



# Investment into Russia



C. SAVVA & ASSOCIATES LTD

# INVESTMENT INTO RUSSIA



**Russia is one of the ten largest economies** in the world, and one of the “Big Four” countries included in BRIC (grouping that refers to the leading emerging markets of Brazil, Russia, India, and China).

Being the European Union’s 3rd largest trading partner, and an essential energy supplier, Russia presents vast opportunities for investment. Traditionally, such investment into Russia has been routed via Cyprus. According to the Federal Statistics Service, Cyprus was the top investor into Russia in 2009 and the first quarter of 2010, accounting for just over 50% of all foreign investment. The following is a list of the top four countries investing in Russia, and their level of accumulated investment respectively:

Country	2009 (US\$ Billions)	% of 2009	Q1 2010 (US\$ Billions)	% of 2010
1. Cyprus	49.10	18.30	52.10	19.60
2. Netherlands	48.60	18.10	43.20	16.30
3. Luxembourg	37.10	13.90	36.40	13.70
4. United Kingdom	23.60	8.80	20.50	7.70

**After the first ever official visit of Russian president Dmitry Medvedev to Cyprus in October 2010, a new era in economic relations between the two countries was signaled in. The visit ended uncertainty for thousands of Russian and Cypriot owned companies based in Cyprus after Russia branded Cyprus as a tax haven in 2007, and placed it in a black list together with more than 50 other countries.**

As a result of the signing of the Protocol, which amends the current Russia – Cyprus Double Tax Treaty (DTT), the government of Russia is expected to announce the removal of Cyprus from the Russian “Black List” effective concurrently with the provisions of the Protocol. Formal ratification is expected before the end of 2010, with the Protocol expected to come into force on 1 January 2011.

With the removal of Cyprus from the Russian Black List, dividends received by Russian shareholders from eligible equity participations in Cypriot subsidiaries will be eligible for the Russian participation exemption. This will undoubtedly strengthen the position of Cyprus as being the most favourable jurisdiction for investment into Russia.

While the Protocol is aimed at continuing to encourage strong economic relations between Cyprus and Russia, the Protocol also establishes new limitations with respect to the application of benefits for transactions involving shares and other corporate rights in companies owning immovable property, as well as restrictions on the application of benefits provided to mutual investment funds organized primarily for the purpose of investing in immovable property. Furthermore, the Protocol broadens the authority of, and obligations imposed on, the contracting state with regard to the exchange of information and mutual cooperation over the collection of taxes. This is aimed at improving information exchange and greater transparency over the relationship between Cyprus and Russia in the tax arena as well as enhancing the efficiency of control over tax abuses.

**Together with our Russian partners, which include some of the most reputable tax advisory firms in Russia, Savva & Associates have analysed the changes within the Protocol. The following is a brief summary of the most significant amendments introduced by the Protocol as well as selected commentary regarding practical aspects of their implementation.**

### **1 Withholding Tax rates – no changes introduced**

The Russia-Cyprus DTT is generally perceived as the most favourable Russian tax treaty due to low withholding tax rates provided. The most significant provisions of the DTT regarding the taxation of dividends, interest and royalty remain unchanged. In particular, there are no changes to the nil rates of withholding tax on interest and royalties and dividend withholding rates remain at 5% or 10% (the current provision that a direct investment in the capital of the Russian entity of less than USD 100,000 results in a 10% withholding tax rate to apply is amended so that 10% withholding tax applies if the direct investment is less than EUR€ 100,000).

### **2 New definition for dividends and interest**

The Protocol also amends the definitions of dividends and interest. The definitions of these types of income are substantially aligned with the wording of the latest OECD Model Treaty.

Thus the amendments add to the definition of dividends, payments on shares in mutual investment funds and similar collective investment vehicles (other than investment funds investing primarily in immovable property), as well as depository receipts over shares.

In addition, the changes to the definition of dividends allow the Russian tax authorities to apply the domestic “thin capitalization” rules to reclassify “excessive” interest payments as dividends and tax such amounts in Russia at source, albeit at the reduced dividend withholding tax rates under Article 10 of the Treaty. Corresponding changes are made to the definition of interest contained in Article 11 of the Treaty.

The changes to the definition of dividends are introduced primarily to broaden this definition with respect to the Russian “thin capitalization” rules and tax in Russia at source the amount of reclassified interest without the possibility of exemption under Article 11 “Interest” of the DTT.

### **3 Changes to Capital Gains**

Perhaps the most material amendment to the existing DTT is the taxation of capital gains on the sale of shares in real estate property-rich companies. As per the current DTT, taxing rights are given to the country of residence of the seller.

The Protocol aligns Article 13 with the latest OECD Model Treaty principle that provides that such gains should be taxable in the country where the real estate is situated (provided that “more than 50% of the value of shares (or other corporate rights) is represented by immovable property situated in the other state”). If however the income is derived from alienating shares listed on a registered stock exchange, or as the result of a reorganization, the income is subject to taxation in the country of residence of the company selling the shares.

Since the Protocol provides for the amendment to come into force only on 1st January of the fourth calendar year following the year the Protocol enters into force, the earliest possible date is 1st January 2015.

It should be noted that The Russian Federation has undertaken that, by the time the Protocol will come into force, it will have adopted the OECD Model Tax Convention on Income and Capital provision for capital gains in its tax treaties with all States which are regarded as main investors in the Russian Federation.

### **4 Exchange of information, Assistance in Collection, Mutual Agreement**

Mutual assistance in tax collection attracts most interest from the press and the general public and arguably is the most notable change introduced by the Protocol. The current version of the DTT does not impose any obligations to cooperate in the area of taxation.

Amendments introduced to articles 25, 26 and 27 of the Protocol generally concern administrative matters and adopt the latest OECD Model Treaty equivalent articles.

It should be noted that the changes introduced do not assume the automatic exchange of information. To obtain information from the Cypriot tax authorities the Russian tax authorities will be required to observe certain procedures, and in particular, in considering the possibility of information provision, the requirements of Cyprus legislation have to be taken into account. In the case of Cyprus, the approval of the Attorney General is needed before any information is exchanged.

# Further Assistance

We look forward to helping you better understand how these changes may affect your business or create new opportunities, and working together to offer you practical and reliable solutions.

For a more comprehensive analysis of the changes introduced by the Russia-Cyprus Protocol, please contact Charles Savva at [c.savva@savvacypus.com](mailto:c.savva@savvacypus.com)

Please contact us if you would like to know more about this opportunity

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