

CYPRUS / UKRAINE: DOUBLE TAX TREATY & BENEFICIAL OWNERSHIP

On 2 December 2010 Ukraine's Tax Code introduced a definition of beneficial ownership when applied to double tax treaties. Taxand Cyprus and Taxand Ukraine comment on how this will affect multinationals investing in Ukraine through Cypriot companies.

The Beneficial Ownership Concept

Eastern Europe has seen Cyprus and Ukraine forge and maintain close business and economic ties for many years now.

The introduction of the beneficial ownership concept into Ukraine's Tax Code has led to the justified perception of additional risks associated with any transactions conducted between the two countries where there is a need to apply treaty benefits.

The Ukrainian Tax Code defines "beneficial owner" as an entity that is entitled to receive income. The Code expressly states that an entity acting in the capacity of an agent, nominee holder (owner) or as an intermediary cannot qualify as the beneficial owner. So, how does this affect the application of the benefits under the current 1982 double tax treaty?

The current double tax treaty contains no provision for beneficial ownership. Based on the current wording of the treaty and the rule of Ukraine's Tax Code stating that double tax treaty overrides Ukrainian legislation, it may be argued that no beneficial ownership requirement can be applied to transactions between Ukrainian and Cypriot enterprises. However, this favourable treatment may disappear soon with the adoption of the new treaty, expected in the near future.

Currently there is no universally accepted approach to dealing with beneficial ownership. Some jurisdictions favour an economic, substance-over-form, interpretation which has not, to date, been consistent with the history of the term, and has not best served the object and purpose of double tax treaties; in contrast other jurisdictions seem to prefer a legal approach which is more straightforward and would resolve the existing controversy.

The different interpretations by the courts and tax authorities of the concept of beneficial ownership has prompted the OECD to invite its members in April, 2011 to provide their comments on the discussion draft for the clarification of the meaning of "beneficial ownership" which includes proposed changes on the articles of the OECD Model Tax Convention relating to this concept. [Read Taxand's response to the OECD consultation paper on beneficial ownership here.](#)

The ultimate aim is to clarify the interpretation in a treaty context as opposed to a domestic law situation and, simultaneously, address the interaction between the concept of beneficial ownership and other anti-abuse provisions included in double tax treaties. These commentaries are expected to be examined later this year and, from a Cypriot perspective, any changes to the OECD Model Tax Convention should ensure that the functionality of double tax

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treaties improves and continues to encourage international business and trade, through the use of cross-border tax structures.

The interpretation and application of the beneficial ownership concept is expected to be highly contentious as the Ukrainian authorities have yet to devise or understand its applicability in practice in various transactional contexts.

Substance

Substance is a key factor in minimising the risk that the Ukrainian Tax Authorities will deny treaty benefits and ultimately tax Ukrainian-source income.

- Management and control are indeed exercised in Cyprus.
- The company has complied with all relevant company and tax legislation.
- The books and records of the Company are duly kept in Cyprus.
- The nature and operation of the company and that of the group to which the company belongs
- The group's business strategy.
- The legal and management structure of the group as a whole.
- The materiality of the transaction/investment by the holding company.

Taxand's Take

Existing structures must be reviewed as soon as possible to assess whether they meet the substance requirements and restructured accordingly to withstand potential challenges from the tax authorities.

This means that companies will need to ensure that sufficient evidence is readily available to demonstrate true economic substance. A number of practical measures to consider would include:

- having a real physical presence in Cyprus, whether in a separate, owned office or by leasing space in a serviced business centre;
- having registered with the Cypriot Ministry of Labour as an employer;
- having real people actually working in the company's offices (part-time or full-time);
- having dedicated telephone and fax facilities, an internet connection, website and e-mail addresses;

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- having at least one bank account opened at a Cypriot bank, operated by a Cypriot member of the board of directors;
- having proper books and records kept at all times in Cyprus, and financial statements prepared on a timely basis and duly submitted;
- having a duly capitalised company, with any share purchase agreements needed to be prepared in Cyprus and in accordance with Cypriot law.

The above are only general guidelines which should not be followed in isolation. Any attempts to generalise substance requirements are not recommended. Every business must a careful analyse its corporate structure in order to determine the necessary level of substance required to meet business needs.

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