Tax Circular 24 August 2010

CYPRUS TAX ADVANTAGES AND INCENTIVES

Following the accession of the Republic of Cyprus to the European Union in 2004, its tax legislation is compliant with EU requirements and with the OECD initiative against harmful tax practices. The “offshore regime” has been abolished. Furthermore, following changes made in 2008, Cyprus has also satisfied the requirements of the Group of Twenty and the OECD by substantially implementing the internationally agreed tax standard on exchange of information.

As a result there is a stable EU, “non-offshore” tax-competitive jurisdiction with a substantial tax planning potential for EU and non-EU companies alike.

In summary, Cyprus is the “lowest-tax EU jurisdiction that is not offshore. Furthermore, the standard corporate tax rate of 10% (0% for shipping companies and 4,25% for maritime management companies) is the lowest non-offshore jurisdiction corporate tax rate in the world.

<u>Other incentives</u>

- Long history of positive approach by Tax Authorities towards helping foreign investors.
- Thin differential of profit is acceptable giving rise to a potential for a lot of legal tax-planning strategies in order to lower Cyprus tax significantly below 10%.
- Invoices from offshore companies are acceptable in Cyprus companies’ books.
- Payments to offshore companies are not subject to any withholding tax.
- There are no strict transfer pricing rules.
- There are no specific substance requirements.
- Financial benefits due to the ability to register for EU VAT in Cyprus.
- No tax on dividend income unless the paying company engages directly or indirectly more than 50% in activities which result in investment income and the foreign tax burden is substantially lower than the Cyprus tax burden.
- No tax on profit from sale of shares, bonds and other securities even if the profits form part of a company’s trading activity.
- No tax on profits from operations of permanent establishments maintained outside Cyprus.
- No capital gains tax on profits arising from the disposal of immovable property situated outside Cyprus.
- No withholding tax on interest payable to non-Cypriot tax residents.
- No tax on dividends payable to non-Cypriot tax residents irrespective of whether companies or individuals.

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- Beneficial use of EU Directives that have been transposed into the Cyprus Tax Legislation.
- Wide and exceptionally beneficial Double Tax Treaty Network.
- Mergers, Takeovers and other Re-organisations can take place within groups without tax implications.
- Unilateral tax-relief is granted to all Cyprus companies for foreign tax suffered irrespective of the absence of a double tax treaty.
- Tax losses are carried forward indefinitely and can also be surrendered as group relief.

<u>EU Directives, Cyprus' Double Tax Treaty Network</u>

- Following Cyprus accession to the EU Cyprus has become a major competitor to traditional Holding Company Jurisdictions such as the Netherlands and Luxembourg. More and more companies now prefer Cyprus. However, sometimes, best results can be achieved by combining Cyprus with other jurisdictions rather than by substitution.
- Beneficial use of EU Directives enacted into Cyprus Law:
    (1) Parent / Subsidiary Directive under which there is no withholding tax on payment of dividends, no transitional period, no minimum participation, no minimum holding period, dividend exempt subject to conditions, tax credit for tax withheld abroad.

    (2) Interest / Royalties Directive under which there is no withholding tax on interest paid to non-residents, no transitional period, 25% minimum participation required only in the case of royalties, no minimum holding period, interest taxed depending on nature, royalties subject to corporation tax , tax credit for tax withheld abroad.

    (3) Merger Directive involving resident and non-resident companies, leads to elimination of the tax implications of any reorganisation, merger, division, transfer of assets and exchange of shares.
- Cyprus has a wide and beneficial Double-Tax Treaty (DTT) Network. There are currently 45 DTTs in force and several others being negotiated. It has to be noted that Cyprus has fewer DTTs than some competing EU Jurisdictions, but in many cases more beneficial than its competitors' treaties such as those with Russia, Romania and the whole of Eastern Europe and the Middle East. The existence of these treaties, combined with the low overall tax regime enjoyed in Cyprus, offer significant possibilities for international legal tax planning.
- A significant number of DTTs concluded by Cyprus, lowers or eliminates foreign withholding taxes on dividends, interest and royalties or capital gains paid out from or arising in the contracting states, some also include particularly beneficial tax sparing credit provisions for dividends, interest and royalties. A "tax sparing credit" is a tax credit available to the recipient, which is higher than the actual tax paid in Cyprus. The Sparing Credit provisions can be found in the treaties concluded with countries such as Canada, China, Germany, Greece, Malta, Romania, Russia and UK.

Cyprus Holding Companies

Apart from the generic features of the tax system, the DTT Network and the adoption of EU Directives, other important features of the tax system beneficial to Cyprus Holding Companies are the following:

- Participation Exemption:
    (1) No tax on dividend income unless the paying company engages directly or indirectly more than 50% in activities which result in investment income and the foreign tax burden is substantially lower than the Cyprus tax burden (practically interpreted by the Tax Authorities to mean less than 5%), no other rules, no transitional period, no minimum participation, no minimum holding period, tax credit for tax withheld abroad.

    (2) No capital gains tax is payable on the sale or transfer of securities and the gains are exempt from Income Tax (except gains from disposal of shares in companies owning Real Estate situated in Cyprus – only to the extent that the gain relates to the particular Cyprus Real Estate).

    (3) Profits from a Permanent Establishment outside Cyprus are tax-exempt and its losses can be set-off against Cyprus Income unless the Permanent Establishment engages directly or indirectly more than 50% in activities which result in investment income and the foreign tax burden is substantially lower than the Cyprus tax burden.
- Simple rules and no need for additional and sometimes complex and expensive tax structuring to circumvent anti-avoidance provisions, as it usually is the case with other jurisdictions in the case of dividends or capital gains.
- No withholding tax on interest payable to non-Cypriot tax residents.
- No tax on dividends payable to non-Cypriot tax residents irrespective of whether companies or individuals.
- No withholding tax on royalty payments for use of the rights outside Cyprus, 10% if the rights will be used in Cyprus (subject to DTT & EU Directives) and 5% on films (subject to DTT & EU Directives).
- No capital gains or income tax on the liquidation of participations or the liquidation of the Cypriot Holding Company itself.
- No net worth taxes during the life of the Cypriot Holding Company.
- Tax losses are carried forward indefinitely and can also be surrendered as group relief. Mergers, takeovers and other re-organisations can take place within groups with no tax consequence.
- Unilateral tax-relief is granted to all Cyprus Companies for foreign tax suffered irrespective of the absence of a DTT.
- No thin capitalisation rules.
- Limited anti-avoidance provisions.
- No specific substance requirements.
- Absence of strict transfer pricing rules.

Cyprus Finance & Royalty Companies

Apart from the generic features of the tax system, the DTT Network and the adoption of EU Directives, other important features of the tax system beneficial to Cyprus Finance & Royalty Companies are the following:

Finance companies

- No withholding tax on interest paid to a Cyprus company (under a DTT or the EU Interest / Royalties Directive).
- Low overall tax burden.
- Possibility of deducting interest expenses from taxable income.
- Absence of thin capitalisation rules.
- No withholding tax on interest payable on loan financing irrespective of jurisdiction or the absence of a DTT.
- Low level of margin expected by Tax Authorities (not exceeding 0,35% depending on the size of the loans).

Royalty companies

- No or reduced withholding tax on royalties paid to a Cyprus company (under a DTT or the EU Interest / Royalties Directive).
- Low overall tax burden.
- Effective tax depreciation of investments in intellectual property.
- Possibility of deducting interest expenses from taxable income.
- Absence of thin capitalisation rules.
- No withholding tax on royalties payable for rights used outside Cyprus irrespective of jurisdiction or the absence of a DTT.
- Low level of margin expected by Tax Authorities.
- Effective protection of intellectual property rights by Legislation and the participation of Cyprus in International Agreements.