

Corporate Tax - Cyprus

Cyprus-Russia double tax agreement and mutual investment fund income

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May 24 2013

Article V of the protocol to the Cyprus-Russia double tax agreement, which entered into force on January 1 2013, amended the definition of 'dividends' as set out in Article 10(3) of the agreement.

The previous version of this article read as follows:

"The term 'dividends' as used in this Article means income from shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident."

The amended version reads thus:

"The term 'dividends' as used in this Article means income from shares or other rights, not being debt-claims, participating in profits, as well as income - even paid in the form of interest - which is subjected to the same taxation treatment as income from shares by the tax legislation of the State of which the paying company is a resident. This term also means any payments on shares of the mutual investment funds or similar collective investment vehicles (other than those mentioned in paragraph 5 of Article 6 'Income from Immovable Property' of the Agreement). The term 'shares' as used in this Article shall include depository receipts thereof." (emphasis added)

Article 10 provides for a reduced tax rate of 5% of the gross amount of the dividends, provided that the beneficial owner of the dividends has directly invested €100,000 or more in the paying company; otherwise, the default rate is 10%.

Under the mutual agreement procedure (Article 25), the competent authorities of both countries agreed to a common understanding and interpretation of Article 10, which is set out in a letter issued by the Russian Ministry of Finance.⁽¹⁾

The concept of 'direct investment' for the purposes of Article 10 means either:

- the acquisition of shares on issue; or
- the purchase of shares on the securities market or directly from the previous owner.

The minimum investment criterion applies directly to each individual company. However, under Russian law, a mutual fund is not a legal entity, but a distinct and autonomous pool of assets consisting of property transferred to a trust, a share in the ownership of which is certified by a certificate issued by a management company. There is a clear distinction between the assets comprising the fund and the management company managing it.

Accordingly, investments in mutual funds fail to satisfy the definition of 'direct investment' in the capital of a legal entity and thus the reduced 5% tax rate is unavailable. Consequently, the default 10% tax rate applies, subject to the Russian tax agent being provided with the requisite confirmation⁽²⁾ that the beneficial owner of the units is resident in Cyprus for tax purposes.

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Endnotes

⁽¹⁾ Letter 03-08-05/3935 on the taxation of income paid on shares in a closed-end investment fund owned by a resident of Cyprus, issued by the Tax and Customs Tariff Policy Department of the Russian Federal Ministry of Finance, February 14 2013.

⁽²⁾ Under Article 312(1) of the Russian Tax Code.

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