Russia and Cyprus sign protocol amending double taxation treaty

Russia · 17.09.2020

Available languages: RU

On 8 September 2020, Russian and Cypriot authorities signed* a Protocol amending the applicable double taxation treaty (DTT).

The proposed amendments increase the applicable withholding taxation (WHT) rates for outbound interest and dividend payments, as previously reported.

The signed version of the Protocol is not yet available to the public. According to the draft Protocol* published on 4 September 2020, the current WHT rate for dividends has been increased from the currently applicable rate of 5% or 10% to 15%.

Despite this, the 5% WHT rate will still apply when the recipient of the dividends qualifies as a publicly listed company meeting the following criteria:

- at least 15% of the shares of the receiving company are freely traded on a registered stock exchange; and
- the receiving company holds (for not less than 365 days) at least 15% of the shares in the company paying out the dividends.

Apart from that, a reduced WHT rate will apply to dividend payments made to insurance institutions, pension funds or specific state bodies in Russia and Cyprus.

The Protocol also introduces a 15% WHT rate on interest.

A reduced 5% WHT rate will still apply to interest payable to a publicly listed company that meets the criteria listed above for the application of a reduced WHT rate to dividends.

Moreover, after the Protocol comes into force, exemption from WHT will continue to apply to interest payable to banks, insurance institutions, pension funds or specific state bodies in Russia and Cyprus.

The WHT exemption will also apply to the income received from certain types of securities traded on a registered stock exchange, such as:

- government bonds;
- corporate bonds;
- external loan bonds (e.g. Eurobonds).

The Protocol will likely be ratified* before the end of the year so that the new provisions will apply beginning 1 January 2021.

The amendments represent a compromise reached after several rounds of negotiations between Russian and Cypriot authorities, which took place around the time when Russia announced* that it intended to denunciate the applicable DTT.

Similar amendments to applicable DTTs have also been agreed upon with Malta and Luxembourg, and are being negotiated with the Netherlands.

Take action

Since the agreed-upon amendments to the DTT are expected to come into force as early as 2021, affected businesses should review business and corporate structures involving Cypriot entities and make a preliminary assessment of additional tax exposure resulting from the changes introduced.

In a limited number of cases, and to the extent that this also meets the business goals of the considered structure, businesses may consider transforming existing Cypriot entities into publicly-listed companies or applying the “look-through” approach to income distributed via Cypriot entities to other jurisdictions as ways to neutralise the negative tax effect of the changes.

Alternatively, reorganising existing structures could be envisaged, including reviewing whether it is possible to relocate existing Cypriot entities to Russia or other European jurisdictions offering an attractive tax regime for holding structures.

When analysing applicable alternatives, companies should make sure that there are real economic grounds behind the chosen structuring of the corporate presence and that the substance criteria for the incorporation of the holding companies have been satisfied.

Combatting artificial structures created to mainly or solely evade taxes remains one of the key objectives of developing tax legislation and corporate practices in Russia. This is partly illustrated by the ongoing review of DTTs with jurisdictions frequently used for tax-planning purposes.

For more information on this eAlert, please contact CMS Russia experts Dominique Tissot, **Maria Kabanova** or your regular contact at CMS Russia.

* *In Russian*

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