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CYPRUS – RUSSIA TAX ALERT

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NEW PROTOCOL TO CYPRUS – RUSSIA TAX TREATY AND REMOVAL FROM RUSSIAN “BLACKLIST”

In April 2009 representatives from the respective Ministries of the Republic of Cyprus and the Russian Federation signed a Protocol to the 1998 tax treaty between the two countries. The Protocol is expected to be ratified by both countries in 2009 so that it will become effective as from 1 January 2010.

The Protocol is viewed as very beneficial to international business and will continue to foster and encourage economic relations between Cyprus and Russia through one of the most favourable treaties the Russian Federation has concluded.

Russia has also agreed to **remove Cyprus from its blacklist** which will mean that dividends received by Russian companies from Cypriot subsidiaries can qualify for the Russian dividend participation exemption.

No changes in:

- Nil withholding tax on interest and royalties
- The withholding tax rates of 5% or 10% on dividends (the only change to the conditions for eligibility for the 5% rate is that rather than a minimum USD 100K investment in the capital of the economy in whose shares are held, the minimum investment is now EURO 100K.

The definition of dividends and interest are amended to align substantially with the wording of the latest OECD Model Treaty definitions with an addition to the definition of dividends to include payments on shares of mutual investment funds and similar collective investment vehicles as well as depository receipts over shares.

However the new definitions of dividends and interest 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 Russia at source, albeit at the reduced dividend withholding tax rates under the treaty.

The major change:

Is the taxation of capital gains on the sale of shares in real estate property. Currently, the treaty provides for the country of residence of the selling entity to have taxing right. The Protocol moves to the latest OECD Model Treaty principle that such gains should be taxable in the country where the real estate is situated.

The taxing right will remain with the country of residence of the selling entity where that entity is a pension fund, a provident fund, the government of Cyprus or the Russian Federation, or the gains are from the disposal of shares in a listed company or in the course of a corporate reorganisation.

The good news is that we as EuroAudit do not expect this amendment to the treaty to apply until 1 January 2014 as the Protocol provided for the amendment to become effective on the first day of the calendar year following four years after the Protocol as a whole enters into force. In the meantime, there are likely to be planning opportunities available to mitigate any negative implications of this change.

For more information we are at your disposal and do not hesitate to contact us.