

Global Tax Weekly - A Closer Look, The New Double Taxation Agreement Between Cyprus And Switzerland, (Aug. 28, 2014)

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Introduction

On July 25, 2014, Switzerland and Cyprus signed a new agreement for the avoidance of double taxation (DTA) with respect to taxes on income and capital. It is the first DTA 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 OECD Model Convention, with only minor modifications, and the Protocol to the agreement clarifies certain detailed provisions. The key features of the DTA and Protocol are set out in the following paragraphs.

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 movable or immovable property. The specific taxes to which it applies are, in the case of Cyprus:

- Income tax;
- Corporate income tax;
- Special Contribution for Defense (commonly referred to as SDC tax);
- Capital gains tax; and
- Immovable property tax.

The Swiss taxes covered by the agreement are federal, cantonal and community taxes on income of all forms, including total income, income from work, income from investments, profits, capital gains and other income, and all forms of taxes on wealth.

The agreement will also apply to any identical or substantially similar taxes that are imposed in the future in addition to, or in place of, the existing taxes.

Income taxed at source and lottery winnings are excluded from the scope of the agreement.

Residence

Article 4 of the DTA reproduces the provisions of the OECD Model regarding residence *verbatim*.

Permanent Establishment

Article 5 of the DTA, which deals with permanent establishment, also reproduces the provisions of the OECD Model *verbatim*, with the same list of ancillary activities that *prima facie* do not give rise to a permanent establishment as appears in the OECD Model, including storage and display of goods, maintenance of stocks for processing by a third party, a purchasing or information-gathering facility, or a facility for preparatory or auxiliary purposes.

A building site, a construction, assembly or installation project, or a supervisory or consultancy activity connected with it, will be deemed to be a permanent establishment if it lasts for more than 12 months.

If an enterprise has a representative in a contracting state, which has, and habitually exercises, authority to conclude contracts in the name of the enterprise, the enterprise concerned is deemed to have a permanent establishment in respect of any activities that the person undertakes for the enterprise. As in the OECD Model, the DTA provides that an independent broker or agent that represents the enterprise in the ordinary course of business will not be caught by this provision. Particular care needs to be taken regarding the issuing of general powers of attorney so as not to risk unintentionally creating a permanent establishment, with potential adverse consequences.

Income From Immovable Property

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

Business Profits

The profits of an enterprise are taxable only in the contracting state in which it 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.

The agreement follows the OECD Model as regards the apportionment of profits to permanent establishments.

International Shipping And Transport

Profits of an enterprise 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 gives taxing 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.

Associated Enterprises

Article 9 of the OECD Model provides that if one contracting state adjusts the profits of an associated enterprise for tax purposes, the other contracting state should make a reciprocal adjustment. The corresponding article of the DTA provides that the adjustment should be made if it is considered appropriate in principle, taking account of the amount.

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 percent.

The DTA 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 percent of the capital of the company paying the dividend for at least a year without interruption. Article 2 of the Protocol to the agreement 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 percent.

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 receiving interest income 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 EU. 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 immovable or movable 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 country of residence of the donor.

Gains made by a resident of one contracting state from the disposal of shares that directly or indirectly derive more than 50 percent of their value from immovable property situated in the other contracting state may be taxed in that other contracting 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 the assets of which comprise real estate used by the company for its normal business activities; or
- Disposals in the course of a reorganization, 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 donor is resident.

Offshore Activities

Like other recent Cyprus DTAs, 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 exercising a trade or business in Cyprus through a permanent establishment in Cyprus 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.

Maritime or air transport, towing, mooring, refueling and similar activities do not fall within the scope of activities on the continental shelf of Cyprus.

A resident of Switzerland providing professional services or other services of an independent character on the continental shelf of Cyprus is considered to be performing those activities from a fixed base situated in Cyprus if the activities on the continental shelf are performed for a continuous period of at least 30 days in any 12-month period.

Salaries, wages and other similar remuneration derived by a resident of Switzerland in respect of employment on the continental shelf of Cyprus exercised through a permanent establishment or a fixed base situated in Cyprus are taxed in Cyprus, since the employment is exercised on Cyprus's continental shelf and supported by the permanent establishment or fixed base.

Taxes On Capital

Capital represented by immovable property owned by a resident of one contracting state and situated in the other contracting state 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.

Elimination Of Double Taxation

Where a resident of Switzerland derives income or owns capital which may be taxed in Cyprus, Switzerland will exempt such income or capital. However, in calculating the amount of tax on the remaining income or capital of that resident, the Swiss tax authorities may use the rate that would apply if the income or assets in question were not exempt. The exemption for gains on shares in "property-rich" companies is restricted to the gain effectively taxed in Cyprus.

A Swiss-resident company receiving dividends from a Cyprus-resident company is entitled to the same advantages for Swiss tax purposes as if the company paying the dividends were a resident of Switzerland.

Relief for Swiss taxes paid will be given against Cyprus tax by the credit method. The relief cannot exceed the Cyprus tax payable on the relevant income or capital.

Mutual Agreement Procedure

The DTA reproduces the corresponding provisions of the OECD Model, except that it does not include any arbitration procedure to settle issues that cannot otherwise be resolved. Article 5 of the Protocol to the DTA provides for the automatic introduction of an arbitration procedure in the event that Cyprus introduces an arbitration clause in an agreement or convention concluded with a third state at some future time.

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 authorizes such wider use.

However, the Protocol to the DTA provides robust safeguards against abuse of the information exchange provisions by requiring the contracting state that requests information to fulfill 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 the following:

- The identity of the person under examination or investigation;
- The period covered by the request;
- A statement of the information sought, including its nature and the form in which the requesting contracting state wishes to receive the information;
- The tax purpose for which the information is sought;
- To the extent known, the name and address of any person believed to be in possession of the requested information.

The Protocol also makes clear that the information requested must be foreseeably relevant, and that "fishing expeditions" are not permitted, and that neither state is obliged to provide information spontaneously or automatically: all information exchange is to take place on a mutual and equitable basis.

In effect, this means that the authorities requesting the information must already have a *prima facie* case even before they request the information, and must make a reasoned request for disclosure.

These provisions are in line with the robust safeguards against abuse of exchange of information provisions contained in Cyprus's Assessment and Collection of Taxes Law. Requests for exchange of information are dealt with by a specialist unit and informal exchange of information between tax officers bypassing the competent authority is prohibited. A request must be much more than a brief email containing the name and identifying information of the individual concerned. Rather, 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. As a final safeguard, the written consent of the Attorney General must be obtained before any information is released to an overseas tax authority.

Assistance In The Collection Of Taxes

The DTA does not include any provisions regarding assistance in the collection of taxes.

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. Its provisions will have effect in both contracting states from the beginning of the following year.

Termination of the agreement will require written notice by either contracting state given 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

As well as the detailed clarifications to various provisions of the agreement outlined in earlier paragraphs, the Protocol introduces an anti-abuse provision, to the effect that the DTA will not apply in cases of abuse and that, in the event that a contracting state intends to refuse the benefits of the DTA on grounds of abuse, it may consult the competent authority of the other contracting state.

Conclusion

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