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Following the visit of Russian President Medvedev to Cyprus and the signing of the Protocol to the double taxation agreement on behalf of the governments of both countries, it is expected that the amended treaty will be ratified by the Parliaments of the two countries and will become effective from 1 January 2011.

The new agreement retains the highly favourable tax provisions between the two countries and will strengthen Cyprus's position as the portal of choice for both inbound and outbound investment between the Russian Federation and the rest of the world.

Commenting on the signing of the Protocol, President Medvedev stated that, "Cyprus is perceived by our businessmen as a very convenient platform to make investments. The amendments to the agreement on avoiding double taxation that have just been signed are aimed at making this area more predictable, transparent and understandable for the authorities regulating it."

The amendments introduced by the Protocol extend the information exchange arrangements between the two countries' respective tax authorities in line with the OECD Model Tax Convention, and include strong safeguards to protect taxpayers.

The Protocol also aligns the taxation of capital gains with the basis set out in the OECD Model Tax Convention. Under the new rules taxation of the capital gains derived on the sale of shares in a property rich company will be vested in the country where the property is located. It is normal to give the right to tax capital gains on immovable property to the state which is entitled under the double taxation convention to tax both the property and the income derived from it, and the Protocol follows this principle. It provides that gains derived by a resident of one contracting state from the disposal of shares deriving more than 50% of their value from immovable property situated in the other contracting state may be taxed in that other state. The exclusive taxing right will remain with the country of residence of the seller if the disposal qualifies as a corporate reorganization, or if the shares are listed on a recognised stock exchange or the seller is a pension fund, provident fund or the government of either country

It is good to note that Russia and Cyprus did not broaden the scope of the amendment (as some other states have done in their bilateral conventions) so that the source taxation of capital gains would also extend to gains from the alienation of interests in other entities that do not issue shares, such as partnerships and trusts. In this respect it remains to be seen whether Russian limited liability companies will be caught by the new rule.

The Protocol provides for a grace period of at least four years as regards the new arrangements regarding taxation of capital gains. The relevant amended article will not become effective until the first day of the calendar year following four years after the protocol as a whole takes effect. This will be 1 January 2015 at the earliest, giving time to consider and implement measures to mitigate any negative impact of the change. If you believe that this change may affect your interests, please get in touch with your usual contact at Andreas Neocleous & Co and we shall be pleased to advise you.

The Protocol clarifies the definition of dividends, regarding which there had previously been some uncertainty. Distributions from mutual funds and similar collective investment vehicles (other than those primarily investing in immovable property) will be subject to the normal withholding tax rates applying to dividends. Distributions from shares held in the form of Depositary Receipts will also be taxed as dividends.

The definition of interest has been aligned with the OECD definition and includes income from debt-claims of every kind.

One of the most important aspects of the Protocol is that there is no change to the extremely favourable withholding tax rates applying to cross-border payments of dividend, interest and royalties. Furthermore, the Russian Federation has undertaken that, by the time the new provisions regarding taxation of capital gains come into force, it will have adopted the OECD Model Tax Convention provision for capital gains in its tax treaties with all states which are significant investors in the Russian Federation.

During his visit, undoubtedly the year's most important visit of a foreign dignitary to Cyprus, President Medvedev signed a further 15 bilateral agreements, covering issues including tourism, commerce, health and security, and addressed a Cyprus - Russia Business Forum.

President Medvedev's visit marks an even closer alignment in economic and trade relations between the Russian Federation and Cyprus as the Joint Declaration signed by the two countries' Presidents in November 2008 has now been developed into a Three-Year Action Plan aimed at increasing cooperation between the two countries at all levels. Indeed, it has been suggested that Cyprus may evolve into a capital intermediation centre for the region, including Africa and the Middle East, just as Singapore has done in Asia.

The Russian authorities are expected to announce the removal of Cyprus from any Russian tax "blacklists" with effect from the date the Protocol takes effect, most likely 1 January 2011, making dividends received by Russian shareholders from eligible equity participations in subsidiaries in Cyprus eligible for the Russian participation exemption.