Bloomberg BNA

TAX PLANNING INTERNATIONAL

EUROPEAN TAX SERVICE

International Information for International Business

JULY 2016

www.bna.com

Reproduced with permission from BNAI European Tax Service Monthly Digest, 18 ETS 27, 7/30/16. Copyright © 2016 by The Bureau of National Affairs, Inc. (800-372-1033) http://www.bna.com

The New Double Tax Agreement between Cyprus and Latvia

Philippos Aristotelous
Andreas Neocleous & Co LLC

Cyprus and Latvia finalized a new double tax treaty on May 24, 2016. The following article assesses the provisions of the treaty.

On May 24, 2016, after negotiations spanning almost 10 years, Cyprus and Latvia signed a new double taxation agreement ("DTA"). Unlike most of the 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 is based on the latest OECD Model Convention but also incorporates provisions from the United Nations Model Double Taxation Convention between Developed and Developing Countries. The key features are set out below.

I. Scope of the Agreement

The agreement covers all 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. Any similar taxes imposed by either country will also fall within its scope.

II. Residence

The provisions for determining the country of residence for individuals who are resident in both countries are the same as in the OECD Model Convention, namely permanent home and centre 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. While the Cyprus authorities base residence on the place where management and control are located, the Latvian authorities consider a company to be resident in Latvia merely if it is incorporated there (and nonresident otherwise).

Philippos Aristotelous is a partner at Andreas Neocleous & Co LLC

III. 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.

IV. 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.

V. Business Profits

The article of the agreement dealing with business profits reproduces the corresponding article of the OECD Model almost word for word, 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.

VI. 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.

07/16 Copyright © 2016 by The Bureau of National Affairs, Inc. TPETS ISSN 1754-1646

VII. 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 a zero rate of tax in the state in which the company paying the dividends is resident 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 condition is not satisfied, tax payable in the first contracting state is limited to 10% of the gross amount in the case of dividends and interest and 5% 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 academic, particularly since both countries are EU members, and the EU Interest and Royalties Directive and the Parent Subsidiary Directive both apply.

VIII. 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. The same applies to gains on disposal of shares or similar interests in a company or other entity deriving more than 50% of its value from immovable property. 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 disposal of all other property (including ships or aircraft operated in international traffic) are taxable only in the contracting state in which the person disposing of the property is resident.

IX. Offshore Activities

Like several of the DTAs which Cyprus has concluded since the discovery of offshore gas reserves, the agreement with Latvia includes comprehensive provisions regulating the taxation of offshore hydrocarbon exploration and exploitation activities, aimed at ensuring that each state's taxation rights in respect of offshore activities are preserved in the event that 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 territory of 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. There are also rules for determining when the 30-day threshold is exceeded in respect of offshore activities undertaken by associated enterprises. These provisions override the articles regarding permanent establishment and business profits. Similarly, the 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 state in which he or she performs his employment duties. 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.

X. 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.

XI. 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 absent. However, Cyprus's Assessment and Collection of Taxes Law provides Cyprus residents with identical safeguards.

XII. 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.

XIII. Conclusion

The new agreement is a further extension of Cyprus's network of DTAs. While Latvia is a relatively small country, 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.

Philippos Aristotelous
Partner, Andreas Neocleous & Co LLC

http://www.neocleous.com