



# Tax & Accounting Newsletter 01/10

## Double taxation treaty with Cyprus

The provisions of the new treaty for avoidance of double taxation and prevention of tax evasion in respect of income tax between the Czech Republic and the Republic of Cyprus, came into force on 1 January 2010; thus replacing the previous treaty of 1980.

The most important change is that interest will be subject to taxation only in the recipient's country of residence. So far, interest has been subject to taxation of up to 10% in the source country. This change also creates the new possibility of using Cyprus for the financing of Czech companies. Cyprus thus becomes a big competitor to the Netherlands in terms of establishing holding companies.

There have been other major changes in the taxation of legal entities from the previous treaty. The most important include:

- As interest is only subject to taxation in the recipient's country of residence, it is no longer necessary to apply to the tax administrator for the issuing of a decision to award exemption of income from credit and loan interest, pursuant to the provision of Section 38nb of the Income Tax Act.
- Penalties imposed for late payments are not expressly deemed to be interest.
- Payment of dividends will be exempt from withholding tax in the source country in the event that a beneficial owner is a company which has held at least a 10% share in the company paying out dividends for one year. Dividends have been taxed at 10% so far. In other cases, a 5% withholding tax will apply.
- For industrial licence fees (including software fees), withholding tax in the source country is increased from the current 5% to 10%. Other licence fees remain tax-exempt in the source country, and are taxed only in the recipient's country of residence.
- Effective as of 1 January 2011, in accordance with the Czech Income Tax Act, licence fees paid by a Czech tax resident (a company) to a company which is a tax resident in another Member State of the European Union will be tax-exempt. If these conditions are met and an application for issuing a decision to award exemption of income from licence fees is filed pursuant to the provision of Section 38nb of the Income Tax Act, the paid licence fees will be exempt from income tax.
- Income from the sale of shares or shareholdings in a company (capital gains) – the assets of which are comprised of more than 50% of real estate located in one state – will be allowed to be taxed in that state.

- Such significant change will mean that capital gains generated by a tax resident of Cyprus from the sale of shareholdings in a Czech company (where more than 50% of its assets consist of real estate located in the Czech Republic) will be subject to taxation in the Czech Republic as of 1 January 2010. If conditions stipulated in the Czech Income Tax Act are met, this income may ultimately be exempt from tax.
- Unlike in the previous treaty, the tax credit method will apply to avoid double taxation.
- The concept of a permanent establishment (Article 5) has been extended to include a so-called “service permanent establishment”. Under this definition, a permanent establishment arises whenever services are provided in the territory of another state for one or more periods exceeding 6 months in any 12-month period.

A protocol has been concluded together with the treaty which includes a most-favoured nation clause related to taxation of industrial licence fees. This authorises competent authorities of the contracting states to refrain from advantages arising from individual provisions of the treaty, upon mutual agreement of the competent authorities, if the principle purpose of the establishment, or existence of the entity using the advantages of this treaty or transactions carried out by this entity was to gain advantages under this treaty which would not be otherwise available.

**If you have any questions regarding the issues above, do not hesitate to contact us.**



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