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a closer look

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SUBJECTS TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

SECTORS MANUFACTURING RETAIL/WHOLESALE INSURANCE BANKS/FINANCIAL INSTITUTIONS RESTAURANTS/FOOD SERVICE CONSTRUCTION AEROSPACE ENERGY AUTOMOTIVE MINING AND MINERALS ENTERTAINMENT AND MEDIA OIL AND GAS

COUNTRIES AND REGIONS EUROPE AUSTRIA BELGIUM BULGARIA CYPRUS CZECH REPUBLIC DENMARK ESTONIA FINLAND FRANCE GERMANY GREECE HUNGARY IRELAND ITALY LATVIA LITHUANIA LUXEMBOURG MALTA NETHERLANDS POLAND PORTUGAL ROMANIA SLOVAKIA SLOVENIA SPAIN SWEDEN SWITZERLAND UNITED KINGDOM EMERGING MARKETS ARGENTINA BRAZIL CHILE CHINA INDIA ISRAEL MEXICO RUSSIA SOUTH AFRICA SOUTH KOREA TAIWAN VIETNAM CENTRAL AND EASTERN EUROPE ARMENIA AZERBAIJAN BOSNIA CROATIA FAROE ISLANDS GEORGIA KAZAKHSTAN MONTENEGRO NORWAY SERBIA TURKEY UKRAINE UZBEKISTAN ASIA-PAC AUSTRALIA BANGLADESH BRUNEI HONG KONG INDONESIA JAPAN MALAYSIA NEW ZEALAND PAKISTAN PHILIPPINES SINGAPORE THAILAND AMERICAS BOLIVIA CANADA COLOMBIA COSTA RICA ECUADOR EL SALVADOR GUATEMALA PANAMA PERU PUERTO RICO URUGUAY UNITED STATES VENEZUELA MIDDLE EAST ALGERIA BAHRAIN BOTSWANA DUBAI EGYPT ETHIOPIA EQUATORIAL GUINEA IRAQ KUWAIT MOROCCO NIGERIA OMAN QATAR SAUDI ARABIA TUNISIA LOW-TAX JURISDICTIONS ANDORRA ARUBA BAHAMAS BARBADOS BELIZE BERMUDA BRITISH VIRGIN ISLANDS CAYMAN ISLANDS COOK ISLANDS CURACAO GIBRALTAR GUERNSEY ISLE OF MAN JERSEY LABUAN LIECHTENSTEIN MAURITIUS MONACO TURKS AND CAICOS ISLANDS VANUATU

Immovable Property

The new agreement elaborates and extends the definition of immovable property, which was previously defined as whatever is recognised as immovable property under the laws of the country in which it is located. In the new agreement immovable property is defined as including property ancillary to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources. Ships, boats and aircraft are excluded.

The Cyprus-USSR agreement provided that income from immovable property belonging to a resident of one contracting state and situated in the other would be subject to taxation only in the country where the property was located. The new agreement provides that such income "may" be taxed in the country in which the property is located but does not specifically exclude taxation in the country in which the taxpayer is resident.

The Cyprus-USSR agreement included income from the sale, exchange or lease of property in its definition of income from immovable property, but the new agreement restricts the definition to income from the use or letting of property.

Dividends, Interest And Royalties

One of the most notable features of the Cyprus-USSR agreement, which was also the main basis

for criticism, was the complete elimination of withholding taxes on dividends, interest and royalties. One of the main reasons for Cyprus's rejection of the 2007 draft agreement was disagreement over the level of withholding taxes. The new agreement allows for the imposition of withholding taxes, but at reduced rates. It should be noted that Cyprus does not impose withholding taxes on dividends, interest and royalties apart from royalties arising from the use of intellectual properties within Cyprus, so the figures refer to Ukrainian withholding taxes on payments to Cyprus residents.

Under article 10 of the new agreement withholding tax on dividends is limited to 5 percent as long as the beneficial owner is a resident in the other contracting state and holds at least 20 percent of the capital of the company paying the dividend or has invested at least EUR100,000 in it. For investments not satisfying these criteria the maximum rate of withholding tax will be limited to 15 percent.

Under article 11, withholding tax on interest is limited to 2 percent. Any Ukrainian withholding tax paid will be credited against the recipient's corporate income tax liability in Cyprus, so no additional tax cost will result from the change.

Under article 12, withholding tax on royalties in respect of copyright of scientific work, patents, trademarks, secret formulas, processes or industrial, commercial or scientific know-how is limited to 5 percent. For royalties in respect of literary or artistic work, such as films, the limit is 10 percent.

For all three categories of payment there is a significant conceptual change: the Cyprus-USSR agreement refers to the recipient of the income being a resident of the other contracting state in order to qualify for the treaty rates; under the new agreement it is the beneficial owner of the income that must be a resident of the other contracting state in order to qualify for the reduced rates of withholding tax. This change in emphasis, from the recipient to the beneficial owner, is in line with the latest OECD Model Convention and is designed to forestall artificial avoidance schemes.

Elimination Of Double Taxation

Article 21 of the new agreement prescribes the credit method of eliminating double taxation on income and the standard OECD Model wording.

Exchange Of Information

Article 24 of the new agreement, which reproduces article 26 of the OECD Model *verbatim*, is modified by a Protocol, which requires any request for information to be supported by the following details in order to demonstrate the foreseeable relevance of the requested information:

- The identity of the person under examination.
- A description of the information requested and the form and manner in which the requesting state wishes to receive it.
- The tax purpose for which the information is sought.
- The reason for believing that the information being requested is held by the contracting state to which the request is addressed, or is in the

possession or under the control of a person within its jurisdiction.

- The name and address of any person who may hold the information requested, if known.
- A declaration that the provision of the information requested is in accordance with the legislation and administrative practices of the requesting state and that where the requested information is found within the jurisdiction of the state in question, the relevant authority may obtain the information according to its laws and according to the terms of its ordinary administrative practices.
- A declaration that the state making the request has exhausted all other reasonable means of obtaining the information concerned.

Information will be provided only if the contracting state requesting the information has reciprocal provisions for providing information of the same nature.

What Has Not Changed In The New Agreement

Taxation Of Gains On Shares

One of the unique greatest attractions of the Cyprus-USSR treaty is its highly favourable provisions regarding capital gains on disposal of shares, including shares in "property-rich" companies, that is companies whose assets principally comprise real estate. Movable property including shares is taxable only in the country of residence of the owner, and since Cyprus imposes no tax on disposals of shares except and to the extent that the gain is derived

from real estate in Cyprus, Cyprus companies have become an ideal means of holding real estate in Ukraine, effectively allowing property to be disposed of free of capital gains tax or transfer charges by selling the shares in the company that owns the property rather than selling the property itself.

While the OECD Model Agreement generally envisages gains from the disposal of shares in companies other than property-rich companies to be taxed in the state of residence of the disponent of the shares, for property-rich companies the contracting state in which the property is located has the right to tax the gain. It was widely assumed that this would be the case with the new agreement but this fear has proved to be unfounded. Gains on disposals of movable property, including shares in property-rich companies, remain taxable only in the contracting state in which the disponent is resident. Consequently there is no diminution in Cyprus's great advantage as a jurisdiction for indirectly holding Ukrainian property assets via corporate structures.

Entry Into Force Of The New Agreement

The new agreement will enter into force when Cyprus and Ukraine have exchanged notifications that the necessary ratification procedures have been completed and its provisions will apply to tax years beginning from January 1 of the following calendar year. Until then the Cyprus-USSR agreement will remain in effect.

When voting took place on the draft law on ratification in the Ukrainian parliament on 18 June

2013 the government failed to secure the requisite majority for approval of ratification. The government will now have to register a new draft law in order to ratify the new double taxation agreement.

As noted above, in the interim period the Cyprus-USSR agreement continues in force. This provides even greater benefits (in the form of zero rates of withholding tax) than the new agreement that will replace it, so businesses should not be adversely affected by the delay.

An Initial Assessment Of The New Agreement

The loss of the zero withholding taxes on dividends, interest and royalties was widely foreseen and could be regarded as inevitable. The new rates are as low as any available under Ukraine's other double taxation agreements and considerably lower than most.

The preservation of the highly beneficial arrangements for taxation of property-rich companies is excellent news, particularly given the widespread expectation that they would be lost. It gives Cyprus an enormous advantage as a jurisdiction through which to hold real estate in Ukraine.

Many of the Ukrainian critics of the Cyprus-USSR agreement focused on the perceived inadequacy of its exchange of information regime which, so they alleged, gave Ukrainian entrepreneurs the means and opportunity to conceal income and evade tax. It was feared that the new agreement would give the Ukrainian authorities

scope to engage in "fishing expeditions" based on unsubstantiated reports and suspicions. However, the Protocol to the new agreement is explicit about the requirement to demonstrate the foreseeable relevance of the information requested and Cyprus's Assessment and Collection of Taxes Law contains robust safeguards against abuse of any exchange of information provisions. Requests for exchange of information are dealt with exclusively by the International Tax Relations Unit ("ITRU") of the Department of Inland Revenue, and exchange of information may take place only via the ITRU: any direct informal exchange of information between tax officers is prohibited. A request for information

must make a detailed case for disclosure, with the criteria set out in a lengthy legal document. In effect, this means that the authorities requesting the information must already have a strong case even before they request the information. As a final safeguard, Cyprus's Assessment and Collection of Taxes Law provides that no information may be released to an overseas tax authority unless the prior written consent of the Attorney General is obtained.

In summary, the new agreement remains highly advantageous and Cyprus looks set to retain its place as the predominant portal for international investment to and from Ukraine once it takes effect.