Tax Planning Opportunities in Cyprus

Since its accession to the European Union on the 1st May 2004, Cyprus has implemented a series of important changes to its fiscal regime to harmonise its tax legislation with the EU Directives and the EU Code of Conduct of Business. The resulting fiscal regime offers a range of very attractive tax advantages for structuring business through Cyprus, including the lowest corporate tax rate in the European Union.

The fiscal regime of Cyprus offers the following benefits:

- Introduction of the concept of tax resident and non-resident companies
- Introduction of an advance ruling procedure
- Taxation of worldwide income for tax residents and Cyprus-sourced income for non-residents
- Uniform corporate tax rate of 10%
- Tax-exempt business profits of non-resident companies
- Tax-exempt gains on the trading and disposal of securities
- Tax-exempt dividend income (subject to applicable criteria)
- Tax-neutral group reorganisations
- Tax-relief for group losses
- Tax-credits for foreign tax
- Tax-relief of 80% on intellectual property (IP) management company's profits (owner of IP)
- Full adoption of the EU parent-subsidiary directive
- Full adoption of the EU mergers directive
- Full adoption of the EU directive on mutual assistance and cooperation
- Full adoption of the EU royalty and interest directive

This fiscal regime coupled with an extensive list of double tax treaties, an enviable time zone location and a mature legal, accounting and banking infrastructure, places Cyprus high on the list of preferred jurisdictions for international tax planners.

This article highlights the main tax planning opportunities that Cyprus has to offer.

The Cyprus Holding Company

A Cyprus company can act as a holding company to effectively consolidate the ownership of a number of operating subsidiaries. Additionally, there are cases where a Cyprus company can act as an intermediate holding company to assist in the repatriation of dividends in a tax-efficient manner.

(a) Dividends paid by the operating subsidiary

- **EU operating subsidiary**
  Dividends will be received in Cyprus with no withholding tax as per the provisions of the EU Parent-Subsidiary Directive.

- **Non-EU operating subsidiary**
  Dividends will be paid to the Cyprus holding company net of withholding tax. The level of the withholding tax is subject to the double tax treaty between Cyprus and the country of residence of the subsidiary.

For example, assuming that the operating subsidiary is resident in Russia, the withholding tax on dividends from Russia to the UK is 10%, to Japan - 15% and to Cyprus - 5%. Hence, a British or Japanese investor can set up an intermediary Cyprus holding company, thereby reducing the tax burden on the distributed dividends to 5%. Similarly, direct investment into an EU country by a non-EU investor may lead to a withholding tax imposed on the dividend. The use of Cyprus as an intermediary eliminates the burden of this withholding tax.

Jurisdiction of source	Withholding tax rate on dividend distribution
Austria	25%
Belgium	15%
Cyprus	0%
Denmark	28%
France	25%
Netherlands	15%
Spain	18%
Switzerland	35%
United Kingdom	0%
United States of America	30%

(b) Dividend received by the Cyprus holding company

Dividend income is exempt from income tax in the books of the Cyprus holding company, but the exemption does not apply if:

(i) Directly or indirectly more than 50% of the activities of the paying company result in investment income, **and**
(ii) The paying company is subject to tax at a rate which is significantly* lower than the Cyprus corporate rate.

***** Significantly lower means 50% of the Cyprus tax rate i.e. 5%

(c) Dividend paid to the non-resident shareholder

There is no withholding tax on dividend paid by the Cyprus Company to the non-resident shareholder, regardless of whether this shareholder is a company or an individual, based in the EU or outside the EU.

(d) Disposal of the operating subsidiary

Gains arising from the disposal of the shares of the operating subsidiary are not subject to any tax in Cyprus, provided that the operating subsidiary does not own any immovable property in Cyprus.

The Cyprus Financing Company

When structuring a multinational group, the borrowing capacity of the group can be utilised to achieve an overall tax reduction. This can be achieved by structuring the group in such a way as to ensure that the tax-exempt dividend is received by the ultimate shareholder or holding company, while at the level of the subsidiary the taxable profits are reduced by deductible interest payments.

An efficient way of accomplishing this is to use a Cyprus financing company. Interest payable reduces taxable profits and interest received in Cyprus is subject to corporate tax of 10%. Any withholding tax suffered in the country of the operating subsidiary is credited against the tax payable in Cyprus and there are no thin capitalisation rules.

The Cyprus Royalty Company

Royalty income arises from the license fees or commissions paid for the use of intellectual property (IP), such as patents, trademarks and copyrights. A Cyprus royalty company can be used to receive the income created from this intellectual property in the most tax efficient manner.

Royalty income is taxed at 10% corporate tax and, if the IP rights are owned by the Cypriot company, taxable profits (including gains on disposal of IP) are reduced by 80%, resulting in an effective tax rate of 2% or less. Additionally, a competitive amortisation rate of 20% (5 years) is offered to reduce the tax burden even further.

Furthermore, the protection of IP rights is covered extensively in Cypriot Legislation. There is a comprehensive system in place that guarantees that the results of innovation and creativity are protected both, at the European and the international level.

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International Collective Investment Schemes (ICIS)

The International Collective Investment Schemes Law 1999 provides the legal framework for the registration and regulation of operations and supervision of ICIS.

There are four main entities that are addressed by the Cyprus ICIS law:

- Fixed Capital Companies
- Variable Capital Companies
- Unit Trusts
- Limited Partnerships

ICIS are approved and registered by the Central Bank of Cyprus and are subject to taxation in accordance with the provisions of the tax laws outlined above.

The key tax benefits of an ICIS include the following:

- Exemption from tax on foreign dividends
- Exemption from tax on profits from the sale of securities
- No withholding tax on income repatriated by the ICIS
- Tax credit for foreign tax paid

The Cyprus International Trust

The concept of the Cyprus international trust was introduced by the International Trust Law 1992, and the establishment and management of a trust in Cyprus is governed by the Trust Law 1955, which is similar to the English Trustee Act of 1925. In March 2012 the Cypriot Parliament voted in favour of the reform of the International Trust Law of 1992. The new law clarifies grey areas and removes restrictions and limitations of the previous law while the foundations remain intact. The main tax benefits of using a Cyprus International Trust are listed below:

- All income derived from any activity of the International Trust is exempt from income tax in Cyprus
- Dividends received from a Cyprus Company are exempt from income tax and are not subject to any withholding tax
- Gains from the disposal of any assets of the International Trust are not subject to capital gains tax in Cyprus

Cyprus International Trusts can be used for the following purposes:

- Estate planning
- Confidentiality / Anonymity
- Pension Planning
- Employee Incentive Schemes
- Charitable Activities
- Commercial arrangement e.g. to protect commercial lenders

The Cyprus Ship Management Company

The Cyprus Shipping Registry is amongst the largest in the EU and is ranked 10th in the world. Cyprus has also developed into one of the largest third-party ship management centres in the European Union and the Cyprus flag is on the white list of Paris MoU.

Cyprus has a very attractive Tonnage Tax system and the lowest corporate tax rate in the EU. The Cypriot Tonnage Tax system provides for tax on a net tonnage basis and a full exemption from corporate income tax. Exempt shipping companies are regulated by the Department of Merchant Shipping and not by the Tax Authorities.

Tonnage	Rate Per Tonne
First 1,000 tonnes	0,3650
Next 9,000 tonnes	0,3103
Next 15,000 tonnes	0,2008
Next 15,000 tonnes	0,1278
Each tonne above 40,000 tonnes	0,0730

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Conclusions

As companies find it increasingly difficult to create and sustain the growth rate required by their shareholders due to ever rising competitive pressures, international tax planning is quickly becoming one of the most effective strategies to maximise shareholder returns.

Cyprus, in turn, is rapidly evolving into the jurisdiction of choice for the international business community, multinational corporations and their trusted tax advisors.

Cyprus has succeeded in harmonizing its tax laws with the EU and the OECD while maintaining its attractiveness to international tax planners. Today, Cyprus is considered to be one of the most sophisticated low tax jurisdictions and is consistently utilised in a growing number of international tax optimisation structures.

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