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# GLOBAL TAX WEEKLY
## 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

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## a closer look

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Using the unrivalled worldwide multi-lingual research capabilities of leading law and tax publisher Wolters Kluwer and its new acquisition BSI (The Lowtax Network), CCH publishes Global Tax Weekly — A Closer Look (GTW) as an indispensable up-to-the-minute guide to today's shifting tax landscape for all tax practitioners and international finance executives.

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## FEATURED ARTICLES



## NEWS ROUND-UP

# A Preview Of The New Cyprus-Latvia Double Taxation Agreement

by Philippos Aristotelous and Stavros Supashis, Andreas Neocleous & Co LLC, Cyprus

The draft double taxation agreement between Cyprus and Latvia has been published by the Latvian authorities, allowing practitioners a "sneak preview" of its provisions. The draft agreement requires the approval of the Latvian Cabinet of Ministers before signature. After signature it will need to be ratified by both countries before taking effect.

The agreement closely follows the form of the latest OECD Model Convention but also includes provisions from the 2011 United Nations Model Double Taxation Convention between Developed and Developing Countries (the UN Model). The key features are outlined below.

## Taxes Covered

The categories of taxes covered by the agreement are:

- the Latvian enterprise income tax and personal income tax; and
- the Cyprus income tax, corporate income tax, capital gains tax and special contribution for the Defence of the Republic (commonly referred to as SDC tax).

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

## Permanent Establishment

The draft agreement includes the usual activities that do not give rise to a permanent establishment, namely storage and display of goods, maintenance of stocks for processing by a third party, maintenance of a purchasing or information-gathering facility or 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 only if it lasts for more than nine months.

If an enterprise has a representative in a contracting state, that 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 which the person undertakes for the enterprise. As in the OECD Model, the draft provides that an independent broker or agent that represents the enterprise in the ordinary course of business will not be caught by this provision. Borrowing from the

UN Model, the draft agreement defines independence by providing that an agent whose activities are devoted "wholly or almost wholly" to a particular enterprise will not be considered to be independent. The interpretation of this provision will no doubt be the subject of interpretation once the agreement is in force.

Taxpayers need to be aware of the potential adverse consequences of unintended creation of a permanent establishment. Particular care needs to be taken regarding the issuing of general powers of attorney.

## Income From Immovable Property

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 draft agreement includes detailed rules for apportionment of profits to permanent establishments, borrowing again from the UN Model.

Profits from the operation of ships or aircraft in international traffic are taxable only in the contracting state in which the enterprise 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 per cent of the gross amount in the case of dividends and interest and 5 per cent of the gross amount in the case of royalties.

As both countries are EU members, the Interest and Royalties Directive and the Parent Subsidiary Directive will also be relevant to any tax planning exercise.

## Capital Gains

Income (unlike most treaties this article also refers to income rather than limiting its scope to just gains) or gains derived by a resident of one contracting state from the alienation of immovable property situated in the other contracting state 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 per cent 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

The draft agreement with Latvia is the first of Cyprus's agreements to include an article dealing specifically with offshore activities.

Article 21 provides that a resident of one contracting state undertaking activities offshore in the other contracting state for more than 30 days in any 12 month period in connection with the exploration or exploitation of the seabed or subsoil or their natural resources is deemed to be carrying on business in that other contracting state through a permanent establishment.

Profits from offshore supply and transport operations in connection with the exploration or exploitation of the seabed or subsoil or their natural resources of a contracting state are taxable only in that contracting state.

Salaries, wages and the like earned by a resident of one contracting state from employment in the offshore zone of the other contracting state are taxable in the contracting state in which the activities are carried out. However, if the employer is not resident in the contracting state in which the activities take place, and the employment is for less than 30 days in any 12 month period, the remuneration is taxable only in the contracting state in which the individual is resident.

Salaries, wages and similar remuneration derived from employment aboard ships or aircraft engaged in offshore supply and similar activities are taxable in the contracting state in which the individual is resident.

Gains derived by a resident of one contracting state from:

- the alienation of exploration or exploitation rights; or
- property situated in the other contracting state and used in connection with the exploration or exploitation of the seabed or subsoil or their natural resources situated in the second contracting state; or
- shares deriving their value or the greater part of their value directly or indirectly from such rights or such property, may be taxed in the second contracting state.

## Elimination Of Double Taxation

Elimination of double taxation is achieved by the credit method. The credit against Latvian tax is limited to that part of the income tax in Latvia as computed before the deduction is given that is attributable to income that is subject to tax in Cyprus.

However, the growing importance of substance over form needs to be taken into account. There are clear signals that artificial structures and transactions which have tax avoidance as their sole purpose will not be tolerated. Careful planning and implementation are essential for Latvian businessmen wishing to obtain the full benefits of the Treaty and Cyprus's benign tax regime.

## Exchange Of Information

The exchange of information article reproduces article 26 of the OECD Model Convention verbatim.

Cyprus's Assessment and Collection of Taxes Law provides robust safeguards against abuse of any exchange of information provisions. Requests for exchange of information are dealt with solely by the International Tax Relations Unit ("ITRU") of the Department of Inland Revenue. Exchange of information may take place only via the ITRU: direct 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 lengthy legal document. In effect, this means that the authorities requesting the information must already have a strong case even before they request the information. Accordingly, it will not be possible to follow up a suspicion without first gathering significant evidence. As a final safeguard, Cyprus's Assessment and Collection of Taxes Law requires the written consent of the Attorney General to be obtained before any information is released to an overseas tax authority.

## Entry Into Force And Termination

The draft agreement provides that it will enter into force when the two governments inform one another that the requisite constitutional procedures have taken place, and its provisions shall 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.

## Conclusions

On independence Latvia did not adopt the Cyprus-USSR double taxation agreement of 1982, and there is currently no double taxation agreement in force between the two countries. The Latvian government announced the commencement of negotiations on an agreement with Cyprus in 2006 and it is hoped that the remaining steps in concluding the agreement and bringing it into effect can be achieved quickly. If it takes effect in its current form, the agreement will be Cyprus's first to include an article dealing with offshore activities, reflecting its newly-discovered energy resources. In the meantime, although there is no agreement in existence, the Cyprus tax authorities will doubtless follow their normal practice of allowing unilateral relief for Latvian taxes paid.