TAX update

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NEW DOUBLE TAX TREATY BETWEEN CYPRUS AND UKRAINE

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A. INTRODUCTION

On the 8th of November 2012, the governments of the Republic of Cyprus and the Ukrainian People's Republic ("the contracting states") concluded a new double tax treaty replacing the 30 year old USSR - Cyprus treaty. The new Treaty aims to put an end to the long standing uncertainty that existed in the future investment relationship between the two countries and to create a new framework which will ensure that a stable tax environment will exist in the years to come.

B. ENTRY INTO FORCE

For the new Treaty to enter into force, further ratification by the respective parliaments of the contracting states is required and will have effect from the 1st of January of the year following the ratification. Therefore, since ratification is anticipated to take place in early 2013, the new treaty is expected to enter into effect from 1st of January 2014.

C. MAIN PROVISIONS OF THE NEW TREATY

The main provisions of the new Treaty are listed below:

- **Dividends**

  Dividends paid by a company which is resident in a contracting state to a resident of the other contracting state will be subject to 5% withholding tax provided that the owner holds at least 20% of the shares of the company paying the dividends or has invested at least EUR 100.000,00 as capital in the company.

  In all other cases the withholding tax rate is 15%.

  Example:
  A Cyprus tax resident company receives dividends from its 100% Ukrainian subsidiary.

  Dividends will be subject to 5% withholding tax in Ukraine. In Cyprus, dividends received from a Ukrainian subsidiary will not be subject to any taxation.

- **Interest**

  Interest paid by a Company which is resident in a contracting state to a resident of the other contracting state will be subject to 2% withholding tax.

Example:
A Cyprus tax resident company receives interest income from its Ukrainian borrower.

Interest income will be subject to 2% withholding tax in Ukraine. Interest income less any relevant expenses (i.e. interest expense) will be subject to taxation in Cyprus. However, the withholding tax paid in Ukraine can be used as a tax credit against the taxation generated in Cyprus.

- **Royalties**

Royalties arising in a contracting state and paid to a resident of the other contracting state will be subject to 5% withholding tax, provided royalties are paid in respect of any copyright of scientific work, any patent, trade mark, secret formula, process or information concerning industrial, commercial or scientific experience.

In all other cases the withholding tax rate is 10%.

Example:
A Cyprus tax resident company receives royalty income on patents from a Ukrainian Company.

Royalty income when paid in Cyprus will be subject to 5% withholding tax in Ukraine. In Cyprus, under the recent amendment in the tax legislation, 80% of the royalty profit is considered as a deemed expense, hence only 20% of the royalty profit will be subject to 10% corporation tax in Cyprus. However, since the withholding tax paid in Ukraine can be used as a tax credit against the tax liabilities raised in Cyprus, no additional tax will be generated in Cyprus.

- **Director's fees**

Director's fees and other similar payments received by a resident of a contracting state in his capacity as a member of the board of directors of a company which is a resident of the other contracting state may be taxed in that other state.

Example:
A Ukrainian individual serves on the Board of Directors of a Cyprus tax resident company and receives director's fees.

Under the new Treaty, such director's fees may be subject to taxation in Cyprus and not in Ukraine.

- **Property rich companies**

The Treaty does not include in the definition of "Immovable Property" and does not make any reference in the "Capital Gains" article to any restrictions on the sale of shares of property rich companies. Under the new Treaty any profit from the sale of shares of property rich companies is taxed at the contracting state of the seller.

Example:
A Cyprus tax resident company holds the shares of a Ukrainian company which holds a significant number of immovable properties in Ukraine. The Cyprus company decides to sell the shares of the Ukrainian company to a prospective investor.

Under the new Treaty, the profit derived from the sale of the shares of the Ukrainian subsidiary will only be taxed in Cyprus. Under, Cyprus tax legislation, profit from sale of shares is exempt from any taxation.

- **Elimination of Double Taxation**

The Treaty also provides for the availability of tax credit, where a resident of a contracting state receives income in accordance with the provisions of this Treaty, which was taxed in the other contracting state. Any taxation paid abroad shall be allowed as a deduction from the tax payable in the other contracting state.

In order to be able to obtain such tax credits in Cyprus, the Cypriot Tax Authorities will need to receive the original tax receipts fully signed and stamped by the Ukrainian Tax Authorities, evidencing the amount of taxation paid abroad.

D. OTHER PROVISIONS OF THE NEW TREATY

- **Exchange of information**

The Treaty adopts an article for the exchange of information in accordance with Article 26 of the OECD model.

- **Place of effective management**

The Treaty defines the term "resident of a contacting state" according to the OECD model and provides that the place of effective management determines the residency of a company.

E. CONCLUSION

The Treaty allows Cyprus to remain one of the most beneficial routes to invest in Ukraine. It removes the uncertainty and controversy created by the applicability of the old treaty with the former USSR.

It is our belief that investments in Ukraine through Cyprus will continue to increase as operating in a stable tax environment is considered as vital for the correct evaluation and planning of future investments. This new Treaty in combination with the favourable tax and legal framework in Cyprus guarantees this required stability and promotes investment.

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Kinanis LLC continues the business of Kinanis & Co established in 1983. The firm started its operation as a traditional law firm. Experience and practice over the years brought forward the need for transformation from a traditional law firm to a more innovative multidisciplinary firm providing a full range of services combining law and accounting with the extensive expertise in corporate and tax advice to ensure that our clients will obtain the best possible spherical advice.

Our involvement and participation in international transactions over the years, have established our firm as one of the key players in the field.

The firm is staffed with over 80 young, energetic and ambitious professionals, including lawyers, accountants and administrators who provide prompt, efficient and high quality services and who are capable of meeting the current demanding challenges of the local and international business environment.

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