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tax notes international

Volume 46, Number 5 ■ April 30, 2007

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Reprinted from *Tax Notes Int'l*, April 30, 2007, p. 479

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In preparation for accession to the European Union in 2004, Cyprus thoroughly overhauled its legislation around the turn of the millennium. All of the country's laws were reviewed and updated and brought into line with the EU's *acquis communautaire*.

The 2002 tax legislation that came into force on January 1, 2003, adopted an innovative approach while continuing to encourage foreign investment in Cyprus and maintaining a favorable environment for all forms of international business activity. The Income Tax Law of 2002 replaced the old remittance-based system of company tax with one based on the concept of residence. Under the income tax law, the locus of management and control is the key test of residence for tax purposes, and resident individuals and companies are liable to tax on worldwide income. Nonresidents are subject to tax on Cyprus-source income, but this is mitigated by the existence of a comprehensive network of double tax agreements.

Like the income tax law, the Law on Insurance Services and Other Related Issues of 2002 also took effect on January 1, 2003, and has since been updated to maintain full compliance with all EU directives. The law seeks to achieve market transparency and to protect policyholders' interests, ensuring confidence in, and the stability of, the insurance market.

The insurance law covers local insurance companies, insurance companies incorporated in another European Economic Area (the EU together with Norway, Iceland, and Liechtenstein) state, and third-country (non-EEA) insurance companies. The requirements are broadly similar for all, except that exemptions are available for companies regulated in another EEA state.

Requirements

To carry on business in Cyprus, a domestic insurance company requires a license under articles 18 to 22 of the Insurance Law. Third-country insurers are licensed under articles 25 and 26 of the Insurance Law. Insurance undertakings of another EEA state may operate in Cyprus either under the freedom of establishment or the freedom to provide services, in accordance with articles 32 to 35 and 37.

One of the consequences of the licensing and monitoring regime for domestic and foreign insurance companies operating in Cyprus is that there is rarely any doubt about the locus of management and control and hence about the company's tax residence. The Insurance Law requires domestic insurers to have their central administration and registered office in Cyprus and to have an adequate, "fit and proper" management team, with all executive directors and managers resident in Cyprus. Similarly, foreign insurers licensed to operate in Cyprus are required to appoint a general representative in Cyprus with full authority to manage the business, supported by an appropriate management infrastructure.

Tax Rates and Exemptions

The statutory corporate income tax rate in Cyprus is 10 percent, the lowest in the European Union. Further, the income tax law provides the following important benefits:

- profits on disposals of securities (defined as "shares, bonds, founders' shares and other titles of companies or legal persons and rights thereon") are exempt from tax;
- dividends received by one Cyprus resident company from another are exempt from all forms of tax;
- if a Cyprus resident company owns 1 percent or more of the share capital of a foreign corporation, any dividends it receives are also exempt from tax, except when directly or indirectly more than 50 percent of the activities of the paying company result in investment income, or the paying company is subject to tax at a rate substantially lower than the Cyprus rate; and
- dividends and interest may be paid to nonresidents without deduction of any withholding tax.

Calculation of Taxable Profits

General Insurance Business

For general insurance business, taxable profits are calculated by adding together all of the gross premiums, interest, commissions, and other income, and deducting any premiums returned to the insured and premiums paid on reinsurance as well as other expenses that include commissions. The reserve for unexpired risks at the end of the year of assessment is deducted from the resulting figure, and the reserve similarly calculated for unexpired risks at the beginning of the year of assessment is added back to arrive at the final taxable profit. Cyprus branches of foreign insurance companies are also allowed to deduct head office expenses up to a limit of 3 percent of net premium income (premiums received, less premiums paid for reinsurance).

Losses may be set off against income from other sources for the same year of assessment or, to the extent to which they are not set off, carried forward and set off against the company's income for subsequent years.

Life Insurance Business

For life insurance business, taxable profits are calculated by adding together all gross premiums and net investment income, and deducting any reinsurance premiums paid, net claims, surrenders, and expenses that include commissions. From the resulting figure, the reserve for liabilities regarding the long-term business in Cyprus at the end of the year of assessment is deducted, and the reserve for liabilities at the start of the year of assessment is added. Cyprus branches of foreign insurance companies are also allowed to deduct head office expenses up to a limit of 2 percent of net premium income (premiums received, less premiums paid for reinsurance).

Cyprus is no longer a tax haven, but it is a low-tax jurisdiction offering attractive planning opportunities.

When no tax is due, or the tax payable is less than 1.5 percent of the gross premiums, excluding contributions to any approved pension or provident fund or any other fund that the insurance undertaking manages for the benefit of its members, the undertaking must pay the shortfall by way of income tax prepayment. The company's income from other sources includes income from the management of any pension, provident, or other fund.

Losses may be set off against income from other sources for the same year of assessment, or to the extent to which they are not set off, be carried forward and set off against the company's income for subsequent years.

Other Taxes

Value Added Tax

Insurance is exempt from the VAT, and companies will not be able to recover the VAT paid for services they offer to customers in the European Union.

Stamp Duty Tax

Stamp duty tax amounts to CYP 1 or less on general insurance contracts and up to CYP 10 on life contracts, and is generally recovered from the customer.

Other Levies

Though not a tax as such, companies providing motor insurance are required to contribute 5 percent of the relevant gross premiums to the motor insurers' fund.

Summary and Conclusion

Cyprus has fully harmonized its laws and practices with the *acquis communautaire* of the European Union. Its tax legislation conforms to the EU Code of Conduct and the EU rules on business taxation. Cyprus is no longer a tax haven, but it is a low-tax jurisdiction offering attractive planning opportunities. Among the most attractive aspects of the tax system are the network of double tax agreements, the absence of tax on capital gains, and the participation exemption for dividends — both receivable and payable — without onerous conditions and without any thin capitalization rules. Those have made Cyprus an attractive option for holding companies for multinational groups, and now Cyprus should be considered as a location for group insurance operations. ◆