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New double tax agreement between Cyprus and Kazakhstan

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Introduction

On 17 January 2020 the Cyprus-Kazakhstan double tax treaty (the agreement) entered into force.**(1)** Its provisions will apply from 1 January 2021. The agreement was signed on 15 May 2019 and ratified by the Cyprus government on 24 May 2019 and the Kazakhstan government on 30 December 2019. The agreement is the first of its kind between the two countries and is closely based on the latest Organisation for Economic Cooperation and Development (OECD) Model Tax Convention framework. However, one exception is the definition of a 'service permanent enterprise' used in the agreement, which follows the definition used in the UN Model Tax Convention.

In line with the OECD Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting, the agreement includes a preamble which makes it clear that it is not designed to:

- eliminate double taxation of an income source in respect of taxes covered by the agreement; or
- create opportunities for fiscal evasion.

The aim of this double taxation treaty, as with all other double taxation treaties signed by Cyprus, is to provide the contracting countries with treaty opportunities and protections.

Dividends

Article 10 of the agreement provides for a maximum of 5% withholding tax if dividends are beneficially owned by a company which directly holds at least 10% of the capital of the company paying the dividends. In all other cases a 15% withholding tax is applied.**(2)**

Interest

Under Article 11 of the agreement, a maximum of 10% withholding tax on interest payments applies, provided that such interest is beneficially owned by the recipient company. The agreement provides for a 0% withholding tax rate on interest payments where the beneficial owner of such interest is:

- the government of the other contracting state;
- a political subdivision of the other contracting state;
- a central or local authority;
- the central bank of one of the contracting states; or
- any other financial institution wholly owned by the government of the other contracting states.

Royalties

According to Article 12 of the agreement, a 10% withholding tax on royalty payments applies provided that the recipient is the beneficial owner of such royalties.**(3)**

Beneficial ownership considerations

Articles 10, 11 and 12 of the OECD Model Tax Convention (with respect to taxes on income and capital) deal with the taxation of income which takes the form of interest, dividends or royalties.

In general, the OECD follows a constraint approach when it comes to limitation on tax rates that may be imposed by the source country where such income is 'beneficially owned' by residents of the other contracting state. The term 'beneficial owner' may be interpreted as the entity which benefits economically from the income received and accordingly has the power to freely determine the use to be given to that income. If there is a contractual or legal obligation to transfer funds, this may be an indication that the funds are not freely available to the beneficiary. The by now globally accepted substance requirements are vitally important to ensure the protection of the interests of structures via the application of the relevant objects and aims of the relevant international treaties and requirements imposed therein. Failure to adhere to these requirements may result, among other things, in:

- the recharacterisation of incomes;
- the loss of treaty benefits;
- double taxation;
- enhanced rates of withholding taxes;
- monetary penalties or prosecution; and
- the application of controlled foreign corporation rules.

Capital gains

Gains derived by a resident of one country from the alienation of immovable property (or of movable property associated with a permanent establishment) situated in the other country are taxed in the country in which the property is situated. Gains from the disposal of shares in a company which derive more than half of their value directly from immovable property situated in the other country may be taxed in the state in which the property is situated, unless:

- the shares are listed on a recognised stock exchange in one of the countries or in a member of the European Economic Area; or
- gains derived from the alienation of all other property (including ships or aircraft and ancillary equipment) are taxable only in the country in which the alienator is resident.

Offshore activities

Under Article 21 of the agreement, any enterprise of a contracting state that carries out offshore activities in the other contracting state will be deemed to have a permanent establishment in the other state. This does not apply if such activities cover an aggregate of 30 days or less in any 12-month period beginning or ending in the fiscal year concerned.

Article 21 also provides that gains derived by an enterprise of a contracting state from the alienation of one of the following may be taxed in the other contracting state:

- exploration or exploitation rights;
- movable property situated in the other contracting state and used in connection with offshore activities carried out in that other contracting state; or
- shares or comparable interest deriving their value or the greater part of their value directly or indirectly from:
  - such rights;
  - such property; or
  - such rights and such property taken together.

Exchange of information

The agreement includes comprehensive regulations based on the OECD Model Tax Convention regarding the exchange of tax information. Its provisions are elaborated on in the protocol to the agreement, which clarifies that the foreseeable relevance standard aims to provide for the exchange of information in tax matters to the broadest possible extent. However, importantly it also stipulates that the contracting countries cannot engage in fishing expeditions or request information that is irrelevant to the tax affairs of a given taxpayer.

Other considerations

Article 22 of the agreement provides that any income not addressed specifically elsewhere in the agreement should be taxed only in the state of residence of the recipient of income.

Comment

Financial and business services are a significant contributor to the economies of both Cyprus and Kazakhstan. The agreement is to be welcomed in view of the possibilities for business, transactional work and business synergies that it may help to create between the two countries. Kazakhstan is considered to be the dominant economic player in Central Asia and often functions as a bridge between East and West. The agreement not only expands the Cyprus double tax treaty network, it also emphasises the growing stature of Cyprus as a gateway to Europe and an investment hub for the Eurasian region.

For further information on this topic please contact Elena Christodoulou at Elias Neocleous & Co LLC by telephone (+357 25 110 110) or email (elena.christodoulou@neo.law). The Elias Neocleous & Co LLC website can be accessed at www.neo.law.

Savvas Petrou, trainee lawyer, assisted in the preparation of this article.

Endnotes

(1) The full text of the agreement may be viewed here. The English version begins on page 96.

(2) According to Cyprus's domestic legislation, and irrespective of the withholding tax rates provided for in the double tax treaty, no tax is withheld for the payment of dividends and interest to non-residents and non-domiciled parties in Cyprus.

(3) No tax is withheld except in the case of royalty payments earned on rights used within Cyprus.