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Global Tax Alert

Cyprus expands treaty network as of 1 January 2021

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Executive summary

Cyprus' Double Tax Treaty network has been further expanded with two new tax treaties concluded with Egypt and Kazakhstan. In addition, a Protocol for amending the existing tax treaty with Russia is now effective.

This Alert summarizes the key provisions of the new tax treaties and the amending protocol which are in effect as of 1 January 2021.

Detailed discussion

Treaty with Egypt

The treaty with Egypt (the Treaty) provides for a 5% withholding tax on dividends if the beneficial owner of such dividend is a company (other than a partnership) which holds directly at least 20% of the capital of the company paying the dividends throughout a 365-day period that includes the day of the payment of the dividend. In all other cases, the withholding tax rate is 10% of the gross amount of the dividends paid, assuming the recipient is the beneficial owner of the dividends.

In the event that a foreign enterprise of one Contracting State has a permanent establishment (PE) in the other contracting/source state, the Treaty gives the right to the source state in which a PE exists to impose a 5% withholding tax on the profits remitted to the foreign head office of a PE.

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Moreover, the Treaty provides for a 10% withholding tax on the gross amount of royalties and interest paid provided that the recipient is the beneficial owner of such income.

In general, capital gains are taxable only in the Contracting State in which the alienator is resident, except for gains relating to immovable property and gains from the alienation of movable property of a PE for which the source jurisdiction maintains taxation rights.

However, capital gains arising to a resident of a Contracting State from the sale of shares or any other comparable interests in real estate rich companies (i.e., deriving more than 50% of their value, directly or indirectly, from immovable property), at any time during the 365 days preceding the sale, may also be taxed in the source state. Moreover, gains derived by a resident of a Contracting State from the sale of shares, comparable interests, securities or other rights (other than those mentioned above for real estate rich companies) of a company which is a resident of the other Contracting State may be taxed in that other Contracting State if the alienator, at any time during the 365 days preceding such sale, held directly or indirectly at least 20% of that company. The above provisions do not apply to the sale of shares listed on an approved stock exchange.

Article 28 of the Treaty includes a principal purpose test whereby a benefit under the Treaty shall not be granted in respect of an item of income or capital if it is reasonable to conclude, considering all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the objective and purpose of the relevant provisions of the Treaty.

The Treaty also includes an article on taxation of offshore activities in connection with the exploration or exploitation of the seabed and subsoil and their natural resources (including the installation and exploitation of pipelines and other installations under or above the surface of the sea) which overrides any other provisions of the Treaty. The inclusion of such article is very important for both countries given the recent discovery of significant oil and gas reserves in their respective exclusive economic zones.

The Treaty between Cyprus and Egypt is effective as from 1 January 2021 for both countries and replaces the Cyprus-Egypt Income Tax Treaty (1993).

Treaty with Kazakhstan

The treaty with Kazakhstan (the Treaty) provides for a 5% withholding tax on dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the capital of the dividend paying company. In all other cases, the withholding tax rate is 15% of the gross amount of the dividends paid.

In the event that a foreign enterprise of one Contracting State has a PE in the other contracting/source state, the Treaty gives the right to the source state in which a PE exists to impose a 5% withholding tax on the profits remitted to the foreign head office of a PE.

Moreover, the Treaty provides for a 10% withholding tax on the gross amount of the interest if the recipient is the beneficial owner such interest. However, if the beneficial owner of such interest is the Government or a political subdivision, a central or local authority, the Central Bank or any other financial institution wholly owned by the Government, no withholding tax should apply.

The Treaty also provides for a 10% withholding tax on the gross amount of royalties if the recipient is the beneficial owner of such royalties.

In general, capital gains are taxable only in the Contracting State in which the alienator is resident, except for gains relating to immovable property and gains from the alienation of movable property of a PE for which the source jurisdiction maintains taxation rights. However, capital gains arising to a resident of a Contracting State from the sale of shares (except shares listed on an approved stock exchange) or comparable interests in the capital of real estate rich companies (i.e., deriving more than 50% of their value, directly or indirectly, from immovable property) may also be taxed in the source state.

Article 29 of the Treaty includes a principal purpose test whereby a benefit under the Treaty shall not be granted in respect of an item of income if it is reasonable to conclude, considering all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the objective and purpose of the relevant provisions of the Treaty.

The Treaty also includes an article on taxation of offshore activities in connection with the exploration or exploitation of the seabed and subsoil and their natural resources (including the installation and exploitation of pipelines and other installations under or above the surface of the sea) which overrides any other provisions of the Treaty.

The Treaty between Cyprus and Kazakhstan is effective from 1 January 2021 for both countries. However, the provisions of Article 27 (Assistance in collection) shall not have effect until Cyprus confirms through diplomatic channels that it is able to provide such assistance under its domestic law.

For more information on the Treaty with Kazakhstan, see EY Global Tax Alert, *Cyprus-Kazakhstan double tax treaty enters into force*, dated 23 January 2020.

Protocol to existing treaty with Russia

The Protocol revises the provisions of Article 10 of the treaty with Russia (the Treaty) and provides that the standard/ordinary withholding tax rate on dividends is 15% (previously 10%) provided the recipient of the dividend income is the beneficial owner of such dividend. The withholding tax rate is reduced to 5% if the recipient is a resident of the other Contracting State and the beneficial owner of such dividends and is one of the following:

a) An insurance undertaking or a pension fund
b) A company whose shares are listed on a registered stock exchange provided that the recipient holds directly at least 15% of the capital of the dividend paying company for at least 365 days and at least 85% of the recipient's voting shares are in free float (i.e. publicly traded)
c) The Government or a political subdivision or a local authority
d) The Central Bank

Moreover, the Protocol revises the provisions of Article 11 of the Treaty and provides that the standard/ordinary on interest is 15% if the recipient is the beneficial owner of such interest (previously there was no withholding tax). However, the Protocol provides for reduced withholding tax rates as explained below.

There is no withholding tax on interest paid to a resident of the other Contracting State, who is the beneficial owner of the interest, if:

A) The beneficial owner is one of the following:
    i) An insurance undertaking or a pension fund
    ii) The Government of a Contracting State or a political subdivision or a local authority thereof
    iii) The Central Bank of that Contacting state
    iv) A bank

Or

B) The interest is paid in respect of government bonds, corporate bonds or Eurobonds, which are listed on a recognized stock exchange

Moreover, the withholding tax rate is reduced to 5% if the recipient is the beneficial owner of the interest and is a company resident of the other Contracting State whose shares are listed on a recognized stock exchange provided that the recipient holds directly at least 15% of the capital of the company paying the interest for at least 365 days and at least 85% of the recipient's voting shares are in free float (i.e. publicly traded).

The Protocol between Cyprus and Russia is effective as from 1 January 2021 for both countries.

Other developments

During 2020, Cyprus initialed an amending protocol to the treaty with Germany and signed an amending protocol to update the treaty with Switzerland. The amending protocol between Cyprus and Switzerland has not yet entered into force.

For additional information with respect to this Alert, please contact the following:

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