

## CYPRUS and NETHERLANDS

### Cyprus and Netherlands: Relative merits of Cyprus and the Netherlands for Ukrainian investment structures – an alternative view

The authors of the article titled “Tax Planning in Ukraine” in the January 30, 2014 edition of *Tax Planning International European Tax Service* make clear that their article “focuses on the benefits of switching from Cyprus to the Netherlands in international investment structures” following the recent changes to the Cyprus-Ukraine double taxation agreement. The article concentrates on only two aspects of the Cyprus-Ukraine double taxation agreement, namely withholding tax rates and exchange of information provisions and, in their zeal to convince readers of their thesis, the authors may have narrowed their focus too far. In the following paragraphs we respectfully put forward a number of other considerations that are likely to be relevant, and that should be taken into account in order to present a balanced picture and arrive at the most appropriate recommendation for the taxpayer.

After alluding to the new information exchange procedures in the Cyprus-Ukraine agreement the authors state that the new agreement “decreased the attractiveness of Cyprus”. It would be ironic, to say the very least, if the authors were to promote the Netherlands, which a year ago was leading the calls for increased transparency on the part of Cyprus, on the grounds that Cyprus is excessively transparent, and I am sure that this cannot be what they intended. In any event, the Ukraine-Netherlands agreement contains generic information exchange provisions which are not greatly different from those in the main body of the Cyprus-Ukraine agreement.

It should be noted, however, that the Protocol to the Cyprus-Ukraine agreement provides taxpayers with robust safeguards against abuse of the information exchange provisions (such as “fishing expeditions”) by the authorities. These are described comprehensively in the article by the author and Phillipos Aristotelous (*supra*) and are not repeated here.

The new agreement between Cyprus and Ukraine allows for withholding taxes in Ukraine of no more than 2 percent on interest and 10 per cent (not 5 percent, as the article states) on royalties. Withholding taxes on dividends are limited to 5 percent provided that the investment in the Ukrainian company paying the dividends is beneficially owned and represents 20 percent or more of the equity or amounts to more than EUR 100,000. These rates are undoubtedly higher than under the USSR – Cyprus agreement that the new agreement replaced. However, that is only part of the story. For a start, the Cyprus company receiving interest or royalties will be able to offset the withholding tax paid against its final tax liability, so for these categories of income the change in rates has no effect on the overall tax burden. Furthermore, as the corporate income tax rate is much higher in the Netherlands than in Cyprus, taxation on royalties and interest in the Netherlands that are not eligible for any special tax regime will be considerably higher in the Netherlands, making for a higher tax burden overall.

As regards dividends, the Ukraine-Netherlands double tax agreement provides for the same withholding tax rates and investment percentages as the Cyprus-Ukraine agreement, except for companies where a majority of shares is held and the investment exceeds USD 300,000. In effect, then, the benefit of the Ukraine-Netherlands DTA is a saving of 5 percent withholding tax on dividends received from companies in which a majority stake costing USD 300,000 or more is held. In some cases this will be a worthwhile saving, but in many others it will be insignificant compared with the additional costs and tax burdens that the article omits to mention.

One of the clearest differences between the Cyprus-Ukraine double taxation agreement and most of Ukraine’s other agreements (including that with the Netherlands) relates to the taxation of capital gains on the disposal of shares in so-called “property-rich” companies. Under the Cyprus-USSR agreement, which applied before the new agreement between Cyprus and Ukraine took effect, movable property, including shares, is taxable only in the country of residence of the owner. Since Cyprus imposes no tax on gains on disposals of shares except and to the extent that the gain is derived from real estate in Cyprus, Cyprus structures have become an ideal means of holding real estate in Ukraine, effectively allowing property to be disposed free of capital gains tax by selling the shares in the Ukrainian company that owns the property rather than the property itself. This benefit continues in the new Cyprus-Ukraine agreement.

By contrast, the Ukraine-Netherlands agreement provides that gains on the disposal of shares in property-rich companies may be taxed in the contracting state in which the property is located. For most real-estate companies this consideration will far outweigh any difference in withholding taxes on dividends.

As noted earlier, Cyprus’s corporate income tax rate of 12.5 percent is much lower than the rate in the Netherlands (20 percent on the first EUR 200,000 and 25 percent above that). Costs of establishment and doing business are also generally much lower in Cyprus than in the Netherlands.

Selection of the most beneficial investment location is a complex matter, involving a host of considerations. It is very rarely that these will all point in the same direction, and it then becomes a matter of weighing the competing factors. In order to achieve a balanced view, and the best outcome for the client, the adviser must consider all the factors, and not merely a restricted range.

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**VOLUME 16, NUMBER 2 >>> FEBRUARY 2014**

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