CYPRUS: A CONTEMPORARY PARTNER TO RUSSIAN CROSS-BORDER TRANSACTIONS

CHRISTODOULOS G. VASSILIADES & CO. LLC
Advocates - Legal Consultants

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CONTENT

LEDRA HOUSE: 15 Agiou Pavlou Str.
Agios Andreas 1105, Nicosia, Cyprus

P. O. BOX: 24444, 1703 Nicosia, Cyprus
E-MAIL: Info@vasslaw.net

TEL: +357 22 55 66 77
FAX: +357 22 55 66 88

www.vasslaw.com

INTRODUCTION

- Our long lasting experience enables us to fully understand the needs of your business and contribute towards its success.
- In this publication, we will concentrate on the business development between Cyprus and the countries applying the former USSR Double Tax Treaty signed in 1982
- Furthermore, we will endeavour to understand the benefits offered by Cyprus to the countries applying the former USSR treaty business world and the international cross border business, as well as the purpose served by the Cypriot companies as holding, financing and licensing investment companies.
- We will close our publication, with the suggested application and the use of the international collective investment schemes set up in Cyprus as well as the benefits obtained by an International Cyprus Trust.

CYPRUS: TAX BENEFITS

- Cyprus provides for numerous tax benefits and it is classed as a low tax jurisdiction. Its tax and legal systems are in full compliance with the EU and the OECD requirements and thus including Cyprus in the white list of international cooperative jurisdictions.
- Cyprus actually provides for the lowest corporation tax in the EU with a tax rate of 10%.
- Under the Cypriot corporation income tax, inbound dividends are not taxable and there are provisions in place which may even exempt such inbound dividends from being subject to the Special Contribution Defense Fund (SCDF).
- Outbound dividends are not subject to any withholding taxes. They are though subject to SCDF if paid to Cyprus tax resident individuals.
- Cyprus does not impose capital gains tax on the disposal of shares unless it relates to immovable property situated in Cyprus. If the immovable property is located outside of Cyprus, such gains are exempt.
- Since 2004, Cyprus has become an official member of the EU and has implemented all EU Directives, which as a result obtained all the tax benefits granted to intra-community transactions. Nonetheless, Cyprus has expanded the applicability of the tax benefits obtained by the EU Directives to all third countries by incorporating the provisions of the EU directives in its national legislation.
- EU Directives that have been implemented are the Parent Subsidiary Directive, the Merger Directive, the Tax Savings Directive and the Interest and Royalties Directive.
- Cyprus provides for no inheritance tax;
- It has concluded an extensive network of Double Tax Treaties for the avoidance of double taxation. Income deriving from countries which signed a relevant treaty with Cyprus will only be taxable once.

CYPRUS: FURTHER BENEFITS

- Irrespective of the tax benefits, it is important to mention that Cyprus is a common law jurisdiction and its Companies' Law is based on the UK Companies Act of 1948.
- During the last few decades it has become known as an international financial center, located in the cross roads of three continents: Europe, Asia and Africa.
- It provides for identification of beneficiaries and disclosure of information thus classing it as a transparent system and has also developed the provision of world class professional services.
- Overall, Cyprus offers a unique European base for international business companies.

CYPRUS – RUSSIA RELATIONS

- Cyprus is a contemporary nation but its relations with Russia date since the early days of the Republic.
- Cooperation between the two countries has increased since 1990s and the fall of the USSR.
- Russia is an important trading partner to Cyprus and constitutes the 6th largest merchandise export market.
- In turn, Cyprus finds itself amongst the largest investor countries in the Russian market in terms of foreign investment.
- From a tax perspective, Cyprus is a pioneer in the Russian market changing its beneficial treaty for the avoidance of double taxation, still maintaining the most beneficial terms of income taxation.

CYPRUS-RUSSIA CURRENT DOUBLE TAX TREATY

- Under the Double Tax Treaty concluded between Cyprus and Russia it is noteworthy to mention in brief the advantageous treatment of dividends, interest, royalties and capital gains.
  - Dividends receive 5% withholding tax of the gross amount of the dividends at source in case the beneficial owner invested directly more than $100.000 in the capital of the company. In all other cases, a withholding tax of 10% will be applicable.
  - Interest arising in a contracting state and paid to a resident of the other contracting state is only taxable in that other contracting state, receiving 0% withholding tax.
  - With regards to royalties 0% withholding tax applies.
- In terms of the capital gains, Cyprus maintains one of the most competitive provisions for their treatment compared to its competitors
- No capital gains are taxable in Cyprus or Russia when derived from the sale of shares (subject to changes introduced by the Protocol as described in section Capital Gains Taxation on page 5) and;
- Furthermore, in the case of the elimination of double taxation, Cyprus and Russia shall both grant a tax credit for foreign tax.

NEW PROTOCOL TO THE DOUBLE TAX TREATY

- The Russian and the Cypriot presidents signed on 7th October the new amending Protocol to the Double Tax Treaty which was in effect since 1998.
- The Protocol still requires ratification from the Russian Parliament in order to come into force. It is expected though that it will be effective as from 1st January 2011.
- Once the Protocol comes into force, the Russian government has committed itself into removing Cyprus from the Russian 'black-list' of uncooperative jurisdictions.

PROTOCOL CHANGES:

- Dividends:
  - Withholding tax rates regarding dividends, interest and royalties will not be subject to any changes. These rates appear to retain Cyprus in a unique position in the Russian market of DTTs, compared to its competitors.
  - Dividends, however are subject to 5% or 10% and this will be determined at the threshold of €100,000 instead of $100.000.
  - Mutual investment funds and other similar collective investment vehicles paying shares will be now treated as dividends and therefore, shall bear withholding taxes of either 5% or 10%.
- Interest:
  - The definition of interest is expanded to include debt-claims and it further clarifies that it does not include penalty charges for late payments or interests regarded as dividends by virtue of other provisions.
- Income from immovable property:
  - A clear definition is provided indicating the place of taxation for the income deriving from immovable property situated in one contracting state. Additionally, various investment vehicles i.e. real estate investment funds, real estate investment trusts receiving such income will be taxable in the contracting state in which the immovable property is situated.
- Capital Gains Taxation:
  - Capital Gains Taxation is regarded as one of the most significant changes brought about by the new Protocol.
  - This change relates to the disposal of shares in a company resident in one contracting state deriving more than 50% of their value from immovable property situated in the other contracting state and therefore be liable to tax where the immovable property is located.

   - No further changes will take place regarding the right for taxation to the seller's country of residence in the case of corporate reorganisations, disposal of listed shares in a recognised stock market and the sale conducted by a pension fund, a provident fund or the government of either of the two contracting states involved.

   - This change on capital gains is given a four year grace period as of the date of the Protocol coming into effect. Upon a potential enforcement of the Protocol as of 1st January 2011, the capital gains clause shall be applicable as from 1st January 2015 and onwards.

- Exchange of Information:

   - This article has been revised to adopt the exact wording of the OECD Model Tax Convention on Income and Capital.

   - Both, Russian and Cypriot, tax authorities are under obligation to permit exchange of information by utilising and mobilising their national mechanisms in order to collect the required information.

   - Information obtained by the competent authorities shall be treated confidentially however it may be disclosed in court proceedings if needed.

   - The exchange of information is not limited to the scope of taxes covered by the Treaty but can also extend to include indirect taxation i.e. VAT matters.

   - In order for a contracting state to obtain the desired information, it is obliged to proceed in line with the national legislation and collection of information mechanism of the other contracting state.

   - Cyprus has amended its national legislation (Assessment and Collection of Taxes law, 72 (I)/2008) back in 2008 providing for the exchange of information as well as the procedure to be followed for the collection of the desired information.

   - The right for the initiation of the national mechanism for the information collection rests with the Director of the Inland Revenue Department whereby he needs to obtain substantial evidence, regarding the reasoning and the person being under question, supplied by the competent tax authorities.

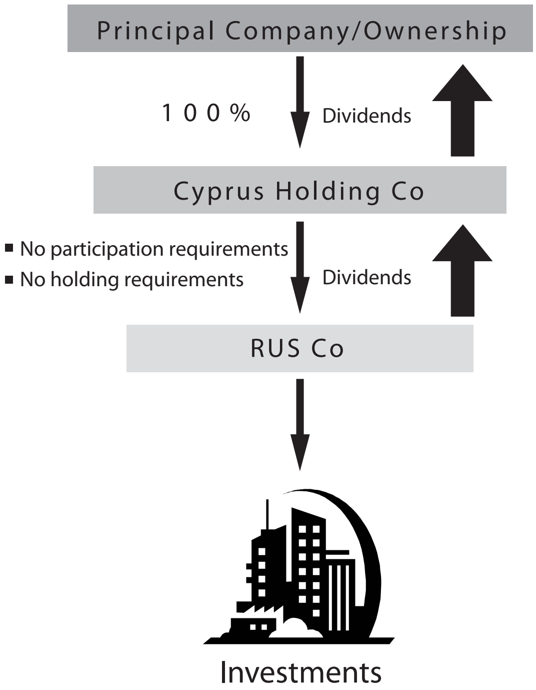
   - The Attorney General of the Republic must grant his written consent for the collection of information to take place and he also reserves the right of declining insufficient cases.

   - Both countries are not expected to go beyond their national legislation in order to obtain this information but are under obligation to obtain the data available and possible to collect.

- Limitation of Benefits:
  - This is a newly incorporated article to the Protocol aiming at the prevention of the Treaty abuse.
  - Tax authorities of both contracting states shall reserve the right to refuse the benefits of the Treaty to all those companies neither registered in Cyprus nor Russia. The decision for the application of the treaty shall be a mutual result of consultation between the two relevant authorities which aim at the elimination of the phenomenon of the'Treaty-shopping'.
- Residence:
  - In those instances whereby confusion is created regarding the 'effective management' of a company, both relevant tax authorities are expected to work together and result in a mutual decision.
- Permanent establishment:
  - An additional clarification has been provided indicating specific timeframes which deem to give rise to a permanent establishment (Under certain conditions a PE may deem to be created in instances, where an individual present in the contracting state for more than 183 days in a 12-month period performs services on behalf of an enterprise resident in the other contracting state).
- International Traffic:
  - International transportation income is clarified to be taxable only in the contracting state where the place of 'effective management' of those persons deriving such income is situated.

    [Note that residency is determined by place of effective management]

NEW CYPRUS HOLDING COMPANY



CYPRUS treatment:

- Corporate Income Tax on worldwide income: 10%
- Dividends received: Dividends not subject to corporation tax and likely to be exempt from SCDF
- Dividends paid: 0% withholding tax

RUSSIA treatment:

- Dividends paid:
  - 5% withholding tax if there is a direct investment of the CY Company in the share capital of the RUS Co exceeding €100.000 (following the enforcement of the Protocol).
  - Direct investment less than €100.000, withholding tax 10%

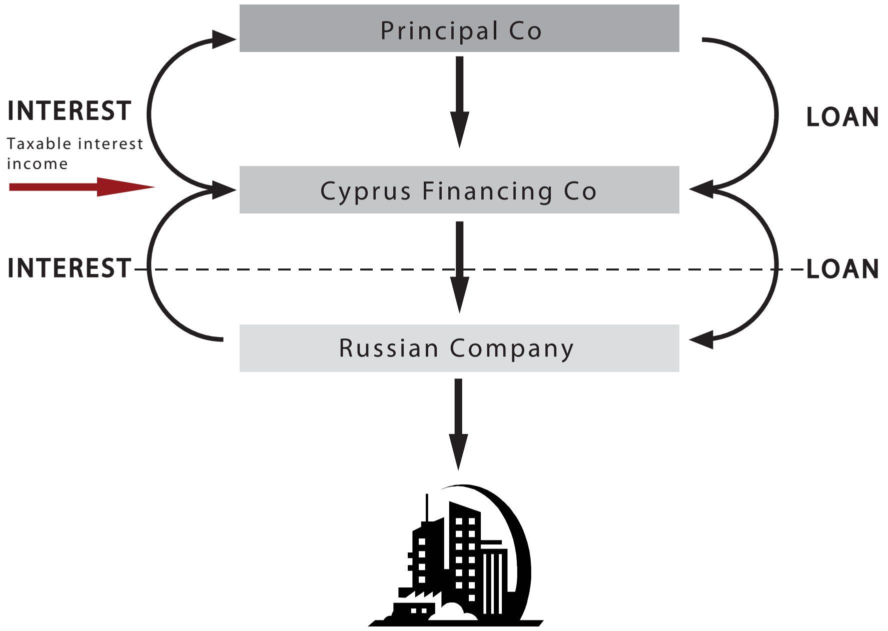
- Cyprus companies can effectively be used as holding companies with Russian or international cross border transactions.
- In the figure above, Cyprus company holds 100% participation in a Russian company conducting various investments. From a Cyprus perspective, no participation or holding requirements exist in order to obtain tax benefits.
- Incoming dividends from Russia, are exempt from corporation tax in Cyprus and may also be exempt from SCDF provided that:

  - no more than 50% of the Russian Company's activities lead to investment income; or

  - the foreign tax obligations amount to at least half of the tax imposed by Cyprus.

- 5% withholding tax is imposed at the Russian level provided that the Cyprus company invested directly in the share capital of the Russian company more than €100.000 (following the enforcement of the Protocol). In those instances, whereby the investment does not exceed €100.000, 10% withholding taxes will be applicable.
- Extensively, dividends paid to the parent company are not subject to any withholding taxes in Cyprus.
- Moreover, the Cyprus company shall be liable to 10% corporation tax on its worldwide income.

NEW CYPRUS BACK-TO-BACK FINANCING



- CYPRUS FINANCING COMPANY
  - Financing the group companies in two ways:
    (a) by way of debt or
    (b) working capital;
- CYPRUS LAW
  - Interest income received from intra-group financing - 10% corporation tax;
  - No thin cap rules / no debt-to-equity restrictions;
  - No specific Transfer Pricing legislation, however the arm's length principle applies;
  - Interest paid to non-resident creditors is not subject to any withholding taxes
- BACK-TO-BACK FINANCING
  - Minimum interest margin accepted by the Cyprus tax authorities is 0.35%.

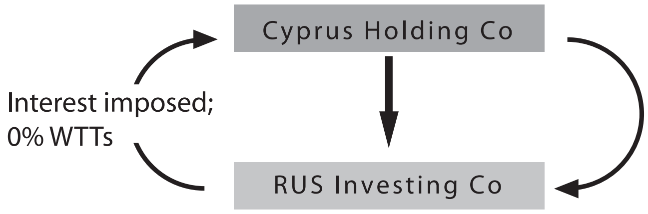
- Cyprus companies are beneficially used as finance investment vehicles suitable for financing group of companies and resulting to an efficient accumulation of interest income.

- In the figure above a Cyprus company is a subsidiary of another jurisdiction's company, onshore or offshore, and a parent company of a Russian company. A loan from the Parent company can be passed down to the Russian company with respective interest received.

- In Cyprus, interest income received from intra-group lending is liable to 10% corporation tax and has no thin capitalisation rules or debt-to-equity restrictions in place. There is also no transfer pricing legislation in place, however, the arm's length principle must be applied– the interest needs to be determined at a market value as if these parties were unrelated. Additionally, interest paid to non-resident creditors is not subject to any withholding taxes.

- According to the tax authorities in Cyprus, the minimum interest margin accepted on interest is determined between 0.125% and 0.35%.

NEW CYPRUS INTEREST BEARING STRUCTURES



Interest means income deriving from:

- Debt-claims;
- Government securities;
- Debentures;
- Bonds (including premiums and prizes).

NEW Protocol provisions:

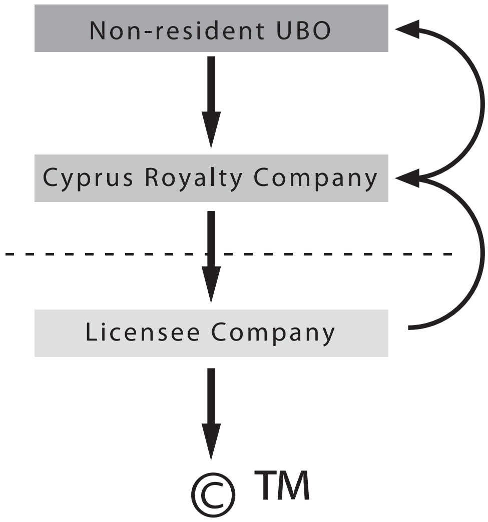
- Clear definition of 'Interest' under the Protocol;
- Interest received from Russia bears no withholding taxes;
- Interest paid from Cyprus to any Russian entity bears no withholding taxes.

Cyprus law:

- Interest income received outside the ordinary course of business or it is not closely connected to the ordinary course of business is subject to 10%SCDF;
- Interest income received within the ordinary course of business or it is closely connected to the ordinary course of business is subject to 10% CIT;

- Based on the new Protocol, the definition of interest is now expanded to include debt-claims of any kind, government securities, debentures and bonds whereby it includes premiums and prizes attached to such debentures, bonds or securities.
- A Cyprus company obtains a debenture or a bond from a Russian entity for which it receives interest. The interest will be determined at a market value and it will bear no withholding taxes on the interest income received from Russia.
- Interest income received within the ordinary course of business of the company will be liable to 10% CIT otherwise if it falls outside the ordinary course of the business it will be liable to 10% SCDF.
- Interest paid from Cyprus to a Russian entity will also bear nil withholding taxes at the level of Cyprus.

NEW CYPRUS ROYALTIES COMPANY



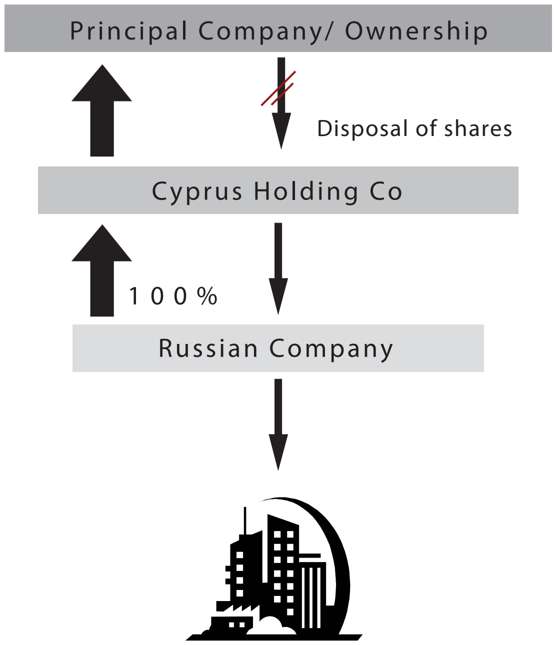
- Sublicensing of intellectual property rights

Cyprus Law

- Net royalty profits are subject to 10% corporation tax;
- Gains on the sale of shares of Royalty Co is exempt from corporation tax;
- Royalty payments are exempt from WHTs (rights must be exercised outside Cyprus)

- A Cypriot sublicensing company may be interposed between the non-resident beneficial owner company and the licensee company which will exercise the rights on the intellectual property obtained. Royalty payments are received with respect to the licenses on the intellectual property rights which are granted.
- In Cyprus, the net royalty profits are subject to 10% corporation tax while any gains deriving from the sale of shares of the Royalty Co are exempt from such corporation tax.
- Furthermore, royalty payments are exempt from withholding taxes in Cyprus provided that the rights are exercised abroad and not in Cyprus.

NEW CAPITAL GAINS TREATMENT



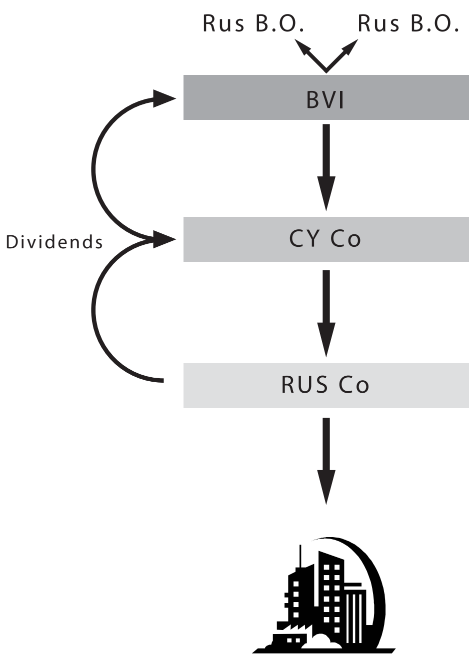
CYPRUS treatment:

- The alienator is BVI, therefore, capital gains arising will be taxable in the country of the alienator unless stated otherwise (in a DTT).
- Disposal of shares are not in any way taxable under the capital gains provisions in Cyprus (provided that immovable property in Cyprus is not directly or indirectly involved).

- The Capital gains clause underwent one of the most significant changes.
- Cyprus companies investing in Russia may be subject to Russian tax upon the disposal of the shares held in the share capital of a Russian real estate company. These restrictions are applicable on the gains from such disposal of shares of the Russian Company which derive more than 50% of their value from immovable property situated in Russia.
- As indicated in the diagram above, it is possible for the sale of shares to take place from the ultimate parent company which can be located onshore or offshore. Gains from such disposal of shares will, therefore, be taxable at the specific level of the ultimate company owner unless a DTT between the two contracting states provides otherwise.
- The restrictions indicated in the Protocol affect the disposal of shares only in a Russian company.

CYPRUS OFF THE RUSSIAN BLACK-LIST

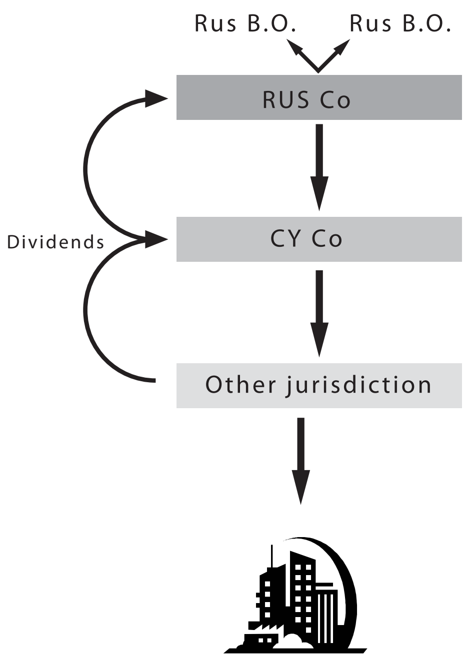
Now...



Investments

- Russian shareholders or beneficial owners (B.O.) are not allowed to repatriate their profits in Russia directly;
- They do not qualify for the participation exemption in Russia.

After the removal from the black list...



Investments in RUS, CY, India, Ukraine, Central & South-Eastern Europe, China etc.

- Repatriation of profits to Russian shareholders and companies will be possible;
- Russian shareholders will be able to claim for the Russian participation exemption.
- Direct investments in the Cyprus and /or Russian markets

COLLECTIVE INVESTMENT VEHICLE

REGION	Dividends	Interest	Royalties
Russia	5/10%	0%	0%
India	10-15%	0/10%	15%
Latin America	0-15%	0-10%	0-10%
Ukraine	0%	0%	0%
Middle East	0-15%	0-15%	0-15%
Central Eastern Europe / Balkans	0-15%	0-15%	0-15%

- Cyprus is also an ideal jurisdiction for structuring international investments in bonds, securities, shares, debentures and other investment instruments.

- A good way of structuring investments through Cyprus is the establishment of an international investment Fund in Cyprus. Collective Investment Funds can proceed into investing not only in investment instruments in Russia but almost in every part of the world i.e. India, Latin America, Middle East, Central and Eastern Europe, with significant benefits.

- Tax benefits available under the Cypriot jurisdiction and the advantage of the DTTs are also obtainable by the International Funds.

CYPRUS SHIPPING: NEW TONNAGE TAX SCHEME

- Cyprus has obtained a new tonnage tax scheme since March 2010 and it has been decided to be enforced for the year 2010 (inclusive) and onwards.
- The new tonnage tax scheme has been approved by the European Commission, for the first time for an EU member state with an Open Registry
- This new Cyprus tonnage tax combines all the favourable provisions of all European and non-European shipping taxation systems.
- Under the new scheme an option for taxation is granted to the companies concerned. They can choose to be taxed on the net tonnage of the vessel or on the actual profits of their maritime transport activities.
- Under the new scheme, the benefits, so far, applicable to ship owners and ship managers of Cyprus flag ships are also extended to the owners and charterers of ships with foreign flags besides Cypriot, provided they are tax residents of Cyprus.
- Qualification requirements need to be fulfilled in order to obtain all the tax benefits granted by the new tonnage tax scheme.

TAX BENEFITS UNDER NEW TONNAGE TAX SCHEME

- No income tax and taxation of profits for the qualified ship owner and charterer
- No income tax for the qualified ship manager
- Tax free dividends from profits at all levels
- Gains deriving from the disposal of or transfer of such vessels or the shares of the ship owning company will be tax exempt
- The emoluments of officers or of the crew on board of such qualified vessels are exempt from income tax
- No tax imposed on interest earned (excluding investment capital)
- Income tax exemption may be granted regarding dividends from qualifying activities

QUALIFICATION REQUIREMENTS

(a) The vessel must fall under the relevant definition of “qualified ship”

(b) The person (individual / company) must fall under the relevant definition of “qualified person”

(c) The activities of the vessel concerned need to comply according to the definition of “qualifying shipping activity”.

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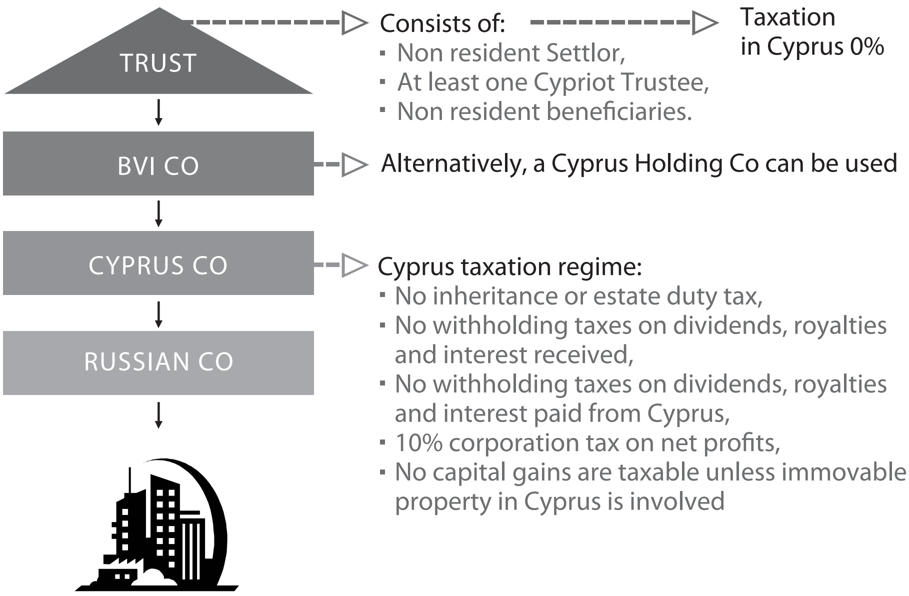
CYPRUS INTERNATIONAL TRUST

- Cyprus International Trusts are considered as efficient wealth management instruments and most significantly instruments for the protection of assets.
- The assets and interests of the beneficiaries of the Cyprus International Trust are being safeguarded from the various challenges of every day life i.e. divorces etc.
- CIT also serves successfully the purposes for the securing of the inheritance
- Its duration can last up to 99 consecutive years.



No immovable property in Cyprus is involved

* Alternative jurisdictions to Cyprus International Trust can be chosen

THE BENEFITS OF THE CYPRUS INTERNATIONAL TRUSTS:

- Exemption from income tax, capital gains tax, special contribution or any other taxes in Cyprus (provided that no immovable property situated in Cyprus is involved),
- No estate duty or inheritance tax in Cyprus,
- There are no reporting requirements in Cyprus,
- Dividends, interest or royalties received by an International Trust from a Cyprus company are not taxable and not subject to any withholding tax,
- There are no exchange control restrictions,
- Trust capital received in Cyprus by a foreigner resident or retired in Cyprus is not taxable on the trustee.

CYPRUS – RUSSIA – CONCLUSION

- Russian business have traditionally turned to Cyprus for tax utilization and beneficial treatment. The New Protocol it is expected to further reinforce business between the two countries.
- Cyprus is a contemporary country offering a unique European base for international business companies.
- It has managed to place itself within the top five countries with higher foreign investments in Russia.
- Cyprus is located in a key geographical position suitable for investments in the Arabic world, the middle East, Europe, Asia, Africa and due to its strong affiliations, to India and Ukraine as well.
- Business between Cyprus and Russia will continue developing and the key to achieve tax optimization lays upon the efficient tax planning.