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## a closer look

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**SUBJECTS** TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

**SECTORS** MANUFACTURING RETAIL/WHOLESALE INSURANCE BANKS/FINANCIAL INSTITUTIONS RESTAURANTS/FOOD SERVICE CONSTRUCTION AEROSPACE ENERGY AUTOMOTIVE MINING AND MINERALS ENTERTAINMENT AND MEDIA OIL AND GAS

**COUNTRIES AND REGIONS** EUROPE AUSTRIA BELGIUM BULGARIA CYPRUS CZECH REPUBLIC DENMARK ESTONIA FINLAND FRANCE GERMANY GREECE HUNGARY IRELAND ITALY LATVIA LITHUANIA LUXEMBOURG MALTA NETHERLANDS POLAND PORTUGAL ROMANIA SLOVAKIA SLOVENIA SPAIN SWEDEN SWITZERLAND UNITED KINGDOM EMERGING MARKETS ARGENTINA BRAZIL CHILE CHINA INDIA ISRAEL MEXICO RUSSIA SOUTH AFRICA SOUTH KOREA TAIWAN VIETNAM CENTRAL AND EASTERN EUROPE ARMENIA AZERBAIJAN BOSNIA CROATIA FAROE ISLANDS GEORGIA KAZAKHSTAN MONTENEGRO NORWAY SERBIA TURKEY UKRAINE UZBEKISTAN ASIA-PAC AUSTRALIA BANGLADESH BRUNEI HONG KONG INDONESIA JAPAN MALAYSIA NEW ZEALAND PAKISTAN PHILIPPINES SINGAPORE THAILAND AMERICAS BOLIVIA CANADA COLOMBIA COSTA RICA ECUADOR EL SALVADOR GUATEMALA PANAMA PERU PUERTO RICO URUGUAY UNITED STATES VENEZUELA MIDDLE EAST ALGERIA BAHRAIN BOTSWANA DUBAI EGYPT ETHIOPIA EQUATORIAL GUINEA IRAQ KUWAIT MOROCCO NIGERIA OMAN QATAR SAUDI ARABIA TUNISIA LOW-TAX JURISDICTIONS ANDORRA ARUBA BAHAMAS BARBADOS BELIZE BERMUDA BRITISH VIRGIN ISLANDS CAYMAN ISLANDS COOK ISLANDS CURACAO GIBRALTAR GUERNSEY ISLE OF MAN JERSEY LABUAN LIECHTENSTEIN MAURITIUS MONACO TURKS AND CAICOS ISLANDS VANUATU

## The New Double Tax Agreement Between Cyprus And Latvia

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### Introduction

On May 24, 2016, after almost ten years of negotiations, Cyprus and Latvia signed a new double taxation agreement (DTA). Unlike many former members of the Soviet Union, Latvia did not adopt the 1982 Cyprus–USSR DTA when it became independent, and the new agreement is the first between the two countries. It closely follows the latest OECD Model Convention but also includes provisions from the 2011 United Nations Model Double Taxation Convention between Developed and Developing Countries. The key features of the DTA are as follows.

### Taxes Covered

The agreement applies to taxes on income imposed by either country, including taxes on gains from the alienation of movable or immovable property. In Latvia these are currently the enterprise income tax and personal income tax; in Cyprus they are income tax, corporate income tax, special contribution for defence (known as SDC tax), and capital gains tax.

### Residence

The "tie-break" provisions for determining residence for individuals who are resident in both countries are the same as in the OECD Model Convention, namely permanent home and center of vital interests, country of habitual residence and nationality, in descending order. If none of these criteria is decisive, residence is to be settled by mutual agreement between the two countries' tax authorities.

For legal persons, residence is to be determined by mutual agreement. The two countries apply different principles in determining tax residence of corporations. The Latvian authorities consider

a company to be resident in Latvia if it is incorporated there (and non-resident otherwise); the Cyprus authorities base residence on the locus of management and control.

### **Permanent Establishment**

Article 5 of the DTA, which defines a permanent establishment, is almost identical to the corresponding article of the OECD Model Convention, except that a building site or construction or installation project will constitute a permanent establishment if it lasts more than nine months, rather than the 12 months required by the OECD model.

### **Income From Immovable Property**

Income derived by a resident of a contracting state from immovable property situated in the other may be taxed in the state in which the property is located.

### **Business Profits**

The article of the agreement dealing with business profits reproduces the corresponding article of the OECD Model almost verbatim, with profits (apart from profits of a permanent establishment in the other contracting state) being taxable only in the contracting state in which the enterprise is resident.

### **Shipping And Aviation**

Profits from the operation of ships or aircraft in international traffic are taxable only in the contracting state in which the enterprise concerned is resident.

### **Dividends, Interest And Royalties**

Dividends, interest and royalties paid by a company resident in one contracting state to a resident of the other are subject to zero tax in the contracting state from which they originate as long as the beneficial owner of the dividend, interest or royalty (as the case may be) is a company (but not a partnership) resident in the second contracting state. If this is not the case, tax payable in the first contracting state is limited to 10 percent of the gross amount in the case of dividends and interest, and 5 percent of the gross amount in the case of royalties.

Since Cyprus does not impose withholding taxes on interest and dividends, and Latvia imposes them only on dividends and interest paid to residents of countries on its tax blacklist, the

provisions are somewhat academic, particularly since the EU Interest and Royalties Directive and the Parent Subsidiary Directive both apply.

## **Capital Gains**

Gains derived by a resident of one contracting state from the alienation of immovable property situated in the other may be taxed in the contracting state in which the property is situated. Gains on disposal of shares or similar interests in a company or other entity deriving more than 50 percent of its value from immovable property may also be taxed in the contracting state in which the immovable property is situated. Gains arising from the disposal of immovable or movable property associated with a permanent establishment, or from the disposal of movable property used in connection with the performance of independent personal services, may be taxed in the contracting state in which the permanent establishment is located or the services are performed.

Gains derived from the alienation of all other property (including ships or aircraft operated in international traffic) are taxable only in the contracting state in which the alienator is resident.

## **Offshore Activities**

Like several of Cyprus's recent DTAs, the agreement with Latvia includes comprehensive provisions regulating the taxation of offshore hydrocarbon exploration and exploitation activities, intended to ensure that each state's taxation rights in respect of offshore activities are preserved in circumstances where they might otherwise be limited by other provisions of the agreement. Special rules are required because of the short duration of some of these activities.

An enterprise of one contracting state carrying on offshore exploration or exploitation activities in the other is deemed to be carrying on business through a permanent establishment if the activities are carried out for an aggregate of 30 days or more in any 12 months. The article dealing with offshore activities also includes rules for determining when the 30-day threshold is exceeded in respect of offshore activities undertaken by associated enterprises. This provision overrides the articles regarding permanent establishment and business profits. Similarly, the normal provisions regarding income from employment are modified to the effect that remuneration derived by a resident of one contracting state employed in offshore activities in the other may be taxed in the second state. Gains derived by a resident of a contracting state from the alienation of assets (either tangible or intangible) relating to exploration or exploitation activities in the second contracting state or its exclusive economic zone may be taxed in the second state.

## **Elimination Of Double Taxation**

Elimination of double taxation is by the credit method. The credit against tax in the country of residence is limited to the amount of tax that would be payable on the income concerned in the country of residence.

## **Exchange Of Information**

Article 26 of the DTA 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. The protocol contained in several of Cyprus's recent agreements setting out the material required to support a request for information and the procedures to be followed in order to demonstrate the foreseeable relevance of the request for information is not included. However, Cyprus's Assessment and Collection of Taxes Law provides Cyprus residents with identical safeguards.

## **Entry Into Force And Termination**

The DTA will enter into force as soon as each country has notified the other through diplomatic channels that the relevant constitutional procedures have been completed. Its provisions will have effect in both countries from the beginning of the following year.

The DTA will remain in force until terminated. Either country may terminate it by giving written notice of termination at least six months before the end of any calendar year through diplomatic channels. The DTA will cease to have effect from the beginning of the following year.

## **Conclusion**

The new agreement is a further valuable extension of Cyprus's network of DTAs. Latvia is a relatively small country, but it has a growing economy and opportunities for inward investment. It is therefore to be hoped that the remaining steps required to bring the agreement into effect can be achieved quickly. In the meantime, the Cyprus tax authorities will doubtless follow their normal practice of allowing unilateral relief for taxes paid overseas.