Corporate Tax Alliance

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Cyprus: what has really changed since March?

by Aspen Trust Group

The dust is settling on the Mediterranean island of Cyprus since the tumultuous events of March 2013. The country signed a Memorandum of Understanding with the "Troika" (European Commission, European Central Bank and the International Monetary Fund) and the reputation of the banking sector suffered a blow, but what has actually changed, especially for corporate structuring?

> "Although the tax rate increased to 12.5%, holding companies are not materially affected"

The Troika imposed fiscal consolidation and structural reforms that momentarily disrupted the business, but aims to restore the soundness of the Cypriot banking system, rebuild depositors' confidence and support competitiveness and sustainable growth. With regards to the reputation of the Island's banking system, Laiki Bank underwent resolution and was absorbed by Bank of Cyprus, but we would like to point out that no banks left Cyprus. In point of fact, all remaining 41 banks in Cyprus continue to operate as usual, with no threat of restructuring.

Cyprus also passed the test of money laundering with flying colours, despite many accusations of wrongdoing. Where these came from is still a bit of a mystery, since the country's anti money laundering system (AML) was favourably rated by the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL) in December 2011, and in 2012 Cyprus scored better than Germany and the Netherlands on the Basel Institute of Governance's AML Index. Also, the IMF has been happy with the compliance of Cyprus' AML procedures. In fact, recent (2013) reports by Deloitte and MONEYVAL indicate that the banks have high level of compliance, especially regarding the identification of beneficial owners and on-going due diligence activities.

Although corporate tax was increased from 10% to 12.5%, Cyprus continues to have one of the most attractive corporate tax rates in the EU on par with that of Ireland and Malta. What is very often forgotten, though, is that most holding companies are not materially affected by the increase and, as for trading companies, the increase is quite marginal and not likely to cause perceptible harm. Further, gains from the sale of securities (including shares, units in funds redeemable shares, GDRs, etc.) are exempt from corporate tax in Cyprus and this hasn't changed.

With respect to the increase in the special defence contribution (SDC) from 15% to 30%, one should remember that non-resident companies and individuals are exempt from this and it is only imposed on passive interest income and therefore should not hinder growth.

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As for the levy payable by banks on customer deposits, which increased from 0.11% to 0.15%, note that no levy is payable for inter-bank deposits. Although the levy cannot be deducted for the purpose of calculating taxable profits, it will reduce the amount of profits subject to deemed dividend distribution.

> “still the most attractive tax regime for IP”

Furthermore, we would like to emphasize the following key advantages of Cyprus that remain unaffected by recent developments:

- Dividends managed and controlled from Cyprus are fully exempt from tax
- No withholding taxes on dividends, interest and royalties paid out to non-resident shareholders
- The most attractive IP tax regime in Europe – effective tax rate of 2% or less
- No capital gains tax for the sale of securities or real estate situated outside Cyprus
- Double tax treaty network with 45 countries, with favourable provisions in tax treaties with such prominent countries as Russia, Ukraine, India and South Africa
- Holding companies and financing companies are exempt from taxation on interest on deposits

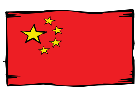
Add Cyprus’ geographical location, highly qualified workforce, common law based legal system, EU membership, wide range of double tax treaties and voilà: you have a competitive tax planning jurisdiction. And we are not alone rooting for Cyprus: The Economist Intelligence Unit describes Cyprus’ tax regime as one of its “strongest features”. It also predicts that the tax regime will be strengthened by the revised law on international trusts, passed in December 2012.

Aspen Trust Group believes that at the end of all this, Cyprus’ financial and corporate services sector will emerge as smaller but stronger, and more adaptable to service clients in need of high quality service.

For more information, contact info@aspentrust.com to discuss these topics in more detail.

Chinese tax treatment partnership structures

by Michael Zheng



Introduction

During the recent years, professional equity investment institutions like private equity/venture captial (PE/VC) funds grow obviously in the China market. Their major activities are making equity investment into unlisted Chinese private companies, and hold their shares for future disposition to derive capital gain. Like PE/VC funds of mature markets like US or Europe, PE/VC funds in China also tend to adopt the legal type of limited liability partnership enterprise (“LLP”). One major reason of choosing such legal type is that a LLP is a “tax transparent” entity. An LLP is not an income tax payer itself. Instead, its profits are “allocated” to its GP (general partner) and LP (limited partner), and then the GP/LP pay income taxes. Therefore, the income tax double taxation issue under a corporate structure can be avoided, so that the investors’ after-tax return can be maximized. Such double taxation issue refers to the situation that a company pays Corporate Income Tax (“CIT”) first, and when it pays dividend to its individual shareholders, there will be Individual Income Tax (“IIT”) cost.

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However, current Chinese tax regulations are not clear about how income "allocated" to GP/LP's income from a LLP should be categorized, which affects the applicable income tax rates. Currently, State Administration of Taxation ("SAT") is drafting the new "Regulation of Income Tax Treatment of Partners of a Partnership Enterprise" ("Draft Regulation"). It is likely that the Draft Regulation may lead to a significant increase of PE/VC funds' investors' tax costs.

Current practice and potential impact of the draft regulation

For the investors of PE/VC funds (LLP), their most important revenue source is the gain derived from selling the shares in Chinese private companies that the PE/VC funds have invested. Normally, PE/VC funds will make equity investment to such companies, and hold their shares for a certain period before share disposition (e.g. after the IPO of the companies).

Type of GP/LP	Applicable Income Tax Rates on Their Share Disposition Gain "Allocated" from PE/VC Funds	
	Normal Practice At Current Stage	Possible Treatment under the Draft Regulation
Chinese Individual:	20% IIT	5%-35% IIT
Chinese Companies:	25% CIT	25% CIT
Overseas Individuals:	20% IIT (but the rate may be reduced under the relevant Sino-foreign tax treaties. Generally, such IIT rate is 10%.)	25% CIT
Overseas Companies:	10% Withholding Tax (but the rate may be reduced under the relevant Sino-foreign tax treaties)	5%-35% IIT

As mentioned above, PE/VC funds are treated as "tax transparent" entities. Under the current practice of Chinese tax authorities at most locations, PE/VC funds' share disposition gain on shares is not subject to income tax at the PE/VC funds (LLP) level. Such gain is "allocated" to the GP/LP. Although the tax regulations are not very clear, under normal practice currently, GP/LP are subject to income tax on such "allocated" profit as "capital gain" (passive income). We have illustrated the detailed tax rates in the following table, according to the different types of GP/LP.

However, the Draft Regulation which is currently under the assessment of SAT, may require that the partner of a PE/VC fund pays income tax on the above share disposition gain as "business operation income" (active income). If so, the applicable tax rates may increase significantly.

> "if the Draft Regulation is finalized this way, the costs of PE/VC funds' investors will be affected significantly"

If the Draft Regulation is finalized this way, the tax costs of PE/VC funds' investors will be affected significantly, as indicated above. Further, it is unreasonable to categorize GP/LP's above-mentioned share disposition gain as "business operation income" (active income), especially for the limited partner. Normally, LP investors do not actively participate in PE/VC funds' daily operation and management activities, like equity investment.

Our view is that it is likely that under the new regulation to be finalized and enforced, GP's above-mentioned share disposition gain will be categorized as "business operation income" (active income). However, for LP, it is possible that their such income may still be categorized as "capital gain" (passive income). Actually, the Draft Regulation has caused disputes from various parties. The final result will be subject to the negotiation among different interest groups, like tax payers, Chinese tax authorities, etc.

Conclusion and recommendation

Given the possibility that the tax costs of PE/VC funds' investors may be affected significantly under the Draft Regulation, it is recommended that various PE/VC funds should consider planning strategies regarding their structures and investment models, in order to minimize the relevant tax costs and increase the certainty of their tax treatment.

Who is the tax payer according to Libyan tax law?

by Tariq Almontaser

First, this news item is prepared mainly to describe the official meaning of the tax payer according to the Libyan Tax Law No. 7 in 2010. Considerably, the Libyan Tax Authority have not officially been translated to English the new tax law which came into force during the year.

Who is obligated to pay tax?
Starting from Article No. (55) Paragraph (A) it is stated that all allowances, salaries, wages, remunerations, etc. whether permanent or temporary, should be subjected to the relevant tax.

More over, this Article also states the taxed income (salary) against services provided in Libya to any person resident inside or outside it, or against services provided outside Libya.

Moving on, Article No. (60) states that firms mentioned in the above-mentioned article (foreign companies are included) should provide the tax authority with full details about people's names whom perform work for the company and their address, positions held and their salaries.

In addition, Article No. (59) of the same law states that if the company neither has residence in Libya nor has a representative; the individual engaged by that company in Libya should personally pay the tax to the tax authority in Libya himself.

Direct costs declared in branch's income statement
In some cases, a project performed in Libya also has part of its scope outside Libya (not importing materials or equipments, etc.). Because of these activities carried out elsewhere, the head office obviously will charge the branch with direct costs, paid outside of Libya.

By direct costs, we mean those costs related to the project in Libya. This includes salaries, wages, services, etc. while the income statement of the Libyan branch identifies such kind of costs clearly.

Headquarter charges to the branch
We would like to draw your attention also to the allowance that the Libyan tax law (Article No. 66) for the ability of booking a part of the general headquarter costs according to accounting policies applied by the head office. These kind of costs are usually charged partially and annually from the head office, these indirect expenses, also includes salaries.

We could consider the general director's salary in the head office or its staff as example of such indirect expenses which is not related directly to any project. Those HQ charges are not taxable.

Foreign Subcontractors
The last part of the Paragraph (A), Article No. (55) states also that income earned by a third party (foreign companies are not people as experts or the like) as subcontractor is excluded from Libyan tax if the business relation between you and the third party is based neither on a contract issued and signed inside Libya nor protected by it.

For example, the payment to the foreign company as consultation fees against the called services provided to you will not be subjected to any tax in Libya even if they the services relate to a project in Libya.