



Cyprus will no longer be on the Russian Blacklist!

Effective from the 1st of January 2013, the Republic of Cyprus will be removed from the Russian commonly known as the “blacklist”. This is a direct result of ratification of the Protocol amending the double tax treaty between Russia and Cyprus which also comes into effect on 1 January 2013.

Here we consider the implications of these more recent changes:

Taxation of dividends - participation exemption rule

Article 284.3 of the Russian Tax Code specifies that dividends earned by Russian companies that meet certain conditions are taxed at 0%. Broadly speaking these conditions are that as at the date of the distribution the entity earning the dividends must have continuously held at least 50 % in the charter capital of the paying entity for at least 365 calendar days.

However, after receiving dividends from Cyprus, a Russian corporate shareholder will no longer pay tax at 9%.

For Russian holding companies, this will make Cyprus a more efficient venue for owning foreign assets and gives it a clear advantage over the traditional offshore centers that remain on the blacklist. Currently the blacklist includes over 40 countries.



Transfer pricing

Under Article 105.14 of the Russian Tax Code, a transaction is deemed to be controlled if one of the parties is incorporated or domiciled, or has tax residency, in a blacklisted jurisdiction. The Russian transfer pricing rules have over the last year resulted in a significant fall in trading of goods and services between Russia and Cyprus. As from 2013, the Russian tax authorities will no longer be able to control amounts paid by a Russian company to an unrelated Cypriot company. Transfer pricing rules will continue to apply to related party transactions.

Having said this, the Russian authorities will still have recourse to price control tools in transactions with Cypriot companies. Specifically:

- a court may rule that parties are related if the specifics of their relationship could affect the transaction terms and/or outcome (Tax Code Article 105.1).



- intermediary companies, i.e. entities that do not perform any additional functions in a transaction, do not bear any risks and do not use any assets can be treated as related party (Tax Code Article 105.14).

It is important therefore to understand that from a transfer pricing perspective the removal from the blacklist is unlikely to benefit to structures created for Russian tax optimization purposes unless there exists the corresponding substance in Cyprus. Structures that are only formally unrelated will also be under risk.

Information exchange

We expect that requests for information exchange by the Russian fiscal authorities will increase significantly.

Having said that, the circumstances under which professional secrecy rules can be lifted and the process that must be followed in this respect are subject to the detailed provisions of the domestic legislation. In the case of Cyprus this requires the written permission by the Attorney General of the Republic of Cyprus and there are safeguards in place to protect investors and to prevent their disclosure in routine investigations or so called fishing expeditions.

What you should do next?

The positive impact of this news is clear, especially regarding the applicability of tax benefits for Cyprus-sourced dividends as well as exempting transactions with unrelated Cypriot companies from transfer pricing controls.

But Russian corporate structures with Cyprus based companies should take a fresh look at their substance in Cyprus to support their position and take advantage of these new developments.

Please feel free to contact us with any questions or queries.

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