

Cyprus Overview



Cyprus – an ideal holding company location

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Despite being among the world's smallest countries, Cyprus has developed into one of the world's major financial and business centres. The island continues to be the largest source of investment into Russia, ahead of Luxembourg, the Netherlands, Germany, Great Britain, the US and France.

Cyprus has always been an excellent location for holding companies for a host of reasons including its transparent legal system, excellent communications and world-class professional and banking services. It has a market economy and no restrictions on

capital movements. It is a member of the EU and its tax system is fully compliant with EU and OECD requirements. Since joining the EU in 2004, Cyprus has become the ideal gateway for investment between the EU and the rapidly developing economies of Central and Eastern Europe, India and China.

The optimum participation regime

From a tax perspective, four things are required of a holding company structure:

- The ability to extract dividends from subsidiary companies free of withholding tax either under the subsidiary's domestic tax regime or the EU Parent/Subsidiary Directive or at a reduced rate of withholding tax under a tax treaty.
- The holding company's domestic tax regime should exempt such dividends from local tax.
- The holding company's domestic tax regime must also allow the holding company to pay dividends without giving rise to any tax charge under the domestic tax regime. This has generally been the most difficult hurdle to overcome.
- Finally, the holding company's domestic tax regime must permit the holding company to dispose of its investment in the subsidiary without any liability to capital gains tax or its equivalent in the subsidiary territory.

How does Cyprus measure up against these benchmarks?

In brief, the answer is 'very well'.

- Under Cyprus law all expenses incurred for the production of the associated income are

deducted before arriving at taxable income. At 10%, Cyprus's corporation tax rate is the lowest in the EU.

- Dividends received by one Cyprus resident company from another are exempt from all forms of tax.
- If a Cyprus resident company owns 1% or more of the share capital of a foreign corporation any dividends it receives are also exempt from tax, except in the event that: directly or indirectly more than 50% of the activities of the paying company result in investment income; and the paying company is subject to tax at a rate substantially lower than the Cyprus rate.
- The profits of a Cyprus company's permanent establishment in another jurisdiction are similarly exempt, subject to the same conditions as for dividends.
- Non-exempt dividend income is subject to defence tax contribution at the rate of 15%. Tax credits are available for taxes paid abroad.
- Interest income that is the result of the main activities of the company or that is closely

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connected to those activities is subject only to corporation tax at a rate of 10% like any other 'active' trading income. Group finance income is treated as active trading income.

- Mergers, acquisitions and other corporate reorganisations may generally be effected without any tax cost.
- The only withholding tax levied by Cyprus is a 10% (subject to treaty provisions) tax on royalties derived from the use of a right or asset within Cyprus. All other dividend, interest and royalty payments made to non-residents of Cyprus may be made without deduction of tax.
- Furthermore, the tax legislation does not contain any thin capitalization rules (a debt: equity ratio requirement) and a Cypriot resident holding company can be primarily financed by debt to capitalise foreign subsidiaries by way of loans rather than equity capital.

Recent developments

The Cyprus government has also acted to remove two potential issues for Cyprus holding companies. First, the Income Tax

Law has been amended to expressly provide for the availability of Cyprus tax credits in the hands of a Cyprus holding company for EU Member State tax suffered by an indirect subsidiary operating at a tier lower than the direct EU subsidiary of the Cyprus holding company. Second, the maximum amount of stamp duty on large transactions has been capped at ten thousand Cyprus pounds (€17,100), which will significantly reduce the amount of stamp duty payable on transactions with a value in excess of five million Cyprus pounds (€8,550,000) and further enhance Cyprus's attractiveness as a financial centre, particularly for bond issues.

The verdict

The factors outlined above make Cyprus a highly attractive intermediate holding company jurisdiction, offering the following benefits:

- Groups investing outside Cyprus may flow-through income streams, which will generally be tax exempt in Cyprus and not attract withholding tax as they leave;
- Subsidiaries that have scope for significant capital appreciation

may be held in Cyprus and sold without any liability to tax on the gain;

- Cyprus's double tax treaty network and the EU Parent-subsidiary directive offer a number of other tax planning opportunities;
- Cyprus offers a favourable exit strategy under Cyprus law which allows payment of dividend, interest and royalties without payment of withholding tax.

Cyprus can also be used as the location for the ultimate holding company, for instance in a group that is relocating to a new jurisdiction or on formation of a new publicly traded corporation with international operations. It is particularly suitable for any fund or investment vehicle since there is no tax on transactions in securities as defined, even if this is the entity's main trading activity. Since there is no withholding tax on dividends there is no uncertainty over recovery of tax paid.

Some caveats are required. Cyprus follows the current trend in international tax as regards the substance requirements and the interposition of intermediate holding companies merely to obtain

treaty benefits is increasingly subject to scrutiny. Cyprus's rapidly developing body of anti-avoidance legislation is aimed at preventing 'brass-plate' companies without any significant substance in Cyprus from benefitting from the Cyprus tax system merely by incorporation. This principle has been reinforced by the decision of the European Court of Justice in the Cadbury Schweppes case, specifically emphasising the requirement of 'genuine economic activity' in the domestic jurisdiction of a holding company.

The final choice of a holding company location is a question of balancing tax and non-tax considerations. While no single location can claim first place on every test, Cyprus should always be on the shortlist.

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