INFORMATION SHEET No.92

Cyprus-Russia New DTT Protocol: Technical Analysis of the changes

March 2012

The Protocol to the Russian Double Tax Treaty (DTT) with Cyprus was ratified by President Dmitry Medvedev in March 2012 and by the Russian Duma a month earlier, essentially confirming the removal of the island from Russia's so called 'blacklist'. It is expected to enter into force on 1 January 2013.
The protocol harmonizes the DTT between the two states with the OECD model agreement and essentially lifts general legal and practical restrictions on the issue of exchange of information, while at the same time retaining the favourable withholding tax rates between the two countries.
The removal from the list essentially implies that the Russian participation exemption will also be extended to Russian shareholders deriving dividend income from qualifying participations in Cypriot companies.
The Protocol amending the Cyprus-Russia Double Tax Treaty (DTT) was officially signed on 7 October 2010 in Nicosia, during an official visit to the island by President Medvedev.

Changes introduced

The new Protocol is annexed to the current DTT of 1998 and, upon its entry into force, shall introduce the following changes:

➢ **Withholding tax rates:**

The very favourable withholding tax rates provided in the current DTT are being retained, with the only change being on the condition for the dividend where a direct investment of at least EUR 100.000 (as opposed to USD 100.000) will be needed for the reduced 5% withholding tax rate to apply. Specifically:

- Dividends: 5% if there is a direct investment of at least EUR100.000, else 10%
- Interest: Nil
- Royalties: Nil

Note: In accordance with the Cyprus tax legislation, there are no Cyprus withholding taxes on payments of dividend, interest or royalties not used in Cyprus to non-Cyprus residents.

➢ **Distributions from mutual investment funds and income from depositary receipts:**

It is clarified that distributions from mutual investment funds (or similar collective investment vehicles) can benefit the reduced dividend withholding tax rates as per above.

However, it is also provided that distributions from mutual investment funds investing only in immovable property will be treated as 'income from immovable property' thereby allocating taxing rights to the source State.

The term 'shares' is given a wider interpretation within the provisions of the Protocol in relation to dividends, thus extending the application of the favourable withholding tax provisions on dividends to rights being in the form of depositary receipts.

- **Capital Gains:**

This is a new provision being entered whereby the taxation of capital gains on the sale of shares of companies which derive more than 50% of their value from immovable (real estate) property situated in one of the States, will now be taxed at the State where the immovable property is situated. It is noted that this provision follows the latest OECD Model Treaty principle.

The taxing right remains with the country of residence of the seller where the seller is a pension fund, a provident fund, the Governments of Russia or Cyprus, where there is a disposal of shares of a listed company or if such disposal of shares is made in the course of a corporate reorganization.

This new provision shall take effect **four years** after the entry into force of the Protocol. As a result, this gives some time for planning opportunities if necessary.

Notwithstanding the above, during this four year timeframe, Russia expressed the intention to revise accordingly the equivalent Capital Gains provisions that exist in DTTs with other countries.

- **Limitation of DTT benefits:**

The limitation of benefits provision applies only to companies that are not registered in either Cyprus or Russia and solely claim to be tax residents of either State. This is a new provision whereby the benefits provided in the DTT will not be allowed if following consultations between the two States it is established that the main purpose or one of the main purposes, of the creation or existence of tax residency in one of the States, was to obtain the benefits of the DTT.

- **Tax resident companies:**

The Protocol clarifies that the decisive factor of whether a company/entity is tax resident in one of the States is the place of 'effective management' (as opposed to the place of 'management'). Where the place of effective management of a company/entity cannot be determined then the two States shall endeavour all factors they consider relevant to determine by mutual agreement the place of effective management in each individual case.

- **Exchange of information:**

The Protocol introduces a revised Exchange of Information article, in line with article 26 of the OECD Model Treaty for the exchange of information for tax purposes, further promoting transparency and information exchange in relation to taxation matters.

Under the current DTT there have also been such exchange of information provisions, but the new additions are merely clarifications of existing obligations and powers.

Considering the Exchange of Information provisions introduced under Cyprus Law, it is noted that in order for one tax authority to comply with an exchange of information request for tax purposes there are several conditions that need to be met (both from a DTT as well as national legislation perspectives) and the request cannot be general but very specific (i.e. 'fishing' enquiries are not allowed).

➢ **Other:**

- An extended definition of interest is introduced, including 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. At the same time, penalty charges for late payment, or interest reclassified as dividends pursuant to other DTT provisions are expressly excluded from the definition of interest.

- The meaning of permanent establishment is extended to allow, under conditions, the taxing of profits from services performed by a company of a State through individual(s) who are present in the other State for more than 183 days in a 12-month calendar year.

- Income from international traffic (i.e. of ships or aircraft) is replaced by giving the taxing right for such income to the State where the effective place of management of the person deriving such income is situated (as opposed to the residency of the person deriving such income). It is noted that this change follows the OECD Model Treaty.

- More details are introduced on the article on the assistance of a State in collection of outstanding revenue taxes/claims of the other State.

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