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Tax alert

May 2009

New Double Taxation Treaty with Cyprus

In the very near future, the Parliament of the Czech Republic and the Senate are to approve the ratification of a new treaty with Cyprus on the elimination of double taxation. If the treaty takes effect in 2009, its provisions will be implemented with effect from 1 January 2010. This treaty will replace the current treaty, which has been in effect since 1980.

Taxation of Real Estate Companies

The new wording of the treaty will enable taxation of profit generated on the sale of shares in companies the value of which (more than 50 percent) arises from immovable assets located in the other respective contracting state. That is, if a Cypriot company sells its share in a Czech company the major part of the assets of which is property located in the Czech Republic, the Czech Republic is entitled to impose a tax on income arising from this sale. An income tax exemption could be applied to such a sale if the relationship between the Cypriot and the Czech company were established on the parent-subsidiary basis, as defined in Section 19 of the Income Tax Act (i.e. the equity share of the Cypriot company must amount to at least 10 percent held over a period of 12 months).

Creation of a "Service" Permanent Establishment

A new definition of a "service" permanent establishment is included in Article 5 of the new treaty. A permanent establishment is created if services are rendered on the territory of the other contracting state over a period of more than six months.

Dividend Taxation

Pursuant to the currently effective treaty, dividends are taxed using a 10 percent withholding tax, which will be decreased to zero percent by the new treaty, if the party receiving dividends holds a company's equity share of at least 10 percent over the period of no less than one year. If these conditions are not met, a 5 percent withholding tax will be applied.

Interest Taxation

The currently effective treaty enables interest taxation using a 10 percent withholding tax rate. On the other hand, in accordance with the new treaty, received interest will be taxed only in the state of the receiving party. Under a provision included in the new treaty, default interest is not deemed interest.

Licence Fees Taxation

According to the current treaty, collected licence fees (e.g. patents, know-how, and other) are taxed in the source state using a withholding tax of 5 percent. The new treaty stipulates increasing this withholding tax to 10 percent, and defining compensation for the use of computer programs as licence fees. The amendment to the treaty includes a pledge of the Czech Republic to apply a lower withholding tax in respect of licence fees, should another treaty on the elimination of double taxation signed by the Czech Republic and another EU state in the future apply a tax rate lower than 10 percent.

Method of Eliminating Double Taxation

Contrary to the currently effective treaty which entitles the Czech Republic to use both double taxation methods, the new treaty only allows a credit method.

Prevention of Treaty Abuse

In addition, the amendment of the treaty includes a provision preventing treaty abuse. The authorities of contracting states may prevent the utilisation of the benefits arising from this treaty if a transaction's principal objective is to obtain the benefits under the treaty which could otherwise not be attained.

Conclusion

With regard to the current political situation, it is not possible to assess whether the procedures which are necessary to adopt so that the treaty can take effect will be met by the end of this calendar year. In the event that the treaty becomes effective by the end of the calendar year, material changes will impact the method of taxation namely with respect to capital income, interest and licence fees.

If the ratification of the new treaty should have a negative tax impact on your business, we recommend contacting our professionals who can provide you with suitable solutions.

If you have any questions concerning the items in this publication, please contact your regular Deloitte Tax contact or one of the following experts:

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