreign investment to Russia

2. Withholding Tax Rates

Without changes remain the withholding rates as one of the most beneficial aspects of the new double tax treaty. These apply to payments of dividends, interest and royalties between the two jurisdictions. Cypriot companies remain the most beneficial vehicles for investing into Russia.

The withholding rates that apply are as follows:

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

* The current provision of a direct investment in the capital of the Russian entity of less than USD 100.000 resulting in a 10% WHT is amended to EUR 100.000.

Cypriot companies remain the most beneficial vehicles for investing into Russia

3. Dividend Definition

The definition of dividends in the new tax treaty has been extended to include distributions from mutual funds and similar collective investment vehicles (other than vehicles primarily investing in immovable property).

In addition, the new definition of dividends covers distributions from shares held as Depositary Receipts.

4. Interest Definition

The term "interest" now covers income from debt-claims of any kind, whether or not secured and whether or not carrying a profit participation right. It does not include however penalty charges for late payment or interest which is reclassified as dividends by virtue of other provisions (e.g. thin capitalization rules).

5. Capital Gains

Capital gains from the disposal of shares remain under the taxing right of the country of residence of the seller.

However, an important change in the treaty relates to the sale of shares in a company of one country, which the substantial part of its value (more than 50%) is related to immovable property in the other country.

In such a case, the country in which the property is situated will also have a taxing right on the gain. This conforms to the OECD model on taxation.

Note the following:

- This change will come into effect four years after the date the treaty will come into force i.e. from 2015
- The taxing right remains with the country of residence of the seller if:

- i) the disposed shares are listed on a recognized stock exchange or
- ii) the disposal qualifies as a corporate reorganization or
- iii) the seller is a pension fund, provident fund or the government of either of the two countries

An important note is that the Russian government has undertaken to amend all other treaties with countries regarded as investors in Russia (e.g Netherlands), so as to adopt the same OECD model.

6. Exchange of Information

This article has been revised in line with the article 26 of the OECD Model Tax Convention and the changes are towards alignment to OECD policy standards on fiscal transparency and exchange of information.

However, from the Cyprus perspective, the tax authorities may only exercise the exchange of information following the satisfaction of a series of conditions.

The requesting state must provide information to the other state's tax authorities, including:

- a) The identity of the person under examination;
- b) A description of the information requested and the nature and manner in which the requesting state wishes to receive the information from the Cyprus tax authorities;
- c) The tax purpose for requesting the information;
- d) The reason for the belief that the requested information is held by the Cyprus tax authorities or found in the possession or under the control of a person within the jurisdiction of Cyprus;

Capital gains from the disposal of shares remain under the taxing right of the country of residence of the seller.

6. Exchange of Information (cont'd)

e) The name and address of any person who may hold the requested information to the extent the information is made available;

f) A declaration that the provision of the information is in accordance with the legislation and administrative practices of the requesting state and, where the requested information is found within the jurisdiction of the state in question, the relevant authorities may obtain the information according to its laws and according to the terms of its ordinary administrative practices; and

g) A declaration that the requesting state has exhausted all means at its disposal within its jurisdiction to obtain the requested information, except where resorting to such means would have imposed an excessive burden.

...for the tax authorities to exchange any information, the written approval of the attorney general of the Republic of Cyprus is necessary...

Please note that the information may not be provided by the Cyprus Tax Authorities where there is no mutual reciprocity between Cyprus and the other Contracting State as to the information being exchanged.

This requires that the requesting state must have similar provisions and/or respective administrative practices for the exchange of information requested from the Cyprus tax authorities.

Last, for the tax authorities to exchange any information, the written approval of the attorney general of the Republic of Cyprus is necessary.

7. Limitation Of Benefits (LOB)

According to the relevant article of the new treaty, the limitation of benefits **does not** apply to Cyprus or Russian registered companies.

It only applies to companies registered in other jurisdictions and that are tax resident in either contracting state and the tax authorities of both countries consider that the main reason for this is for the company to obtain treaty benefits.

Worldserve can assist you or your clients with any queries in relation to the above, in existing or envisaged structures.

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