

## THE NEW CYPRUS-RUSSIA PROTOCOL

### 1. IMPORTANT CHANGES OF THE TREATY INTRODUCED BY THE PROTOCOL

#### 1. Profit on disposal of shares of immovable property rich companies

Taxation in Russia of capital profits from the disposal/sale of shares deriving more than 50% of their value from immovable property situated in Russia (and vice versa). This will come into effect four years after the entry into force of the Protocol. It does not apply to disposals of shares listed on a recognised stock exchange or to gains in the course corporate reorganisations.

This seems not to be restricted only to shares of Russian companies holding the property or to the shares of any foreign company holding directly property in Russia but seems to extend to higher level holding or associated companies whose shares are disposed/sold, the value of which derives mainly but indirectly from immovable property situated in Russia.

#### 2. Permanent Establishment

A permanent establishment is considered to be created in Russia (and vice versa) and thus taxed there, where an enterprise resident in Cyprus operates in Russia through an individual who is present in Russia for more than 183 days in any twelve month period and more than 50% of the gross revenue of this enterprise comes from the operations in Russia.

The creation of a permanent establishment extends to the provision of services by the Cyprus enterprise in Russia for a period or periods exceeding 183 days in any 12 month period and these services are performed for the same project or for connected projects through one or more individuals who are present and perform such services in Russia. This rule is aiming to avoid the breaking of a project/connected projects into smaller parts.

#### 3. REITs and REIFs

The distributions by Russian Real Estate Investment Funds or Real Estate Investment Trusts or similar collective investment schemes, investing **primarily** in immovable property, fall under the provisions of Article 6 "Income from Immovable Property" and are taxed accordingly in Russia.

#### 4. Withholding tax on dividends

In order to benefit from the reduced rate of withholding tax of 5% the **amount invested** (actual cost) in the Russian company has to be at least €100.000 instead of the limit of \$100.000 existing before.

#### 5. Exchange of information

The exchange of information article aligns to the OECD Model Treaty and includes the provision of information covered by the bank secrecy and professional secrecy other than the professional secrecy of lawyers acting as such. Thus Cyprus will be obliged to provide information requested concerning bank accounts and information about the real beneficial shareholders where such information is available in Cyprus. Such information certainly covers persons resident in Russia maintaining bank accounts in Cyprus or being beneficial shareholders in Cyprus companies but it is not limited only to them.

It can be extended to persons who are resident of Cyprus, including Cyprus resident companies, or even residents of third countries maintaining bank accounts or other forms of property in Cyprus, **provided** that the Russian Authorities can establish a close relationship between the resident of Russia under examination/investigation and the holder of the bank account.

#### 6. Limitation of benefits

The protocol excludes from the benefits of the treaty persons who become residents of Cyprus or of Russia mainly to obtain the benefits of the treaty which would not otherwise be available to them.

## 2. OTHER CHANGES

### 1. Definition of resident

The protocol introduces a mutual agreement procedure where the place of effective management of a person other than an individual cannot be determined.

### 2. International traffic

This is now taxed where the place of effective management is situated and not where the person is resident.

### 3. Definition of dividend

It Includes interest reclassified as dividend under the thin capitalisation rules of Russia, any form of profit participation, profit distributions by mutual funds and other collective investment schemes (other than REITs and REIFs) and payment of profits in respect of Depositary Receipts on shares.

#### 4. Definition of interest

This is aligned to the definition included in the OECD Model Treaty and covers income from debt claims of every kind. It excludes from the definition amounts reclassified as dividends under the thin capitalization rules and penalty charges for the late payment.

#### 5. Mutual agreement procedure

A person affected by a decision of one state may present his case in any of the two states instead of the state of his residence only as before.

### **BENEFITS ARISING FROM THE CYPRUS RUSSIA TAX TREATY FOR COMPANIES USING CYPRUS**

1. Only 5% withholding tax on dividends paid by Russian companies to residents of Cyprus when investment in Russian company exceeds €100.000. In other cases the withholding tax is only 10%. Cyprus can be used for the establishment of holding companies having subsidiaries in Russia and extract the profits from Russia with withholding tax of only 5%.
2. With the exclusion of Cyprus from the black list Russian companies investing abroad can use Cyprus companies as intermediaries in order to benefit from the parent subsidiary directive for their operations in the European Union and can then repatriate profits without any further tax. They can also profit from other Tax Treaties of Cyprus with third countries in that respect.
3. No withholding tax on interest paid to Cyprus companies by Russian companies or other entities (subject to thin capitalization rules). Interest reclassified as dividend under thin capitalization rules is subject only to 5% withholding tax if the amount of investment of recipient of interest in Russian company exceeds €100.000. Investors can use Cyprus as the base of the company providing finance to Russian companies and get the interest free of tax out of Russia, having to bear only the low tax of Cyprus on their profits.
4. No withholding tax on royalties paid by Russian companies to Cyprus companies.
5. Full tax credit provided by Cyprus against Cyprus tax on same income in respect of foreign tax.
6. In the case of international traffic, income of companies engaged in such trade will be taxed only in Cyprus if their effective management is situated in Cyprus.

7. It is clarified through the protocol that distributions by Investment Funds are taxed as dividends carrying the same withholding tax.
8. Once the protocol comes into force the participation exemption will apply in respect of dividends paid by Cyprus companies to Russian companies holding at least 50% of the shares of the Cyprus company, thus exempting these dividends from tax in Russia.

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