

Corporate Tax - Cyprus

Certificates of residence under Cyprus-Russia double tax agreement

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Cyprus finance structures are widely used for Russian operations. A recent case in a Russian provincial court⁽¹⁾ gives important guidance on the stance taken by the Russian tax authorities regarding the evidence required for a taxpayer to demonstrate Cyprus residence in the context of the Cyprus-Russia double tax agreement and thereby qualify for the benefits available under it.

In order to benefit from the provisions of a double tax agreement, the taxpayers concerned must satisfy the tax authorities that they are residents of one of the contracting states. A foreign organisation must provide the Russian tax agent that is to pay it income with confirmation of residence in the other contracting state. The confirmation must be provided before the income is paid.

The case in question concerned interest paid in 2009 by Russian company LLC Samaraorgsintez to Cyprus company Nervia Trading Company Limited. The two parties had entered into a loan agreement in 2008. The lender (Nervia) provided the borrower (Samaraorgsintez) with an apostilled certificate of Cyprus residence issued in 2007. The borrower had paid interest on the loan without deducting withholding tax, on the basis that the interest was exempt from taxation at source under Article 11 of the double tax agreement between Russia and Cyprus.

Following an audit of the borrower's 2009 accounts and tax computations, the Russian tax authorities imposed additional tax liabilities, fines and penalties on the grounds that there was no evidence that the company to which the interest was paid was resident in Cyprus for that year, and that interest should therefore have been paid after the deduction of withholding tax. Essentially, they contended that a fresh confirmation of residence must be obtained each year.

The court decided in favour of the taxpayer, concluding that there is no clause in the law that limits the period of validity of residence certificates and no requirement that the tax agent reconfirm the residence of a foreign company on an annual basis. The tax authorities had provided no evidence that the foreign company had changed its location or established a permanent establishment in Russia since 2007. In addition, the court noted that in any event, the tax authorities would have had no right to claim the amount of tax not withheld from the tax agent.

This is a welcome development, but it is likely to take a decision of Russia's Supreme Arbitration Court to bring about a change in the tax authorities' approach regarding this issue. In the meantime, in view of the importance of Cyprus finance structures for Russian operations and given the limited cost involved, it would be prudent to obtain fresh confirmation of residence as a matter of routine.

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Endnotes

⁽¹⁾ The Federal Arbitration Court of the Povolzhsky Region.

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