Cyprus revises tax treaty with India, ratifies new tax treaties, announces 2016 NID yields, and expedites ruling process

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In brief

The Cyprus government has reported several important tax developments that will affect multinational enterprises doing business in Cyprus.

Regarding tax treaties:

- The Cyprus government on June 30, 2016, announced that it completed negotiations and reached an agreement in writing for a revised tax treaty between Cyprus and India.
- The first tax treaty between Cyprus and Bahrain, signed on March 9, 2015, entered into force on April 26, 2016, and will take effect on January 1, 2017.
- The first tax treaty between Cyprus and Latvia, signed on May 24, 2016, was ratified by Cyprus on June 3, 2016. The treaty will take effect on January 1 of the year after the countries complete the legal formalities to bring the treaty into force.

The Cyprus Tax Authority (CTA) announced a list of various countries' interest yields on 10-year government bonds for purposes of the notional interest deduction (NID). The list includes Cyprus, Czech Republic, Germany, India, Latvia, Poland, Romania, Russia, Ukraine, and United Arab Emirates.

The CTA also announced that written responses to expedited advance ruling requests will be issued within 21 business days.

In detail

Cyprus and India complete negotiations for a revised tax treaty

The revised Cyprus-India tax treaty, announced on June 30, 2016, is expected to be signed in the coming months, and will enter into force following ratification by both countries.

Complete details of the treaty have not yet been released. However, the announcement revealed that the treaty includes provisions for source-based taxation of capital gains from the disposition of stock. The announcement also referenced a 'grandfathering' clause for investments acquired prior to April 1, 2017, providing the seller's country the exclusive right to tax future disposals of such investments.

Once the treaty enters into force, Indian authorities will rescind the classification of Cyprus as a 'Notified Jurisdictional Area,' effective retroactively from November 1, 2013 — the date that Cyprus was first classified as a 'Notified Jurisdictional Area.' One of the effects of the current classification is that, in certain circumstances, a taxpayer may rely upon the existing treaty only by following certain administrative procedures in India.

Observation: The grandfathering of stock investments acquired prior to April 1, 2017, is a welcome development that provides clarity to taxpayers holding existing investments. When a Cyprus tax resident disposes of a grandfathered investment, Cyprus retains the exclusive right to tax the realized gains under the revised tax treaty, which is consistent with the existing tax treaty.

The upcoming rescission of Cyprus's status as a 'Notified Jurisdictional Area' by the Indian authorities also is a welcome development. Because this will occur once the revised tax treaty enters into force, taxpayers must continue to comply with the Indian 'Notified Jurisdictional Area' requirements until they are rescinded retroactively.

Tax treaty between Cyprus and Bahrain enters into force

Cyprus and Bahrain on March 9, 2015, signed the first tax treaty between the two countries. The treaty entered into force on April 26, 2016, and will take effect on January 1, 2017.

The treaty provides for a 0% withholding tax rate on dividends, income from debt claims, and royalties.

Under the treaty, Cyprus retains the exclusive right to tax capitals gains from the disposition of stock by Cyprus tax residents in Bahraini companies, including Bahraini companies holding immovable property located in Bahrain.

Observation: Cyprus is an ideal geographic location for the establishment of regional headquarters for business in Eastern Europe, North Africa, and the Middle East. The treaty between Cyprus and Bahrain further expands the Cyprus tax treaty network in the region.

Cyprus and Latvia sign first tax treaty

Cyprus and Latvia on May 24, 2016, signed the first tax treaty between the two countries. Cyprus on June 30, 2016, ratified the treaty. The treaty will take effect January 1 in the year after both countries complete the legal formalities to bring the treaty into force.

The treaty provides for a 0% withholding tax rate on dividends, interest and royalties if the payer is a company that is resident in one country and the beneficial owner of the income is a company that is resident in the other country — that is, company-to-company payments.

For all the other cases — not company-to-company payments — except for certain governmental interest, the treaty provides for a withholding tax rate of 10% on dividends and interest and 5% on royalties.

Under the treaty, Cyprus retains the exclusive right to tax capital gains from the disposition of stock in Latvian companies. Except for dispositions in which more than 50% of the value of the shares is derived directly or indirectly from immovable property located in Latvia or more than 50% of the value of the shares relates directly or indirectly to certain Latvian offshore rights or property.

Observation: Although the new treaty provides for withholding taxes on dividend and interest payments — other than company-to-company payments — domestic Cyprus tax law does not require withholding on dividend and interest payments to non-Cyprus tax residents in all cases.

Further, although the new treaty provides for withholding taxes on royalty payments — other than company-to-company payments — domestic Cyprus tax law requires withholding on royalty payments to non-Cyprus tax residents only if the royalty relates to rights used within Cyprus.

The treaty is expected to create new investment opportunities and enhance trade relations between Cyprus and Latvia.

CTA announces NID interest rates for 2016

The CTA announced the applicable yields on the Cyprus and other selected countries' 10-year government bonds for the 2016 tax year.

According to the Cyprus NID provisions, the NID interest rate is the yield on 10-year government bonds (at December 31 of the prior tax year) of the country where the funds are employed in the business of the company plus a 3% premium. This is subject to a minimum amount equal to the yield of the 10-year Cyprus government bond (at the same date) plus a 3% premium.

The 2016 NID interest rate for Cyprus is 6.685%. This is also the applicable 2016 NID interest rate to be used for the Czech Republic, Germany, Latvia, and Poland, being the minimum amount under the rule described above, given that the 10-year government bond yield for these countries plus a 3% premium is below that of Cyprus.

The announcement also includes yields for Romania (6.703%), United Arab Emirates (10.490%), India (10.758%), Russia (12.570%), and Ukraine (12.622%).

For more details on the Cyprus NID provisions, see PwC's Tax Insight dated February 11, 2016.

Observation: The CTA announcement establishes an important part of the 2016 NID calculation for the listed countries.

Advance tax ruling requests

The CTA announced that, starting May 16, 2016, written responses to tax rulings filed with an expedited request will be issued within 21 business days. The CTA made this announcement following a decree issued by the Council of Ministers imposing a fee for the issuance of tax rulings — €1,000 for non-expedited rulings and €2,000 for expedited rulings.

Observation: This announcement formalizes the timeframe for expedited tax ruling requests and their associated administrative costs.

The takeaway

Negotiation of the Cyprus-India tax treaty is a welcome development that will provide certainty to investors.

Cyprus is rapidly expanding its tax treaty network, as indicated by the new treaties with Latvia and Bahrain, which should pave the way for new investment opportunities and trade relations between Cyprus and these two countries.

The CTA announcement of the 2016 NID interest rates establishes an important part of the NID calculation for 2016 for the countries to which the announcement refers.

Finally, formalization of the timeframe for the expedited issuance of rulings by the CTA provides certainty of the turnaround of expedited ruling requests.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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