

E6: Cyprus

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Introduction

E6.1 Cyprus is an island in the eastern Mediterranean Sea. Situated at the crossroads of Europe, Africa and Asia, it is easily accessible to overseas clients. It is two hours ahead of London, seven hours ahead of New York, and seven hours behind Tokyo. The administrative capital is Nicosia, with most international enterprises based in the island's second city, Limassol, which is also the financial capital and major port.

Cyprus was invaded in 1974 by Turkey, which presently occupies almost 40% of the island. In 1983, the Turkish-held area declared itself to be the 'Turkish Republic of Northern Cyprus'. However, this 'state' is only recognised as such by Turkey.

Cyprus joined the EU on 1 May 2004. The entire island entered the EU but the EU *acquis* – the body of common rights and obligations – applies only to the areas under government control, and is suspended in the Turkish-occupied area, where EU laws do not apply.

Except where stated to the contrary, information in the following sections relates to the government-controlled areas.

Despite the *de facto* division, Cyprus has enjoyed remarkable political and economic stability, with steady growth and low inflation. Cyprus has a record of successful economic performance, reflected in rapid growth, full employment and external and internal stability. In terms of per capita income, currently estimated at US \$21,600 (2005), the country is among the world's high-income countries. The success of Cyprus is due in no small part to the existence of a dynamic and flexible entrepreneurial spirit, together with a highly educated labour force. Cyprus ranks 29th in the world on the UN Human Development Index, a measure of quality of life. The standard of living is among the highest in the world, with a thriving tourist and service sector.

The population of the government-controlled area is estimated at 766,400 at the end of 2005. Greek and Turkish are the official languages of the Republic, but English is also widely spoken and used, especially in business. The unit of currency is the Cyprus pound, divided into 100 cents. Cyprus joined ERM2 in 2005 and on 1 January 2008 it will become a member of the Eurozone and adopt the Euro as its currency.

Constitution

E6.2 The President is elected by universal suffrage for a five-year term of office, and exercises executive power through the Council of Ministers appointed by him. Legislative authority lies with the House of Representatives.

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Legal system

E6.3 The British came to Cyprus in 1878, and remained in control until independence in 1960. The legal framework in Cyprus is based on the English common law model. Much English case law was codified by the British, for example the Contract Law (Cap 149), which was based on the Indian pattern.

The Constitution provides that the laws in force at the time of independence should remain in force until repealed or amended. Further, pursuant to section 29 of the Courts of Justice Law (Law 14 of 1960), the courts must adhere to the principles of common law and equity, unless these are inconsistent with statute law or the Constitution.

A large body of legislation has recently been passed in order to harmonise the laws of Cyprus with those of the EU.

Court structure

E6.4 The judicial system consists principally of:

- the Supreme Court, exercising original and appellate civil and criminal jurisdictions;
- the Assize Courts, with unlimited criminal jurisdiction; and
- the District Courts, which exercise civil and summary criminal jurisdiction.

Trials are adversarial in nature and conducted orally. The common law rules of evidence, modified by various statutes, apply. Hearsay evidence is not generally admissible. Civil procedure is governed by the Civil Procedure Rules (Cap 12). The Supreme Court lays down additional practice statements and directions. The old English Rules of Civil Procedure, in particular the Annual Practice of 1958 which was applicable prior to independence, are also referred to for guidance. The courts have inherent jurisdiction to ensure proceedings do not achieve injustice. Successful litigants are normally awarded costs.

Infrastructure and communications

E6.5 Cyprus has two international airports and a wide network of air routes connecting the island with Europe, America, Africa and Asia. A new motorway system links all major towns and cities. Cyprus has invested heavily in the latest communications technology, and is now among the most developed countries in the world in this field, making widespread use of fibre-optic cables and satellite ground stations. The internet is widely used, and there are numerous ISPs and IT support companies.

Professional representation

Lawyers

E6.6 The profession is unified and lawyers are allowed to act both as solicitor and advocate. In practice, most lawyers specialise either in litigation or non-contentious work. Members of the Cyprus Bar must possess a recognised law degree, have satisfactorily completed a one-year pupillage, and have passed the practical Bar exams.

Contingency fees are prohibited in Cyprus. For contentious matters a written agreement may be made fixing the fees and disbursements. Where there is such an agreement, costs are not subject to taxation. Fees for contentious matters which have not been fixed by agreement are controlled by the Rules of Court. A client dissatisfied with a fee note may apply to the Registrar of the Court for taxation.

Accountants

E6.7 All the major international accounting firms are represented in Cyprus, ensuring availability of high quality accounting and auditing practitioners.

To become a member of the Institute of Certified Public Accountants of Cyprus, candidates must either undertake a training contract (three years for graduates or four years for non-graduates who have passed the Foundation Course) with an authorised training office in Cyprus or the EU and pass a test of professional competence, or be a member of an approved equivalent body in another country.

Bankers

E6.8 Cyprus has a number of long-established and highly regarded domestic banks. Following the abolition of the Exchange Control Law in 2004, authorised subsidiaries and branches of foreign banks (formerly 'International Banking Units') may carry on business in the same way as domestic banks, though most continue to function principally as representative offices.

Trust companies

E6.9 A draft Bill of the Regulation of Fiduciaries, Administration Businesses and Company Directors Law was published for consultation early in 2006 and is expected to enter into law in 2007.

Under the proposed new law, individuals or companies offering trustee or company management services on a commercial basis ('fiduciary services') will need to be authorised as 'fit and proper' by the Central Bank of Cyprus ('CBC'). Licensing will be mandatory and no person may carry out any regulated activities in or from Cyprus except under the conditions of a current licence issued by the CBC.

Members of the legal and accounting professions authorised to practise in Cyprus will be entitled to a licence as of right, as will banks and investment firms licensed in Cyprus and fiduciary service providers authorised by another EU Member State. They will nevertheless be subject to the overall regulatory regime. Regulated service providers will be required to put in place adequate internal controls, policies and procedures. The new law will set out accounting and reporting requirements and ensure that the authorities have accurate and up-to-date information on settlors, trustees and beneficiaries of trusts.

Adequate arrangements must be made for the segregation and protection of clients' monies. Licensed fiduciaries will be obliged to maintain a separate accounting system to record all transactions related to clients' monies and the CBC will be given power to issue detailed accounting rules to safeguard and protect clients' ownership rights, especially in the event of insolvency.

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The powers given to the CBC are extremely wide-ranging and extend from initial approval of applications through control over changes in personnel and ownership of licensed businesses to operational issues such as the form and content of advertisements and the regulation and monitoring of operations. The CBC will have the right to issue orders requiring licensed persons or businesses to take, or to cease from, specified actions and may, in appropriate cases, revoke their licence and suspend their operations.

Trust legislation – sources of law

Trustee Law (Cap 193)

E6.10 In 1955 Cyprus enacted its own statute, the Trustee Law of 1955 (Cap 193), which was the basic law that dealt with the principal aspects of the trust relationship. Thus, at the time of independence in 1960, Cypriot trust law was to be found in domestic law and the doctrines of equity applicable in England.

Whilst there is no specific statutory definition of a trust in Cyprus law, the Hague Convention on the Law Applicable to Trusts and their Recognition (1984) applies.

International Trusts Law (Law 69 of 1992)

E6.11 Building on the Trustee Law, the International Trusts Law starts from the basis that existing statutory and common law principles of trust law continue to apply unless overridden by a specific provision contained within it.

An international trust is defined as one in respect of which:

- the settlor is not a permanent resident of Cyprus;
- no beneficiary (other than a charity) is a permanent resident of Cyprus;
- the trust property does not include any real property situated in Cyprus; and
- there is at least one trustee resident in Cyprus at all times.

A trust will still qualify as an international trust even if the settlor or the local trustee or a beneficiary (or any combination of these) is a Cypriot International Business Company or partnership.

The courts of Cyprus have powers similar to those set out in the English Variation of Trusts Act 1958 to vary the terms of an international trust.

Law and jurisdiction

E6.12 A trust settled in Cyprus will *prima facie* be governed by the laws of Cyprus. Section 9 of the International Trusts Law provides that the law applicable to an international trust can be expressly changed to a foreign law provided that the new law recognises the validity of the trust and the interests of the beneficiaries. A trust established in a foreign jurisdiction may, by its terms, select Cypriot law provided that the foreign law itself recognises such a change.

Trustees' powers and duties

E6.13 Trustees must administer the trust property prudently and comply strictly with all the trust terms. Any action by the trustees outside their powers is a breach of trust, rendering the trustees personally liable. Powers of investment must be exercised with the prudence and diligence of a reasonable person. Fiduciary duties may not conflict with private interests unless duly authorised; thus, in the absence of express authorisation trustees have no right of remuneration beyond out-of-pocket expenses.

Trustees may not generally delegate their duties, except for the employment of various professionals. Accounts must be kept and, according to section 22(4) of the Trustee Law, these may in the trustees' absolute discretion be audited once every year, at the expense of the trust estate, or more often if the nature of the trust property makes this reasonable.

All possible present and future beneficiaries of full age and capacity can collectively authorise the trustees to deal with the trust property in any manner desired. The trustees have no other power to vary the trust. A court may, upon application, amend the trustees' powers where it is satisfied that this would benefit the person(s) concerned, as was the position in England prior to the introduction of the Variation of Trusts Act of 1958.

Perpetuity and accumulation period

E6.14 Except for charitable trusts, no trust may continue in perpetuity. Domestic trusts endure for either the period of the life or lives in being plus 21 years or, where there is no life in being, merely for 21 years. The accumulation period of a trust may be extended to include the entire perpetuity period.

An international trust may remain in force for up to 100 years notwithstanding any contrary statutory provision of any country to the contrary. International trusts that are charitable may continue indefinitely, according to section 5 of the International Trusts Law. Section 6 of the same law provides that income may be accumulated for the entire period of the trust.

Unit trusts

E6.15 An International Unit Trust Scheme is constituted by deed, made between the manager and trustee, which must be corporate personalities independent of each other. The manager and trustee must obtain the prior written authorisation of the Central Bank of Cyprus and the Capital Securities Committee before they assume duties in relation to such a scheme established in Cyprus. They must also satisfy the CBC and the Capital Securities Committee that they have the appropriate experience to carry out their functions. Unit-holders may redeem or repurchase their units directly out of the assets of a scheme. The combination of Cyprus' existing trust, companies and partnership laws allows for funds to be structured in a flexible manner.

Charitable trusts

E6.16 The Charities Law (Cap 41), section 15, adopts the common law classification of charities as those for:

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- the relief of poverty;
- the advancement of education;
- the advancement of religion; or
- other purposes beneficial to the community.

Charitable trusts are enforced at the suit of, or under the authorisation of, the Attorney General, and are favourably treated in terms of perpetuity and taxation.

Section 7 of the International Trusts Law defines charitable international trusts in the same way as the Charities Law. It additionally provides that purpose trusts, that is, trusts which are not necessarily only for established charitable objects or for the benefit of ascertained individuals, are enforceable either by the settlor (or his personal representatives) or by the person named in the trust instrument as having the right to enforce the trust. Such a person may also be a beneficiary under the trust.

Trustees

E6.17 There are no general rules as to the number required. Mere appointment does not oblige a trustee to take office. Where one of a number of trustees dies, his duties devolve upon the rest. Where a sole surviving trustee dies, his personal representatives can exercise his powers.

Under the terms of section 40 of the Trustee Law, the court has special powers to discharge trustees and sanction the appointment of new trustees, upon application. According to section 35 of the same law, a trustee may also be replaced by a new trustee in certain circumstances (for example, if he remains abroad for over a year) by the persons (if any) nominated in the deed to appoint new trustees, or by the other trustees.

Protectors

E6.18 There are no specific provisions in statute for the appointment of a protector. Much depends on the trust instrument and letter of wishes, if any. The role of the protector is usually fiduciary, or quasi-fiduciary at least, involving the protection of the trust property from various hazards, whether relating to trustees, beneficiaries or trust arrangements. This means that the protector must independently and consciously consider whether or not to exercise a fiduciary power, must not exercise it perversely against any sensible expectation of the settlor, and cannot release it otherwise than in accordance with the trust instrument. Usually the protector's prior consent is required for the trustees to carry out certain acts and in some cases the protector is given power to appoint or remove trustees.

Taxation of trust income

E6.19 Local trusts are treated as transparent vehicles for income tax purposes. Trustees are required by law to make returns to the Inland Revenue, pay any tax due on the trust income and to supply details of trust beneficiaries and accounts.

The International Trusts Law, section 12, provides that the income and the profits of an international trust derived or deemed to be derived from a source outside Cyprus are completely exempt from income tax or any other tax imposed in Cyprus, such as capital gains or special contribution for defence.

Therefore, trust income such as royalties, interest or dividends received from an international business company, is exempt from income tax in the hands of the trustees. Further, the beneficiaries of an international trust are also exempt from payment of income tax in respect of any monies they receive from the trustees.

Under section 12(2) of the International Trusts Law, the instrument creating an international trust is subject to a stamp duty of CYP 250 (approximately US\$ 550).

There are no succession taxes in Cyprus.

Company legislation

Companies Law (Cap 113), as amended

E6.20 This statute, which governs all companies limited by shares registered in Cyprus, is based on, and in many respects, closely follows, the UK Companies Act 1948.

Companies must register their Memoranda and Articles of Association. Memoranda must contain:

- the name of the company;
- a limited liability clause;
- a capital clause;
- an association clause; and
- an objects clause.

Articles generally follow a standard pattern, Table A, set out in a schedule to the Companies Law. The Articles may be altered provided that the changes do not breach any statutory provision or oppress or defraud minority shareholders. The Memorandum and Articles of Association must be drafted and printed in Greek and subscribed by at least one founding member, prior to being registered.

Companies may be public or private. Since July 2006, Cyprus law has also allowed the formation of European Public Limited Companies ('SEs').

Alteration of objects clause

E6.21 A company's objects clause may be amended, within the seven conditions mentioned in section 7(1) of the Companies Law, in order to:

- carry on its business more economically or efficiently;
- obtain its main purpose by new or improved means;
- expand or otherwise change the local area of its operations;
- carry on some business which under existing circumstances may be conveniently or advantageously combined with the business of the company;
- restrict or abandon any of the objects specified in the memorandum;
- sell or dispose of the whole or any part of the undertaking of the company; or
- amalgamate with any other company or body of persons.

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The alteration must be effected by special resolution and confirmed by the court.

Capital requirements

E6.22 Although usually denominated in Cypriot pounds, the nominal share capital of a company may, subject to the consent of the Registrar of Companies, be denominated in other currencies. As noted earlier, it is intended that the Euro will replace the Cyprus pound as the national currency with effect from 1 January 2008. Shares may be used as working capital.

Shares

E6.23 A private company may have only one shareholder, and unlike public companies must:

- restrict members' right to transfer their shares;
- limit the number of members to 50;
- prohibit any invitations for public subscriptions; and
- prohibit the issuance of bearer shares.

Shares of limited companies are personal property and may be transferred in the manner provided in the articles. An instrument of transfer is always required and no transfer should be registered unless a proper instrument is filed with the company. There is no special form for this instrument. A company may issue redeemable preference shares and, subject to the satisfaction of statutory criteria, redeem them at a later date. However, a company may not purchase its own shares, except by way of reduction of capital with the sanction of the court in accordance with sections 64 and 65 or in the special circumstances set out in section 57 of the Companies Law.

Section 28(1) provides that a subsidiary company may not be a member of its holding company except where otherwise permitted. Section 53(1) further prohibits a subsidiary company from providing direct or indirect financial assistance for the acquisition or subscription of shares in its holding company.

Alteration of share capital

E6.24 If so authorised by its articles, and by ordinary resolution unless the articles otherwise provide, a company may amend the provisions of its memorandum regarding its capital so as to:

- increase its share capital by new shares of any amount;
- consolidate and divide all or any of its share capital into shares of a larger amount;
- convert any paid-up shares into stock, and reconvert the stock into paid-up shares of any denomination;
- subdivide any of its shares into shares of a smaller amount; or
- cancel shares which have not been taken up.

A company with share capital may, if so authorised by its articles, reduce its share capital by special resolution and in particular may:

- extinguish or reduce the liability on shares in respect of share capital not paid-up;
- cancel or reduce liability on any of its shares;
- cancel any paid-up share capital which is lost, either with or without extinguishing or reducing the liability on any shares; or
- pay off any paid-up share capital which is in excess of the needs of the company.

A reduction of capital requires confirmation by an order of the court, which will need to be satisfied that the reduction of capital does not harm the interests of creditors.

Directors

E6.25 The Companies Law does not define the term director, but section 2(1) provides that a 'director includes any person occupying the position of director by whatever name called'. A private company may have only one director and a secretary but the same person may not be a sole director and secretary. A public company must have at least two directors and a secretary. Appointment is left to the articles. Directors need not hold shares in the company. Loans to directors are normally absolutely prohibited by section 182(1), except in the case of an 'exempt' private company (described below). There are no residency requirements for the directors – however, the residency of directors may affect the company's tax treatment (see E6.33 below).

Internal management

E6.26 The Companies (Amending) Law 21(I) of 2000 introduced section 33A into the existing Companies Law, in order to embrace the EU First Council Directive 68/151/EU on the co-ordination of safeguards for the protection of shareholder interests.

This amendment limits a company's liability to perform its obligations under a transaction it has entered into, where those powers are expressly limited by the Memorandum or Articles of Association of the company, or any other law.

Secretary

E6.27 Normally the secretary will be appointed by the board of directors. The Companies Law does not explicitly define the duties of a secretary but in general they are administrative and not managerial. Unless the secretary is otherwise empowered by the company or the board, he may not bind the company, except in respect of contracts of an administrative nature such as the employment of office staff. Certain statutory duties are incumbent upon the secretary, both *per se* and as an officer of the company.

Resolutions

E6.28 The Companies Law contemplates three types of resolution of members:

- ordinary;
- special; and

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- extraordinary.

An ordinary resolution is one passed by a simple majority, and is used for all matters not requiring an extraordinary or special resolution. A special resolution is passed by a three-quarters majority at a meeting of which not less than 21 days' notice has been given, specifying the intention to propose the resolution as a special resolution. An extraordinary resolution also requires a three-quarters majority at a general meeting of which notice specifying the intention to propose the resolution as an extraordinary resolution has been given. The notice period, however, depends on the notice of the meeting at which the resolution is to be proposed. If it is to be proposed at an annual general meeting, 21 days' notice is required, but if it is to be proposed at an extraordinary general meeting, 14 days' notice will suffice.

Returns

E6.29 Every Cyprus company is required to adopt 31 December as its accounting reference date. Under section 118 of the Companies Law, every company having a share capital is required at least once in every calendar year to make an annual return to the Registrar setting out particulars relating to the company. The particulars are as specified in Part I of the Second Schedule to the Companies Law and include particulars of members, directors and indebtedness. A company need not file an annual return either in the year of its incorporation or the following year provided that no more than 18 months elapse from the date of incorporation. The annual return must be completed within 42 days of the annual general meeting for the year, and must be made up to the fourteenth day after the annual general meeting. Section 121 provides that, unless the company is an 'exempt' private company (described below), there must be annexed to the return certified copies of the balance sheet, profit and loss account, and directors' and auditors' reports.

Accounts

E6.30 All companies are obliged to keep proper books of account with respect to:

- money received and expended by the company, together with the reason for such;
- sales and purchases by the company; and
- assets and liabilities of the company.

Section 141(1) of the Companies Law obliges the directors to keep accounts of all sums of money received and expended, with explanations, all sales and purchases and the assets and liabilities of the company, following the format set out in the Eighth Schedule to the Companies Law.

Exempt companies

E6.31 Exempt companies:

- do not require auditors to be qualified under section 155 of the Companies Law;
- do not need to make an annual return to the Registrar;
- do not need to print special resolutions to be filed with Registrar; and

- may give loans and guarantees to directors.

For a company to be an 'exempt' company, it must fulfil all the requirements of a private company. In addition:

- no corporate body may hold any of its shares or debentures unless it is itself an exempt private company registered in Cyprus;
- the number of debenture holders may not exceed 50;
- no corporate body may be a director of it;
- nobody other than the holder may have any interest in any of its shares or debentures; and
- neither the company nor directors may be privy to any agreement whereby company policy is determined by persons other than its shareholders and directors.

Registration of charges

E6.32 Section 90(1) of the Companies Law provides that every registrable charge by a company registered in Cyprus conferring security over that company's property or undertaking shall be void and unenforceable against any liquidator or creditor of the company, unless the prescribed particulars of the charge together with the instrument creating it are delivered to the Registrar of Companies for registration within 21 days of the date of its creation. In the case of a charge executed outside Cyprus over property situated outside Cyprus, the prescribed period is 21 days from the date on which, in due course of post and if dispatched with due diligence, the charge could have been registered in Cyprus. The period of registration may be extended by court order. Section 90(2) lists the categories of registrable charges, including *inter alia* a charge for securing any issue of debentures, a floating charge on the undertaking or property of the company and a charge on immovable property wherever situated. The registration of a registrable charge is a perfection requirement rather than a priority point.

Corporate taxation

E6.33 A Cyprus-resident company's worldwide income is taxed at 10%. A company is resident if it is managed and controlled in Cyprus. The law does not explicitly define management and control, but the following tests are relevant:

- residence of directors;
- economic purpose;
- locus of decision-making.

A non-resident company will only be taxed on its Cyprus-source income.

A Cyprus-resident company which acts as a trustee of a Cypriot international trust is liable to tax on its trustee management fee. In the event that the trustee carries on business on behalf of an international trust, corporate income tax may be avoided as the profits will be considered to be the profits of the international trust and thus be tax-exempt according to the provisions of the International Trusts Law.

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Dividends are not subject to Cypriot income tax generally, but a 15% special defence contribution tax is levied on the dividend income of a Cyprus-resident person (company or individual) subject to the following exemptions.

- *Exemption for dividends payable abroad.* Non-residents of Cyprus are not subject to special defence contribution tax, and therefore dividends payable by a Cyprus-resident company to a foreign shareholder (company or individual) are not subject to withholding taxes in Cyprus.
- *Exemption for inter-company dividends.* Dividends payable by one Cyprus-resident company to another are exempt from taxation and are not included in the taxable income of the recipient company. A Cypriot-resident company which has not declared a dividend is deemed to have distributed 70% of its profits arising or accruing in the year of assessment, after their reduction by transfers to reserves as legally required and by corporation tax paid or payable on such profits, in the form of dividends to its shareholders, as at the end of a two-year period from the end of the year of assessment to which the profits relate, and SDC is charged on the deemed distribution attributable to resident shareholders. Where a dividend has been paid within the two-year period in relation to the particular year of assessment, the deemed distribution is reduced by the actual dividend paid. If resident corporate shareholders subsequently receive dividends from a company that has been subject to a deemed distribution they are entitled to reclaim the underlying SDC.
- *Exemption for dividends receivable from non-resident companies.* Dividends payable by non-resident companies to resident companies are exempt from special defence contribution tax provided that the Cyprus-resident company receiving them owns at least 1% of the company paying them (under the transposition of the EU Parent/Subsidiary Directive, which applies to all non-resident subsidiaries, not only EU subsidiaries). This exemption does not apply, however, if more than 50% of the paying company's activities results in investment income and the foreign tax is significantly lower than that payable in Cyprus.

This provides an attractive regime for holding companies in Cyprus because it provides a participation exemption for dividends, both receivable and payable, with the least onerous conditions attaching. In addition, there is no tax liability on capital gains from the disposal of shares other than shares in companies holding real property in Cyprus. Furthermore, the tax legislation does not contain any thin capitalisation rules (a debt: equity ratio requirement) and therefore a Cyprus-resident holding company can be primarily financed by debt to capitalise foreign subsidiaries by way of loans rather than equity capital.

Liability to corporation tax and SDC on interest receivable is determined by whether the interest is earned in, or closely related to, the ordinary activities of the company (for example, in the case of a bank or finance company) ('active interest'). If so, the interest is subject to corporation tax at 10% on the whole amount of the interest. There is no liability to SDC. Group finance income is included under this heading.

If, on the other hand, interest received is merely incidental to the main activity (eg a manufacturing business receiving interest on temporary deposits of surplus funds) ('passive interest') it will be subject to:

- corporation tax at 10% on half the interest; and
- SDC at 10% on the whole amount of the interest.

This means that the effective rate of tax and SDC for interest received or closely related to the ordinary activities of the business is 10%, whereas for interest which is incidental to the main activity the effective tax and SDC is 15%.

Non-residents are not subject to any tax on interest. It will therefore be beneficial to continue to use Cyprus-resident companies as finance vehicles in countries with which Cyprus has concluded double taxation treaties that either eliminate or reduce interest withholding charges. Cypriot finance companies may also be used to on-lend funds to entities within the same group so that interest payments may be deducted from their taxable base, or to non-related third parties at arm's length.

Any profits from the disposal of securities (shares, bonds, debentures, founder's shares and other company securities) are exempt from taxation both under the Capital Gains Tax Law and the Income Tax Law. Gains from the sale of shares of companies owning immovable property in Cyprus will continue to be subject to capital gains tax.

Many of the Cypriot double taxation treaties provide for taxation of capital gains only in the country of residence of the person (company or individual) disposing of a capital asset. The above-mentioned provision could therefore lead to double non-taxation, as a capital gain made by a Cyprus-resident company from a sale of its foreign subsidiary's shares will be exempt from taxation both in Cyprus and in the country where the subsidiary (i.e. the capital asset) is located.

Asset protection/Creditor protection

E6.34 Section 3 of the International Trusts Law contains specific provisions which allow a Cypriot international trust to be used as an asset protection vehicle.

Section 3(1) provides that an international trust can be validly created by any non-resident of Cyprus and a settlor who is of full age and sound mind under the laws of his country of domicile at the time of the transfer will be deemed to have the capacity to transfer property.

Section 3(2) states that an international trust is not void or voidable as a result of the settlor's bankruptcy or liquidation or of any proceedings at the suit of the settlor's creditors, notwithstanding any contrary provisions of Cypriot law or the law of any other country and notwithstanding that the trust is voluntary and without valuable consideration having been given or is for the benefit of the settlor or his family, unless it is proved to the satisfaction of the court that the international trust was made with the intent to defraud the creditors at the time of the transfer of property. The burden of proof is on the person alleging the fraud, who must be the person claiming to have been defrauded.

The law does not shield settlors from creditors who have claims on the assets prior to the trust being settled or where there are contingent claims. Subsequent creditors are clearly excluded. Case law under the Fraudulent Transfer Avoidance Law of 1886 (Cap 62) suggests that if at the time of transfer the settlor had sufficient property to meet all liabilities, not including the trust property, and the settlor did not anticipate bankruptcy at the time of settlement, then an intention to defraud cannot be proved.

Section 3(3) of the International Trusts Law states that a claim against a trustee of an international trust pursuant to section 3(2) must be filed within two years from the

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date of transfer of property to the trust, after which the transfer is considered conclusive. Cyprus is not a party to the arrangements set out in section 426(4) and (5) of the UK Insolvency Act 1986, by virtue of which the United Kingdom courts and the courts of certain other jurisdictions are required to assist each other in insolvency cases.

Forced heirship

E6.35 Section 3(1) of the International Trusts Law further states that no domestic or foreign law relating to inheritance or succession will invalidate the trust or affect in any manner any transfer or disposition relating to the creation of such a trust. This section should be read together with section 9, which states that the proper law of the trust may be changed to or from the laws of Cyprus assuming that the new proper law would recognise the validity of the trust and the respective interests of the beneficiaries. Further, Article 1 of the 1976 Convention on the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters, which has been ratified by Cyprus, states that the provisions of the Convention do not apply to decisions concerning the capacity of persons or questions of family law, including personal or financial rights and obligations between parents and children or between spouses, and questions of succession.

An international trust would therefore appear to be immune to a large extent from forced heirship and 'claw back' rules, especially in those cases where the settlor is domiciled in a civil law jurisdiction which has forced heirship rules applicable on death. There are no provisions relating to this matter in the Trustee Law and there is no case law concerning it. It seems likely, therefore, that a local trust would not be defeated by a forced heirship claim in the Cypriot courts, especially where the trust assets are situated in Cyprus.

Confidentiality – filing and disclosure

E6.36 A trust is not required to be registered with any authority.

Section 11 of the International Trusts Law prevents trustees, government officials and officers of the Central Bank of Cyprus from disclosing any information to third parties unless specifically authorised by a Cypriot court. A court should only issue an order for disclosure if the disclosure is of paramount importance to the outcome of a case.

The Prevention and Suppression of Money Laundering Activities Law (61(I) of 1996, as amended by Laws 25(I) of 1997, 41(I) of 1998, 120(I) of 1999, 152(I) of 2000 and 118(I) of 2003) empowers courts to issue orders for the disclosure of information where there exist reasonable grounds for suspecting that a 'predicate' or 'laundering' offence has been committed.

Subject to section 11 and any express term in the trust instrument, trustees are entitled to disclose trust information where they believe *bona fide* that disclosure is necessary to carry out their fiduciary duties or exercise their powers, where such disclosure would not prejudice the interests of the beneficiaries.

Section 11, however, does entitle beneficiaries of international trusts to compel disclosure of documents or information relating to, or forming part of, the trust accounts. Section 11 supplements the more general equitable duty of trustees to

provide trust information to beneficiaries. The right to receive information under section 11 is also available to a charity named as a beneficiary, provided that the trust is a charitable trust as defined by section 8 of the International Trusts Law.

Tax treaties

E6.37 Cyprus provides an extremely favourable environment for all forms of international business activity and foreign investment. Its tax legislation, enacted in 2002, conforms to the EU Code of Conduct and the EU rules on business taxation and Cyprus is not a tax haven, but a low-tax jurisdiction offering attractive planning opportunities.

Treaties for the avoidance of double taxation have been concluded with most of the western European countries and with almost all eastern European countries. Cyprus has also concluded treaties with almost all economically powerful nations, such as the USA, Canada, Russia, India and China. A full list is given in the Appendix at the end of the chapter.

The OECD model treaty has been followed as much as possible. Avoidance is usually achieved either through the allowance of a tax credit against the tax levied on the taxpayer by his country of residence or through tax exemption in one contracting state of the income taxed in the other contracting state. Normally, the result is that the taxpayer pays no more than the higher of the two rates.

Mutual legal assistance treaties (MLATs)

E6.38 The Government of Cyprus ratified the US-Cyprus Mutual Legal Assistance Treaty on 18 September 2002, promoting closer co-ordination between the two countries with regard to the transfer of persons in custody, the execution of searches and seizures, the sharing of documents, records and intelligence materials, the identification of persons or items of interest to authorities and the taking of other measures designed to assist in the prosecution of a wide range of criminal offences.

Cyprus is party to various other international instruments aimed at facilitating and organising mutual legal assistance. Cyprus was among the first countries to sign the European Union Criminal and Civil Law Conventions on Corruption in 2001. The Criminal Law Convention on Corruption provides for enhanced international co-operation in the investigation and prosecution of corruption offences, principally the bribery of public-sector officials and private-sector employees, together with the money-laundering and accounting offences related thereto. The corresponding Civil Law Convention on Corruption provides further reinforcement in the form of the introduction into domestic law of private law remedies for those adversely affected by corruption.

Cyprus ratified and implemented the European Convention on Extradition as early as 1971. Further, the European Convention on Mutual Legal Assistance in Criminal Matters, designed to enhance arrangements for co-operation between Member States' judicial and prosecuting authorities for both criminal investigations and proceedings, came into force on the island in 2000. Cyprus has also recently applied to become a member of the OECD Working Group on Bribery in International Business Transactions.

Money laundering regulations

E6.39 The Prevention and Suppression of Money Laundering Activities Law (61(I) of 1996, as amended by Laws 25(I) of 1997, 41(I) of 1998, 120(I) of 1999, 152(I) of 2000 and 118(I) of 2003) covers three principal areas, namely:

- laundering offences;
- predicate offences; and
- procedural matters, such as confiscation orders, disclosure of information and international co-operation.

Anyone who knows or ought to have known that property comprised the proceeds of a predicate offence and:

- converts, transfers or removes the property for the purpose of concealing or disguising its origin,
- conceals or disguises the true nature or source of the property,
- acquires, possesses or uses the property, or
- participates, conspires or assists in the commission of any such conversion, concealment, acquisition, etc,

commits an offence punishable by up to 14 years' imprisonment or a fine or both where the action was undertaken knowingly, or 5 years' imprisonment or a fine or both where someone should have known that property comprised the proceeds of a predicate offence.

Predicate offences range from murder, through drug trafficking and extortion, to living off the earnings of prostitutes.

The Money Laundering Law places additional administrative requirements on all institutions engaged in 'relevant financial business' to apply special measures for the prevention of money laundering under the Law, such as customer identification procedures, identity and transactional record keeping, and the training of employees in the recognition of money laundering offences, on pain of 2 years' imprisonment or a fine of CYP 2,000 (US\$ 4,500). 'Relevant financial business' includes *inter alia*:

- acceptance of deposits from the public;
- lending money to the public;
- finance leasing, including hire purchase financing;
- money transmission services;
- issue and administration of means of payment (eg credit cards, travellers' cheques and bankers' drafts);
- trading on one's own account or on account of customers in securities, etc or foreign exchange;
- consultancy services to enterprises concerning their capital structure, industrial strategy etc;
- investment services, including dealing in investments, managing investments, giving investment advice and establishing and operating collective investment schemes;
- safe custody services; and

- custody and trustee services in relation to stocks.

Know Your Client

E6.40 In January 2001 the Central Bank of Cyprus issued the *Guidance Note to International Financial Services Companies, International Trustee Services Companies, International Collective Investment Schemes and their Managers or Trustees*. This provides an effective guide to non-lawyers on the reasoning behind the law, and spells out the minimum ‘Know Your Client’ procedures, designed to facilitate the detection and reporting of suspicious transactions and to ensure that adequate record-keeping procedures are in place, and that the audit trail will be complete.

The trustee or managing company must have a clear understanding of its client’s identity, and pattern of its client’s business, at all times. Whenever a business relationship is to be established involving transactions of more than CYP 8,000 (US\$ 18,000), identity must be confirmed as soon as is reasonably practicable following first contact, and records of all transactions kept. Irrespective of the size and nature of the transactions, however, where any unusual and unexplained movements are observed, and money laundering is suspected, identity must be verified and the details reported in line with set procedures. Verification of identity is not required in respect of clients who are themselves engaged in relevant financial business in or from within Cyprus. The best identification documents possible should be obtained from the prospective client, and copies made and retained. Details of the introducer, if any, should also be recorded.

In the case of partnerships and other unincorporated businesses whose partners are previously unknown, the identity of at least two partners should be verified. For companies, the principal requirement is to look behind the corporate veil to identify which individuals have ultimate control over the business and assets, especially shareholders who inject a significant proportion of capital.

Internal procedures must be in place, and a Money Laundering Compliance Officer appointed, to ensure that the above requirements are fulfilled and that staff are made aware of their responsibilities. Suspicions must be reported to the Unit for Combating Money Laundering without alerting the client, and organisations are required to provide full co-operation to the Unit for Combating Money Laundering.

Position vis-à-vis the OECD

E6.41 Cyprus has embraced international standards of transparency, exchange of information and tax competition. Its tax system fully complies with the EU Code of Conduct for Business Taxation and the OECD’s rules for the elimination of harmful tax practices.

Cyprus is a member of the OECD’s Global Forum Working Group which developed the model agreement for effective exchange of information in tax matters, published in April 2002. In relation to trusts, the model agreement provides that information on settlors, trustees and beneficiaries is among the information which the competent authorities of every party to such an agreement must have the authority to obtain and provide on request for certain specified purposes.

E6.42 *Cyprus*

The EU Savings Tax Directive

E6.42 Cyprus has fully implemented the EU Savings Tax Directive, which requires Member States to exchange information on the savings accounts of individuals who are resident in other EU Member States, in order to ensure that tax is paid on savings in accordance with the national régime of the Member State in which the recipient is resident.

Appendix: Cyprus's double tax treaties

E6.43 Cyprus has concluded double taxation agreements covering the following countries:

Armenia	Hungary	Singapore
Austria	India	Slovakia
Azerbaijan	Ireland	Slovenia
Belarus	Italy	South Africa
Belgium	Kuwait	Sweden
Bulgaria	Kyrgyzstan	Syria
Canada	Lebanon	Tajikistan
China	Malta	Thailand
Czech Republic	Mauritius	Ukraine
Denmark	Moldova	United Kingdom
Egypt	Norway	United States
France	Poland	Uzbekistan
Germany	Romania	
Greece	Russia	

