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Tax treaties: Application and updates

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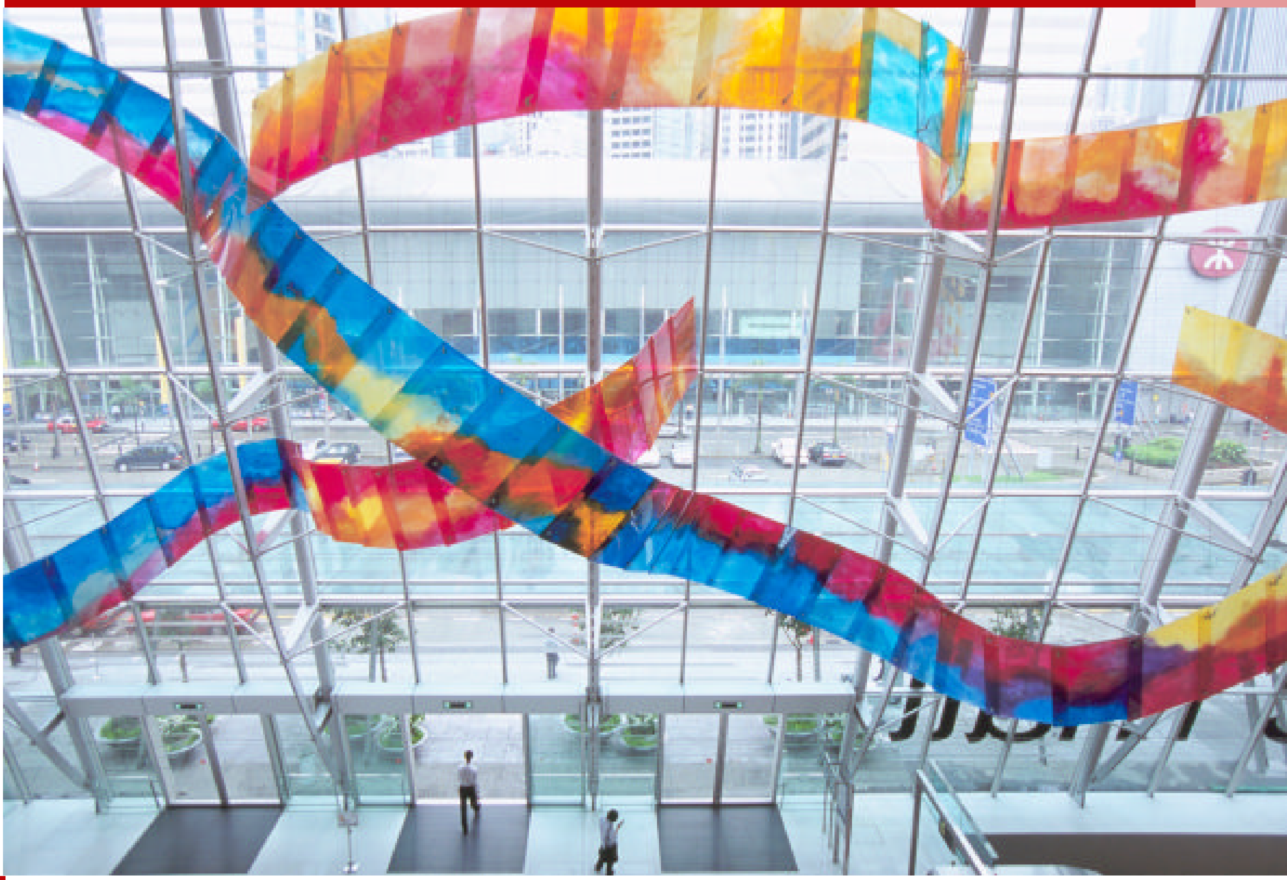

Practical application of the tax treaties has been changed

Tax treaties play an important role in stimulating cross-border trade and investment. Treaties provide clear rules for determining when a foreign company has sufficient presence in a country for its business profits to become taxable in that country, as well as for determining how the amount of taxable income should be measured. Treaties also reduce the amount of tax that a country imposes on income that a foreign company earns from the passive investment of property and capital in that country. By establishing a clear framework for how foreign investors will be taxed and reducing taxes to a reasonable level, treaties help create the stable tax environment that investors require when investing their capital.

Armenian Government by the Decree No. 1052-N of 21 July 2011 has introduced an important change to the rules of application of the tax treaties in Armenia. [1]

Tax treaties will apply directly

Armenian Government has recently amended the rules of the practical application of the tax treaties in Armenia.

Amendments were introduced to the Decree No. 1398-N of 7 October 2004.

Effective from 20 August 2011 the requirement to confirm a treaty relief with the tax authorities is repealed.

Previously, taxpayers were required to obtain a pre-confirmation from the tax authorities before claiming relief under a treaty.

As part of the process, the local company had to obtain and submit to the Armenian tax authorities a special form signed by the foreign tax authorities. Submission of the copies of supporting documents was also required. The procedure of confirming the relief took two weeks in average.

What should you already start thinking about?

Now, if the Armenian resident company holds an appropriate certificate of residency issued by the foreign authorities for that particular tax year, that will be enough to apply the treaty provisions. The certificate will be valid for the tax year for which it was issued.

For the taxpayer it would be prudent to obtain the certificate upfront, as under the new rules the certificates provided during the tax audit would not be considered.

The compliance burden for the practical application of treaties has been reduced.

However, these amendments also impose additional risks to the local taxpayers who should now apply the treaty provisions more carefully. Instead of confirming a treaty relief with the tax authorities, taxpayers should analyse and apply the treaty provisions directly.

This would mean that for some complex issues (e.g., permanent establishments, etc.) the taxpayers should be ready to defend their position taken during a tax audit, if the tax authorities take a different view.

When do the new rules take effect?

The new rules will apply within ten days from publication, i.e., on 20 August 2011.

[1] Government Decree No. 1052-N of 21 July 2011. Published in Official Journal No. 47 (850) of 10 August 2011

Tax treaties signed in 2011

Armenia is rapidly expanding its network of tax treaties. A couple of new treaties that has been signed during the first eight months of 2011 are summarised below.

Armenia-Cyprus

Status: Pending exchange of instruments

On May 26 Armenia's National Assembly adopted a law ratifying the pending Armenia-Cyprus income tax treaty.

The treaty, which is the first income tax agreement between the two countries, was signed on January 17 in Nicosia and will enter into force after the two countries exchange ratification instruments.

Under the Armenian-Cyprus tax treaty, dividends are subject to 0% rate if the beneficial owner has invested in the capital of the company not less than the equivalent of EUR 150 thousands at the time of the investment and 5% rate in all other cases. Interest is subject to 5% rate withholding, however, interest on the State loans would be taxed at 0% rate. Royalties would be taxed at 5% rate if paid to the beneficial owner.

Armenia-UK

Status: Signed, pending ratification

A first-time comprehensive Double Taxation Convention between the United Kingdom and the Republic of Armenia was signed in London on 13 July 2011 .

The Convention generally follows the OECD Model Double Taxation Convention. Important features include limits on withholding tax rates for dividends, interest and royalties, the latest OECD Model provision on exchange of information, and a provision for arbitration as part of the mutual agreement procedure.

Under the treaty, dividends are exempt if the beneficial owner is a pension scheme.

Dividends are taxable at a 5% rate if:

• the beneficial owner is a company that is a resident of the other contracting state;

• holds at least 25% of the share capital of the payer company, and

• has invested at least £1 million in the share capital of the payer company at the date of payment of the dividends.

Dividends are taxable at a 15% rate if they are paid from income (including gains) derived from immovable property by an investment vehicle that distributes most of the income annually and whose income from such immovable property is exempted. In other cases, a 10% rate applies.

Interest and royalties are subject to a 5% withholding tax rate.

The Convention will enter into force once both countries have completed their legislative procedures.

Armenia-Ireland

Status: Signed, pending ratification

A first-time tax treaty between the Government of Ireland and the Government of the Republic of Armenia was signed in Dublin on 14 July 2011.

The agreement generally follows the OECD Model Double Taxation Convention.

Under the treaty, dividends are taxable at 0% rate if the beneficial owner is a company that is a resident of the other contracting state (other than a partnership), which:

• holds directly at least 25% of the capital of the paying company;

• owns that holding for a period of at least 2 years prior to any claim to reduce the withholding tax rate being made, and

• is entirely relieved from tax on dividends by an exemption or would be entirely relieved by a credit for tax paid in respect of the dividends by the company paying the dividends in the contracting state of which it is a resident.

Dividends are taxable at a 5% if the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends.

Dividends are taxable at a 15% rate in all other cases.

Interest is taxable at a 0% rate if it is paid to a contracting state or a local authority, including the Central Bank of a contracting state or any institution, agency or fund wholly owned by a contracting state.

Interest is taxable at a 5% rate if it is paid in respect of a loan of any kind granted by a banking enterprise.

Interest is taxable at a 10% rate in all other cases.

Royalties are subject to a 5% reduced withholding tax rate.

The Agreement enters into force once both countries have completed their legislative procedures.

Contact your PwC advisor today for a detailed discussion on how we can help you navigate these latest developments.

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