

CYPRUS REPUTATION IS ENCHANCED

AS A CREDIBLE FINANCIAL CENTRE

Introduction

On the 7th October 2010 the President of the Russian Federation Mr. Dmitry Medvedev during his official visit to Cyprus signed the Protocol to the existing double tax treaty of 1998 between Russia and Cyprus.

The signature of the Protocol prepared the way for the removal of Cyprus from the black list of the Russian Ministry of Finance.

In the case that the Protocol is ratified by the Russian legislative authorities by the end of 2011, it will be effective as of 1 January 2012 (certain articles are exempted).

The new changes enhance the transparency of the Cypriot regime and strengthen the reputation of the Island as a credible financial centre. Furthermore, the two countries aim to expand and strengthen the economic relations between the countries at all levels.

The Protocol expands the definition of certain types of Income and therefore Russian's taxing rights. On the other hand the favorable withholding tax rates have been retained and since Cyprus will be removed from the Russian black list any dividend distributions from Russia to Cyprus will be eligible for the Russian participation exemption.



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Major issues related to the Protocol

Dividend Distributions

Although the withholding tax rates remained unchanged, in order to take advantage of the favorable five per cent (5%) withholding tax rate on dividends the beneficial owner of the Company should invest in the share capital of the Company paying the dividend at least EUR 100.000. (The amount of the investment was USD 100.000).

Comment

Any existing structures with Cyprus Holding Companies that participate in Russian subsidiaries should consider increasing the value of their investments to the Russian subsidiaries up to the amount of EUR 100.000 in order to qualify for the 5% withholding income tax rate on dividends.

Interest and Royalties

Despite the fact that the withholding tax rates on interest and royalties remained unchanged, the Protocol expands the definition of dividends and classifies the interest that is subject to the same taxation as dividends under the domestic laws of the paying entity, as dividends for treaty purposes.

The provision of the Protocol is in accordance with the Russian thin capitalization rules, for the partial reclassification of controlled debt interest to dividends.

Comment

It should be taken into consideration whether it is possible the application of five per cent (5%) withholding tax rate instead of ten per cent (10%) on the reclassified interest.



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Tax implications from the disposal of Russian Company by its Cyprus holding Company

Under the existing Cyprus – Russia Treaty, any income derived by the Cyprus holding company from the disposition of the shares in the Russian subsidiary is exempt from the Russian tax, irrespective of the value of the immovable property held by the Russian subsidiary.

By the 1st January 2015, any income that will arise from the disposal of shares or similar rights provided that more than 50% of the assets of the Russian Company consists of immovable property located in Russia, the income will be subject to twenty percent (20%) withholding tax in Russia.

The above amendment does not relate to capital gains that might be effected during:

- corporate reorganizations (not defined in the Treaty)
- the disposal of shares listed on a recognized stock exchange
- whether the seller is a pension fund,
- provident fund or
- the government of the two countries

Therefore, such gains will continue to be exempt from taxation in both countries.

The transition period should provide the necessary time to analyze existing assets and consider alternatives in order to minimize the negative impacts from the above mentioned change.

Limitation of benefits- new article

The above mentioned article was included in the new Protocol in order to discourage the treaty shopping.

The article only applies to Companies registered in other countries (i.e UK) and become Cypriot residents by moving the effective place of management to Cyprus in order to claim all the benefits of the Treaty.

The article does not apply to Companies registered either in Cyprus or Russia.



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Changes to the definition of resident

In accordance with the existing Treaty the residency of the Company is determined by the place of effective management and control.

The Protocol, in cases where the place of effective management cannot be determined, enables Russia and Cyprus to determine the place of effective management by mutual agreement, therefore reinforcing the existing tie breaker test.

Finally the definition of Permanent Establishment is extended to the activities of an enterprise resident in one country through the services performed by individuals who are present in the other country for more than 183 days in a 12 month period, subject to compliance with specific criteria.

Comment

Every company registered or not in Cyprus, claiming that it is a tax resident of Cyprus should take all the necessary actions to archive substance in order to demonstrate that effectively is managed and controlled through Cyprus.

Information of Exchange-Amendments

After the amendments to the above mentioned article, the wording came in line with the OECD Model convention and extended the scope of the information that might be requested by the Russian authorities from the Cypriot authorities.

The Cypriot Tax authorities have the right to gather information and documentation (including shareholders) related to any transactions entered between persons governed by the Cypriot tax laws and a taxpayer who is a resident of the Country requesting the information.

The information should only be exchanged in case there is a request from the Russian authorities. The information is not limited to the information held by the banks or professional advisors.

The Cypriot authorities do not automatically collect the information. In order for the Cypriot authorities to disclose any information requested by the Russian authorities, the requesting authorities must produce a substantiated request specifying the particulars as required by the Cyprus legislations and must prove to the Cypriot authorities that they have leveraged all the available resources in Russia to obtain information, with the exception to those that would cause excessive difficulties.

Finally, in order to ensure that the legislation is not going to be misused, the Attorney General of Cyprus must grant the consent for the Cyprus tax authorities to exercise respective rights once it is satisfied that all conditions have been fulfilled.



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Exclusion from the Russian black list-Opportunities

From 1 January 2011, as per Russian profits tax legislation, any dividend income received by a Russian Company from a foreign subsidiary (i.e Cyprus Company) could be subject to zero percent (0%) corporate tax rate, provided the following conditions are satisfied:

- Holding period of the distributing entity is at least 365 days with no interruption
- The Russian Company participates at least by 50% in the share capital of the subsidiary
- The foreign payer's country of residence is not included in the black list issued by the Russian Ministry of Finance.

Russian companies can set up Cyprus Companies such as asset management companies and investment funds in order to utilize and take advantage of the Russian participation exemption rules in respect of dividend income as well as the EU tax Directives and the extensive network of the Cyprus Double Tax Treaties.

Conclusion

The amendments to the Treaty aim to prevent tax evasion and treaty shopping and they also demonstrate the willingness of the Russian authorities to focus on the existence of substance and real business purpose in the multinational structures.



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