Russia revises double tax treaties

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In our previous article ("Covid-19 as a useful tool to amend double tax treaties") we reported that Russian authorities proposed to some countries (namely, Cyprus, Malta and Luxembourg) to amend the terms and conditions of double tax treaties.

The first results have recently appeared. On 8 September 2020 Russia and Cyprus signed the Protocol amending the Agreement between the Government of the Russian Federation and the Government of the Republic of Cyprus for the avoidance of double taxation with respect to taxes on income and capital dated 5 December 1998.

The Protocol will be temporarily applied from 1 January 2021 and enters into force from the date of the last written notification of the completion of the procedures necessary for its entry.

The Protocol provides that the State, source of dividends paid to tax residents of another State, can tax dividends at 15%.

A reduced tax rate on dividends (5%) is also provided. However, according to the Protocol it can be applied only in a very limited number of cases. The withholding tax on dividends may not exceed 5%, provided that the person receiving dividends:

1. has the actual right to dividends (i.e. the beneficial owner),
2. is a tax resident of the other contracting State, and also
3. is any of the following:

    a. an insurance institution or pension fund;
    b. a public company that has at least 15% of its voting shares in free circulation and directly owns at least 15% of the capital of the company paying the dividends during period of 365 days;
    c. the Government or its political division or local authority; or
    d. the Central Bank.

The Protocol also amends taxation of interest. Interests can be taxed not only in the State of the resident, but also in the state of the source. The withholding tax may not exceed 15% of the total amount of interests, provided that the person who has the actual right to interest (i.e. the beneficial owner of interests) is a resident of the other contracting State. It is worth mentioning, Russian domestic tax legislation provides for the taxation of interest at the rate of 20%.

The Protocol also provides for a limited list of cases, when interests are not subject to taxation in the state of the source. Interests are taxed only in the state of the resident when they are paid to a resident of that other state who is the person having actual right to the interests (i.e. beneficial owner), and also is any of the following:

1. an insurance institution or pension fund;
2. the Government or its political subdivision or local authority;
3. the Central Bank; or
4. a bank.

Furthermore, interests paid to a resident of another state who has actual right to such interests are not taxed in the source state if the interests are paid in respect of the following securities that are listed on a registered stock exchange:

1. Government bonds;
2. Corporate bonds;
3. Eurobonds.

Therefore, the amendments introduced by the Protocol do not affect the existing taxation of interests paid on Eurobond, corporate bonds of Russian companies and loans provided by foreign banks.

In the information letter dated 8 September 2020 the Russian Ministry of Finance indicates that currently the work is underway to make similar amendments to tax treaties with other jurisdictions. In particular, these changes have been preliminary agreed with Malta and Luxembourg. Negotiations with The Netherlands are continuing. It is expected that the changes made to the tax treaties with these countries will be similar to those described above.

According to the estimation of the Russian Ministry of Finance, the amendments to the agreements with Cyprus, Malta, and Luxembourg may bring to the Russian budget revenues for an amount of approx. 130-150 billion rubles per year (mainly from Cyprus) (i.e. about 2 billion US dollars).

These amendments may likely induce multinationals to revise their corporate structures used in doing business in Russia and, in particular, to consider the possibility to relocate their holding or sub-holding companies in other jurisdictions (e.g. Russia), to reassess and possibly increase the substance needed for proving actual right on income (beneficial ownership).

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