Corporate Tax - Cyprus

New double tax agreement between Cyprus and Switzerland

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On July 25 2014 Switzerland and Cyprus signed a new agreement for the avoidance of double taxation. It is the first double tax agreement between the two countries and will contribute to the development of bilateral economic relations. The agreement will come into force once it has been ratified by both countries.

The new agreement closely follows the 2010 Organisation for Economic Cooperation and Development (OECD) Model Convention, with only minor modifications, and the protocol to the agreement clarifies certain detailed provisions.

Taxes covered

The agreement covers all taxes on income and wealth levied by a contracting state or by any of its subdivisions or local authorities, including taxes on capital appreciation and on gains from the alienation of property. Income taxed at source and lottery winnings are excluded from the scope of the agreement.

Income from immovable property

As in the OECD Model Convention, income from immovable property may be taxed in the contracting state where the property is situated.

Business profits

Business profits are taxable only in the contracting state in which the taxpayer is resident, unless it carries on business in the other contracting state through a permanent establishment there, in which case the profit attributable to the permanent establishment may be taxed in the contracting state in which it is located.

International shipping and transport

Business profits from the operation of ships or aircraft (including income from containers, trailers and related equipment) in international traffic are taxable only in the contracting state in which the enterprise is resident. While the OECD Model Convention grants taxation rights to the state in which the effective management of the enterprise is located, in practice the outcome is the same, since residence is defined by the location of management and control.

Dividends

Cyprus does not impose withholding taxes on dividends paid to non-residents. In Switzerland, dividends paid to non-resident shareholders are generally subject to withholding tax at a rate of 35%.

The double tax agreement exempts dividends paid by a company resident in one contracting state to a resident of the other from withholding taxes in the contracting state from which they originate, as long as the beneficial owner of the dividend is a company (but not a partnership) resident in the second contracting state that has held at least 10% of the capital of the company paying the dividend for at least a year without interruption. Article 2 of the protocol makes clear that the shares need not have been held for a year before the dividend is paid, but that the minimum holding period may be completed after the payment of the dividend.

Dividends paid to pension funds or to government bodies (including a central bank) in the other contracting state are also exempt. Otherwise, the dividend may be taxed at up to 15%.

Interest and royalties

Interest and royalties are taxable only in the country in which the recipient is resident, provided that the recipient is the beneficial owner.

Cyprus-resident natural persons who receive interest from Switzerland will be subject to a lower tax charge by disclosing the interest and opting for taxation in Cyprus, rather than imposition of withholding tax in Switzerland under the taxation of savings income agreement between Switzerland and the European Union. In any event, the current renegotiation of the taxation of savings income agreement is expected to result in automatic information exchange.

Capital gains

Gains derived by a resident of one contracting state from the alienation of immovable property situated in the other contracting state, or from the disposal of property associated with a permanent establishment situated in the other contracting state, may be taxed in the contracting state in which the immovable property or the permanent establishment is situated.

Gains from the disposal of ships and aircraft used for international traffic are taxable only in the disponor's country of residence.

Gains made by a resident of one contracting state from the disposal of shares that directly or indirectly derive more than 50% of their value from immovable property situated in the other contracting state may be taxed in that other state, with the following exemptions:

- shares listed on a stock exchange established in either contracting state or agreed upon by the competent authorities of the contracting states;
- shares of a company the majority of whose assets comprise real estate used for its normal business activities; and
- disposals in the course of a reorganisation, merger, demerger of companies or similar transaction. Article 3 of the protocol provides that the entities concerned must be members of the same group in order to qualify.

Gains derived from the disposal of all other property are taxable only in the contracting state in which the disponor is resident.

Offshore activities

Like other recent Cyprus double tax agreements, the Cyprus-Switzerland agreement includes an article dealing specifically with offshore activities. It provides that a Swiss-resident enterprise undertaking activities on the continental shelf of Cyprus will be treated as conducting a trade or business in Cyprus through a permanent establishment in respect of the activities concerned, unless the aggregate duration of the activities is no more than 30 days in any 12-month period. Associated companies are treated as one for the purpose of assessing the duration of their activities.

Taxes on capital

Capital represented by immovable property owned by a resident of one contracting state and situated in the other may be taxed in the state in which the property is located. The same applies to movable property forming part of the assets of a permanent establishment which an enterprise of one contracting state has in the other contracting state, or of a fixed base for the performance of independent personal services.

All other elements of capital of a resident of a contracting state are taxable only in the state of residence.

Exchange of information

The exchange of information article reproduces Article 26 of the OECD Model Convention verbatim, and adds a proviso allowing information received by a contracting state to be used for wider purposes than the determination of tax liabilities if this is allowed under the laws of both states and the competent authority of the state that supplied the information authorises such wider use.

However, the protocol to the agreement provides robust safeguards against abuse of the information exchange provision by requiring the contracting state that requests information to fulfil specified procedures to demonstrate the foreseeable relevance of the information to the request. No request is to be submitted unless the state making the request has exhausted all reasonable means available in its own territory to obtain the information, and every request must be accompanied by detailed information to justify it.

The protocol also makes clear that:

- information requested must be foreseeably relevant;
- 'fishing expeditions' are not permitted; and
- neither state is obliged to provide information spontaneously or automatically - all information exchange is to take place on a mutual and equitable basis.

These provisions are in line with the robust safeguards against abuse of the information exchange provisions contained in Cyprus's Assessment and Collection of Taxes Law. Requests for the exchange of information are dealt with by a specialist unit and informal exchange of information between tax officers bypassing the competent authority is prohibited. When making a request, a detailed case must be made, with the criteria set out in a formal, reasoned document. In effect, this means that the authorities requesting the information must already have a strong case before they request the information, and it will not be possible to undertake fishing expeditions without first gathering significant evidence. As a final safeguard, the written consent of the attorney general must be obtained before any information is released to an overseas tax authority.

Entry into force and termination

The agreement will enter into force when the two governments inform one another that the requisite constitutional procedures have been completed.

Termination of the agreement will require written notice by either contracting state at least six months before the end of any calendar year, whereupon the agreement will cease to have effect from the beginning of the following year.

Anti-abuse

The protocol introduces an anti-abuse provision, to the effect that the agreement will not apply in cases of abuse and that, in the event that a contracting state intends to refuse the benefits of the agreement on grounds of abuse, it may consult the competent authority of the other contracting state.

Comment

As well as being one of the world's most important financial centres, Switzerland is the base for many ultra-high net worth individuals with business and personal interests in Cyprus. The new double tax agreement will be a valuable addition to Cyprus's extensive treaty network and it is hoped that the remaining steps required to bring it into effect will be completed soon.

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