

Legal Newsletter – “Changes in Russia- Cyprus Double Tax Treaty”

May, 2009

On April 21, 2009, representatives of the Russian Federation and the Republic of Cyprus signed the Protocol, which is an amendment to the Agreement for the avoidance of double taxation with respect to taxes on income and capital, dated December 5, 1998 (hereinafter referred to as “the Agreement”), introducing **significant changes** to the Agreement. The Protocol will come into force **only after its ratification** by both states. Please find below the main changes the Protocol brings to the Agreement.

I. Residency status

New amendments **specify the rules regarding residency status**, i.e. it additionally stipulates that if the place of the effective management of a person other than an individual cannot be determined, the competent authorities of the contracting states are entitled to determine by mutual agreement the place of effective management in each individual case.

II. Permanent Establishment

The Protocol extends and **clarifies the grounds for the creation of a Permanent Establishment**, in particular, it specifies that the activity of a company of one contracting state on the territory of another contracting state shall be deemed to be a permanent establishment if the company is either acting through (i) an individual which resides in the territory of this state more than 183 days in any twelve month period and more than 50% of the gross revenue of this company is garnered as a result of this activity, or (ii) if this individual (or group of individuals) resides in the territory of this state more than 183 days in any twelve month period and per-

forms services for a single project or several inter-related ones.

III. Terms “dividends” and “interest”

With the Protocol, the contracting states have clarified the term “**dividends**” and “**interest**”. It was specified that income paid in the form of interest but subject to the same taxation as dividends shall be regarded as dividends as well as **any payments on shares, mutual funds or similar collective investment vehicles**. Also, the amount of investment into the registered capital of the company necessary for the application of the decreased tax rate (5%) was changed from 100,000 US **dollars** to 100,000 **EURO**.

The term “**interest**” was slightly amended by the Protocol which clarifies that income from debt-claims shall be deemed as interest regardless of whether or not it is secured by a mortgage and whether or not it carries a right to participate in the debtor’s profits. Also, it was particularly identified that **penalty charges** for late payments or interest that is regarded as dividends **shall not be treated as interest**.

IV. Taxation of the capital gains

The amendments cancelled the tax exception with regard to capital gains. The new version of the Agreement provides that **capital gains** by a resident of a contracting state from the **alienation of shares deriving more than 50% of their value from immovable property situated in the other contracting state may be taxed in that other state**.

This rule implies that if **Cypriot shareholder sells its shares of a Russian entity** the main activity of which is to hold real estate in Russia (i.e. the Cypriot shareholder is using the Russian entity as a means to own real estate in Russia), such action may be taxable **also in the Russian Federation**.

However, the amendment provides for several **exemptions** when the above-mentioned taxation rule is not applied, i.e. if the shares are sold in the course of a corporate reorganization or if the shares are listed on a recognized stock exchange. The new rule is also not applicable to the pension funds, provident funds and the Government of the contracting state.

V. Taxation of mutual investment funds

This new version of the Agreement provides that the taxation rules with regard to the income from immovable property, i.e. derived from the direct use, letting of the immovable property, etc., are **also applicable to mutual equity funds** invested in immovable property.

VI. Enhancement of cooperation between the competent authorities

The Article concerning the **exchange of information** between the competent authorities of the contracting countries was **extended**, in particular, it was agreed that the competent authorities will help each other with the provision of information. Even if the party requested to provide such information does not need this information for its own tax purposes, it may not decline the provision of this information based on the fact that it has no domestic interest in such information. In any case, the **general limitations** applicable before **are still in force**, i.e. there is no obligation to provide the other state with information which can not be obtained under its own law or in the normal course of administration.

VII. Assistance with tax collection

The article on assistance with tax collection describes in greater detail the process of cooperation between the states. The article introduces a new term “**revenue claim**”, which generally means owed taxes and certain relevant administrative penalties etc., and provides rules with regard to the **enforcement of revenue claims** by the contracting parties, including the relevant injunctive measures, etc.

However, in accordance with the Protocol, these amendments shall take effect upon Cyprus' introduction of the necessary legal basis.

VIII. Limitation of benefits

A new article stipulating the **limitation of benefits** provided under the Agreement (i.e. decreased tax rate, exemptions, etc.) has been added. In particular, according to the new version of the Agreement, an interested company being resident in a contracting state may not be entitled to benefit from the Agreement in the case that the competent authorities conclude that **the main purposes of the creation or existence of such resident is to obtain such benefit**. However, this limitation is applicable only to companies that are not registered in the contracting states but claim benefits, therefore, the new article **does not concern companies registered in Cyprus or Russia**.

IX. Protection of rights

The Article regarding the protection of the rights of taxpayers was **extended** and new version of the Agreement provides that, in the event of any improper taxation, the person is entitled to present its case **to the competent authority of either contracting state within 3 years** from the first notification of the action resulting in improper taxation. Previously, presenting such case was allowed to be made only to the competent authority of the contracting state of which it is a resident and within a 2 year period.

The above-mentioned amendments shall become effective in the tax period **beginning on or after January 1** of the calendar year immediately following that in which the Protocol enters into force, except for the amendments in respect of the taxation of capital gains - which become affective as of the calendar year following the expiration of a period of four years from the date on which the Protocol comes into force. Also, the amendments concerning the assistance in the collection of the taxes shall take legal effect only upon Cyprus' introduction of the necessary legal basis for their implementation.

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This BBH Newsletter is to serve as a general piece of information in respect of certain important news and events taking place in the area of international double tax treaties. The contents hereof do not, and shall not, serve as legal advice of any kind.

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