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Disappointing, but investors have time to respond

A new treaty with Cyprus could remove the easy access to 0% withholding tax rates on investment into Ukraine, but would not plug the gap entirely.

Investors through Cyprus need to start thinking about how withholding taxes would impact on the bottom line from their investment in Ukraine, and whether the effect is sufficient to encourage a review of their investment structure.



A new tax treaty with Cyprus?

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For many years, investors into Ukraine have benefited from a very favourable treaty between Ukraine and Cyprus.

This treaty, which is a legacy from Soviet times, provides for a 0% rate of tax in Ukraine on interest, dividends and royalties paid to companies in Cyprus. It also exempts gains from the sale of shares in Ukrainian companies, including those owning real property. Consequently, Cyprus has become a favoured location for holding companies for investment into Ukraine.

This may now change. On 21 February 2007, the Cabinet of Ministers of Ukraine authorised the Ministry of Finance to sign a new agreement with Cyprus. It is understood that the new treaty would result in Ukrainian tax being imposed at the following rates:

- 5% on dividends if the beneficial owner is a Cypriot company that directly owns at least 25% of the Ukrainian company. A 15% rate would apply to dividends otherwise
- 10% on interest.
- 10% on royalties.

The new treaty was expected to be signed in March. The treaty could take effect as early as 1 January next year,

although it still needs to be ratified by the Ukrainian parliament and there is no certainty of this happening.

Not all gloom

A new treaty could be inconvenient for existing investors through Cyprus, but it is not the only avenue for reduced tax rates. Ukraine has treaties with Finland, France, the Netherlands and Sweden also offer 0% tax rates on dividends if sufficient capital is invested in Ukraine. Furthermore, interest paid to entities in Spain, United Kingdom and United States is similarly subject to 0% tax. For investors sensitive to the new tax rates, there are alternatives.

Further developments will be awaited with interest. At this stage though, time is still on the side of investors.

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