Corporate Tax - Cyprus

New double taxation agreement between Cyprus and Germany

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Introduction

After lengthy negotiations, Cyprus and Germany have signed a new double tax agreement which, when ratified, will replace the existing 1974 agreement.

Most of the changes brought about by the new agreement merely reflect changes to the Organisation for Economic Cooperation and Development (OECD) Model Tax Convention (eg, there is no longer an article covering personal services), or update definitions (eg, the 1974 agreement referred only to income tax in Cyprus, whereas the new agreement specifies all of the taxes covered). However, a number of the changes are more substantive.

Permanent establishment

Article 5(3) of the new agreement extends the definition of 'a construction or installation project' to include supervisory activities, but no permanent establishment arises until after 12 months of activity. (Under the 1974 agreement, a permanent establishment arose after six months.)

Article 5(5) provides that the exercise of activities on behalf of an enterprise by a representative other than an independent agent may create a permanent establishment, even though there is no fixed place of business.

Shipping, inland waterways transport and air transport

Article 8 has been updated to reflect the current OECD wording, which includes inland waterways transport (the 1974 agreement referred only to shipping and air transport). As Cyprus has no navigable inland waterways, this is unlikely to be material in practice.

More significant is the removal of Article 8(3) of the 1974 agreement, which allowed Germany to tax the profits of Cyprus resident companies or partnerships engaged in international shipping with greater than 25% foreign ownership in certain circumstances.

The protocol to the new agreement makes clear that the profits of third-party ship management companies (ie, enterprises which perform the various tasks of operating a ship for shipping enterprises, such as crewing, technical and commercial management) are included within the definition of 'profits from the operation of ships' for the purposes of Article 8.

Associated enterprises

In line with the latest OECD Model Convention, Article 9 includes a provision stating that where taxable profits in one country are increased to bring them onto an arm's length basis, a corresponding downward adjustment must be made in the other country.

Dividends

The maximum tax charge in the country of residence of the paying company is 5%, provided that the recipient is the direct beneficial owner of 10% of the paying company's capital. For holdings below the 10%

threshold, the maximum rate is 15%. Under the 1974 agreement, the maximum rate was 10% and the minimum holding threshold was 25%. Furthermore, no tax will be imposed on dividends paid where a company resident in one contracting state derives income or profit from the other contracting state, unless the dividends or the holding in respect of which they are paid are connected with a permanent establishment in that other contracting state.

Interest

Interest arising in one country which is beneficially owned by a resident of the other country is taxable only in the country of residence of the recipient. The 1974 agreement provided that tax of up to 10% could be imposed by the country in which the interest arose. Penalty charges for late payment are not regarded as interest for the purposes of the new agreement.

Royalties

Royalties arising in one country which are beneficially owned by a resident of the other country are taxable only in the country of residence of the recipient, unless the recipient has a permanent establishment in the other country and the royalties are derived from that permanent establishment.

The term 'royalties' includes any kind of payment for the use or the right to use a person's name, picture or any other similar personality rights, and payments received as consideration for the registration of entertainers' or sportspersons' performances by broadcasting media.

Business profits for partnerships

Article 7 of the new agreement provides that in the case of partnerships, business profits include the remuneration received by a partner from the partnership for activities in the service of the partnership and for the granting of loans or the provision of assets.

Capital gains

In line with the current OECD Model Convention, Article 13 includes a provision stating that gains from the disposal of shares or similar rights in companies which derive more than 50% of their value directly or indirectly from immovable property may be taxed in the country in which the property is situated. Similarly, gains from disposal of ships and aircraft are taxable in the country in which the place of effective management is situated.

Elimination of double taxation

The 1974 agreement included a complicated mix of methods to eliminate double tax, but in the new agreement double tax is eliminated by the credit method in both countries.

Exchange of information

Article 25 of the new agreement goes a little further than the corresponding article of the current OECD Model Convention by allowing the use of information gathered for purposes outside the normal scope if both countries' laws permit it. Otherwise, it mirrors the OECD text. The protocol to the new agreement provides safeguards for taxpayers, requiring personal data to be appropriately protected and irrelevant data to be removed, and holding the authorities liable for any unlawful damage resulting from the exchange of information.

Definition of 'place of effective management'

The protocol to the new agreement defines 'the place of effective management' - a term of increased importance in the context of all OECD model-based treaties - as "the place where the key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made". This is in line with the current commentary on the OECD Model Tax Convention.

Procedural rules for taxation at source

The new agreement includes a new Article 26 regarding the imposition of tax at source and setting out provisions for the relevant amounts to be refunded.

Entry into force and effective date

The new agreement will enter into force when ratified by both countries and will take effect from the following January 1, on which date the 1974 agreement will cease to apply.

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