

October 11, 2010



The Protocol amending the Cyprus - Russian Double Tax treaty

On 16 April 2009, representatives from the respective Ministries of the republic of Cyprus and the Russian Federation signed a final draft Protocol to the Double Tax Treaty of 1998 between the two countries. The Protocol was signed by both countries on 7 October 2010 during Russian President Dmitry Medvedev's official visit to Cyprus. Formal ratification is expected to occur before the end of 2010 so that the Protocol will become effective from 1 January 2011. As a result of this development the Russian government is expected to announce the removal of Cyprus from the Russian Blacklist.

What does that mean?

Dividends received by Russian shareholders from eligible participations in Cyprus subsidiaries can qualify for the Russian dividend participation exemption.

Main changes introduced by the Protocol include

1. **Dividends, Interest and Royalties**
2. **Capital Gains**
3. **Others including**
 - **Permanent Establishment definition**
 - **The income from international traffic**
 - **Limitation of Treaty Benefits**
4. **Exchange of information clause**

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1. Dividends, interest and Royalties

Income received in Cyprus from Russian

- Dividends (Article 10)
 - Dividends include payments on shares of mutual investment funds or similar collective investment vehicles. Shares include “depository receipts” over shares.
 - 5% withholding tax of the gross amount of dividends if the beneficial owner has invested in the capital of the company not less than €100.000
 - 10% withholding tax in all other cases
- Interest (Article 11)
 - the definition of interest is in line with the wording of the latest OECD model treaty definitions including interest from debt-claims of any kind
 - penalty charges for late payments or interest considered as dividends are not included for the purpose of this article
 - 0% withholding tax on interest income
- Royalties (Article 12)
 - Royalties are taxed in the country of the resident receiving the royalties
 - 0% withholding tax on royalties

Income paid from Cyprus to Russian (as per Cyprus Income Tax Law)

- Dividends
 - 0% withholding tax of the gross amount of dividends (5%-10% as per Article 10)
- Interest
 - 0% withholding tax on interest income (same rates apply)
- Royalties
 - 0% withholding tax on royalties (same rates apply)

The new definition of interest and dividends will not prevent the Russian Tax authorities from applying domestic “thin capitalisation rules” to reclassify excessive interest payments as dividends and tax such amounts in Russian at source, albeit at the reduced dividend withholding tax rates under the treaty.



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2. Capital Gains- the big change

The important change to the existing treaty is the taxation of capital gain on the sale of shares in real estate property-holding companies. The Protocol change in line with the latest OECD Model Tax Convention in that gain should be taxable in the country where the real estate property is situated. More specifically, on the disposal by a resident of one country of shares of companies which derive a substantial part of their value (more than 50%) from immovable property situated in the other country, the country in which the immovable property is situated will also have a right to tax the resulting gain.

The following relate to this change:

- The change will apply on 1 January 2015, that is 4 years after the Protocol will come into force
- The exclusive taxing right will remain with the country of residence of the seller if :
 - The disposal is in the course of a corporate reorganisation
 - The disposed shares are listed on a recognised stock exchange
 - The seller is a provident fund, a pension fund or the government of Cyprus or the Russian Federation.

Income from immovable property is taxed in the country in which the property is situated irrespective of its ownership. The definition of immovable property has been extended so that Income of Mutual funds investing only in immovable property would be treated as Income from immovable property and may be subject to tax in the country where the immovable property is situated.

Under the current treaty, residence is determined by the entity's place of effective management. The protocol introduces a clarification of the existing test in relation to residency so that in cases where the effective management cannot be determined the Russian and Cypriot tax authorities should consult and come to mutual agreement in this respect.



3. Other amendments

a) Permanent establishment

The definition of permanent establishment is extended to allow for the taxation of profits from services performed in one country by an entity of the other country through an individual or individuals present in the other country for more than 183 days in a 12-month period and more than 50% of the gross revenues of the enterprise attributable to its active business activities during this twelve month period are derived from the services performed in that other country through that representation.

b) Income from international traffic

The existing treaty's article regarding taxation of income from international traffic (i.e. shipping and aircraft) is replaced. This type of income according to the existing treaty was only taxed in the country in which the person deriving such income was resident, whereas according to the Protocol, the taxing right of Income from international traffic belongs to the country where the effective place of management of the person deriving the income is situated.

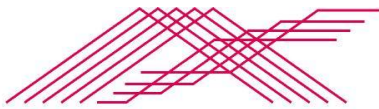
c) Limitation of Treaty Benefits

The limitation of benefits introduced does not apply to Companies registered in Cyprus or Russia. The limitation applies to tax residents of Russia or Cyprus which are not registered companies in either of the two states and only in cases where, after consultation of the two countries competent tax authorities they agreed that, the main purpose or one of the main purposes that the entity was created was to obtain the benefits of the agreement.

4. Exchange of information

One of the most discussed features of the proposed protocol is the exchange of information clause. Although the existing treaty contains an exchange of information clause (art 26), the protocol now brings the article into line with the OECD model Convention. The new article 26 contains the following new provisions:

- Information exchange can be extended not only to taxes included in the Treaty but also to other indirect taxes.
- Banking secrecy cannot form grounds for refusal to exchange information with a competent authority of the other state.
- The fact that the required information is not necessary or valuable for the purposes of collecting taxes for a competent authority cannot serve as grounds for refusal to exchange the information with a competent authority of the other state.



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