

European Tax Newsalert

A Washington National Tax Services (WNTS)
Publication

Cyprus

April 5, 2012

Russia and Cyprus ratify treaty protocol

The Protocol to the Russia-Cyprus Double Tax Treaty, which was signed in Nicosia on October 7, 2010, was ratified by the Russian State Duma on February 15, 2012 (Cyprus already ratified the Protocol in August 2011). The Protocol will be effective beginning in 2013.

Cyprus accounts for a significant share of foreign direct investments into Russia and US multinational companies ("US MNCs") use Cyprus frequently to invest in Russia. This newsalert summarizes those provisions that may apply to US MNCs with operations in Russia.

Provisions effective in 2013

No changes to withholding tax rates

One of the tax treaty's key aspects is its favorable withholding tax rates which apply to cross-border payments of dividends, interest and royalties.

The business community has welcomed the positive and important decision not to change the current withholding rates which will continue to apply as follows:

Dividends:	5%*
Interest:	0%
Royalties:	0%



* Currently a direct investment in the capital of a Russian entity of less than USD 100,000 results in a 10% withholding tax rate. This provision is amended such that the 10% withholding tax applies if the direct investment is less than Euro 100,000.

New definition for dividends

The Protocol clarifies that distributions from mutual funds and similar collective investment vehicles (other than real estate investment trusts or real estate investment funds or similar vehicles primarily investing in immovable property) will be subject to the normal withholding tax rates applicable to dividends (i.e., 5%/10%). This clarifies which withholding tax rates apply on such distributions.

The Protocol extends the definition of dividends to cover distributions from shares held in the form of Depositary Receipts.

New definition for interest

The Protocol substantially aligns the definition of “interest” with the OECD definition and 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. However, 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 dividend withholding tax.

Exchange of information

This article was revised in line with article 26 of the OECD Model Tax Convention on Income and Capital and reflects the changes which were introduced in the Cypriot tax legislation in 2008.

The changes align with OECD policy standards on fiscal transparency and exchange of information on taxation matters.

Limitation of treaty benefits

The limitation of benefits introduced does not apply to companies incorporated in Russia or Cyprus.

Limitation of benefits applies to tax residents of Russia or Cyprus which are not companies registered in either of the two states. In addition, this provision only applies when 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.

Other changes

The Protocol clarifies the existing “tie-breaker” clause for residency. Thus, where the effective management cannot be determined, the tax authorities of Russia and Cyprus should confer and reach mutual agreement.

The Protocol extends the definition of Permanent Establishment (“PE”) to cover activities of an enterprise resident in one country through services performed by individuals present in the other country for more than 183 days in a 12-month period.

However certain specific criteria must be met prior to such services being deemed to create a PE in the other country.

Income from international traffic will be subject to tax in the country where the effective place of management of the person deriving the income is situated.

The Protocol clarifies that income received through a real estate investment trust, a real estate investment fund or a similar collective investment vehicle which is organized under Russian laws primarily for the purposes of investing in immovable property would be treated as “Income from Immovable Property” per article 6 of the Treaty and may be subject to tax in the country where the immovable property is situated.

Capital gains provision effective in 2017

In general, capital gains from the disposal of shares remain under the exclusive taxing right of the country of the seller's residence.

The important change relates to disposals by a resident of one country of shares in companies which derive a substantial part of their value (more than 50%) from immovable property situated in the other country. In this case, the country in which the immovable property is situated will also have a right to tax the resulting gain. This change is in line with the OECD Model Tax Convention on Income and Capital.

This change will come into effect four years after the date the Protocol comes into force (i.e., it will be effective beginning in 2017).

The exclusive taxing right will remain with the country of the seller's residence if:

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

For more information, please contact:

Your international tax service team in the United States

Constantinos Leontiou (646) 471 0942 constantinos.leontiou@us.pwc.com

Your international tax service team in Cyprus

Panikos Tsiailis (357) 2255 5255 panikos.n.tsiailis@cy.pwc.com

Stelios Violaris (357) 2255 5300 stelios.violaris@cy.pwc.com

Joanne Theodorides (357) 2255 3694 joanne.theodorides@cy.pwc.com

Jovanna Tannousis (357) 2255 5393 jovanna.tannousis@cy.pwc.com

This document is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

SOLICITATION

© 2012 PricewaterhouseCoopers LLP. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers LLP, a Delaware limited liability partnership, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.