

## Corporate Tax - Cyprus

### Implications of latest Russian 'de-offshorisation' proposals

Contributed by **Andreas Neocleous & Co LLC**

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#### Introduction

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#### Introduction

In September 2014 the Russian Ministry of Finance published the third version of the draft law on the package of tax initiatives generally referred to as 'de-offshorisation'. This draft differs from its predecessors in areas including the controlled foreign company (CFC) rules (particularly the parameters for classifying companies as CFCs), criteria for determining tax residence of foreign companies and penalties for non-disclosure.

Towards the end of October a draft law was presented to the Russian State *Duma* for consideration. The draft law differs in several respects from the third draft published by the Ministry of Finance.

Since Cyprus is one of the principal portals for investment into Russia (in 2013 it accounted for \$22.7 billion, more than 13% of Russian inward investment), the proposed changes are of great importance for users of Cyprus structures. This update outlines the specific aspects that are likely to affect Cyprus structures.

#### Relevant aspects

##### **Whitelist**

One of the exemptions available in the current draft law relates to companies resident in jurisdictions that exchange information with Russia for tax purposes and impose an effective tax rate in excess of 75% of the entity's average Russian tax rate on income calculated in accordance with the formula set out in the CFC legislation. In most cases this will equate to 15%.

##### **Gains on disposal of shares in property-rich companies**

Gains derived from the sale of shares and similar interests in foreign companies deriving more than 50% of their value from real estate in Russia will be taxable in Russia unless the securities concerned are traded on a recognised stock exchange.

##### **Determination of tax residence of legal entities by place of management**

A company incorporated overseas is to be regarded as tax resident in Russia if it is so under an international taxation agreement or if its place of effective management is in Russia. The place of effective management is determined according to three main criteria:

- the location of the majority of the meetings of the board of directors or equivalent management body;
- the location of the executive management of the organisation; and
- the location in which the key executives principally operate.

#### Effects on Cyprus structures

The provisions on company residence are consistent with the principle used in Cyprus: that residence is determined according to the locus of management and control.

Although Cyprus has a comprehensive double taxation agreement with Russia which includes up-to-date information exchange arrangements, the Cyprus corporate tax rate of 12.5% is below the effective tax rate (generally 15%) required for exemption on the basis of the effective tax rate. Holding companies and companies with income that is principally characterised as passive will also be affected by the proposals as they stand.

The double taxation agreement between Cyprus and Russia provides that until January 1 2017, gains on shares in property-rich companies will be taxable only in the donor's country of residence. The proposal to tax such gains in the country in which the property is located is incompatible with this provision and, under the Vienna Convention on the Law of Treaties (to which both Russia and Cyprus are parties), Russia is bound by its obligations under the agreement.

These issues will need to be resolved at an early stage. In the meantime, it would be prudent for users of Cyprus structures for investment into Russia to analyse the companies and other entities involved in order to assess the possible implications in terms of future tax costs and develop strategies for mitigating them. However, the significant differences between the draft law published by the Ministry of Finance in September and the version submitted to the *Duma* only a few weeks later demonstrate that the law is very much a work in progress and that further significant changes are likely to emerge during the legislative process. Any irreversible steps should not be taken until its final provisions are clearer.

*For further information on this topic please contact Philippos Aristotelous at Andreas Neocleous & Co LLC by telephone (+357 25 110 000), fax (+357 25 110 001) or email (aristotelous@neocleous.com). The Andreas Neocleous & Co LLC website can be accessed at www.neocleous.com.*

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#### Author

##### Philippos Aristotelous

