

Insights

Cyprus – Kazakhstan Double Tax Treaty

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Introduction

On 15th May Cyprus and Kazakhstan signed a treaty for the avoidance of double taxation (DTT) which was ratified by Cyprus on 24 May, 2019¹. Once the DTT enters into force, which requires conclusion of internal procedures in Cyprus and Kazakhstan to be completed, it will become effective on 1 January of the year following its entry into force. It is expected that it will be effective as and from 1 January, 2020.

The DTT is firmly based on the OECD Model Convention and thus as expected contains usual provisions as to exchange of information, mutual agreement procedure, as well as principal purpose test.

The purpose of this memo is to examine the main types of income under the DTT.

Dividends

Any dividends received by a resident of one contracting state (e.g. Cyprus) from a company in the other Contracting State (e.g. Kazakhstan) may be taxed in the first Contracting State. Under Cyprus Income Tax Law, dividends are exempted from corporate income tax. Further, where the dividends are paid to a tax resident Cyprus company by an non-resident company (say from a Kazakhstan company) then they will also be exempt from the Special Contribution for Defence levy (“**SCD Levy**”) PROVIDED that

- (i) 50% or more of the income of the dividend paying company is not derived from passive / investment income; and
- (ii) the tax liability of the dividend paying entity is not substantially lower than the Cyprus tax burden².

The DTT however provides that the Contracting State where the company paying the dividends is resident may tax the dividends which withholding tax will not exceed 5% where the recipient is the beneficial owner of the dividend. In other cases, the withholding tax is 10%.

The important element (in addition to establishing residence of the Cypriot company) is to determine if the Cypriot company is the beneficial owner. This is not defined in the DTT, so we have to examine the OECD commentary on the model convention. We can arrive at a number of conclusions from the commentary, viz.:

- the term “Beneficial Owner” should not be interpreted in a narrow technical sense;
- the recipient of the income must have the right to use and enjoy the dividends received and not be subject to an obligation to pass on the payment received;

¹ Published in Official Gazette on 24 May, 2019

² As a rule of thumb, the foreign tax burden should not be less than 6.25%.

- the recipient must not receive the payment as an agent, nominee or conduit company acting as a fiduciary or administrator.

With treaty relief, the tax exposure of a holding company structure based in Cyprus is 5%.

Interest

The basic principle is that interest arising in one Contracting State (e.g. Kazakhstan) and paid to a resident of the other Contracting State (e.g. Cyprus) may be taxed in that other Contracting State. The Contracting State where the interest arose may also impose a 10% withholding tax.

In Cyprus, interest income is exempt from corporate income tax, unless the interest is earned in the ordinary course of business or closely connected with the ordinary course of business. Where the interest is earned from the ordinary activities or closely connected with the ordinary activities of the Cyprus resident entity, then it is trading interest income and is taxed at the notional rate of 12.5%. If not, it is passive income, which is exempt from corporate income tax but subject to 30% SCD Levy.

The provisions of Article 11 of the DTT also have as a requirement to qualify for treaty relief that the recipient of the interest income is the beneficial owner. The analysis of the meaning of beneficial owner discussed above equally applies here.

Royalties

Again, the main principle is that where royalties are paid by a resident of a Contracting State, they may be taxed in that other State. The provisions of Article 12 of DTT provide that there may be a withholding in the paying Contracting State of 10%.

Royalties under the Cyprus Income Tax Law are subject to corporate income tax at the rate of 12.5%, unless the relevant intellectual property rights fall within the IP Box regime which is valid until 30 June 2021. If the IP is qualifying IP then effective tax rate can be reduced to 2.5% (from 12.5%). However, even if the IP cannot benefit from the IP Box regime the effective tax rate can be reduced to 2.5%, since under the DTT and Cyprus Income Tax Law, a credit will be allowed for the 10% withholding.

Capital Gains

In accordance with Article 13, the exclusive taxing rights with respect to the disposal of immovable property or shares deriving more than 50% of their value from immovable property in companies owing immovable property rests with the Contracting State where the property is located unless the disposal is of shares listed on an approved stock exchange.

Principal Purpose Test (PPT) and Substance

The DTT incorporates the OECD / G20 BEPS project Action 6 PPT, which is the minimum standard. The PPT provides that treaty benefits will not be enjoyed if obtaining the benefits

was one of the principal purposes of an arrangement or transaction. This measure is designed to prevent or restrict treaty shopping and also to ensure operations are supported by real substance and commercial rationale.

The issue of substance is of paramount importance as its relevance to determining tax residency, a requirement for claiming DTT benefits, grows in importance.

Conclusion

The Cyprus – Kazakhstan treaty offers many opportunities to efficiently and effectively structure holding groups through Cyprus.

This memo serves as a guide only to the provisions of the DTT and should not be considered legal or tax advice. For specific legal and tax advice please contact us as per the below.

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