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CYPRUS on "taxes, trusts and funds" Europe's #1

DESPITE THE FINANCIAL CRISIS CYPRUS' TAX AND FINANCIAL regime not only remains stable but has changed for the better. This article provides a briefing on Cyprus' taxes, trusts and funds markets. Space limitations restrict us to providing only a brief glimpse of the great advantages that Cyprus can offer international investors, consultants and professionals. For detailed reports please get in touch with our firm and/or the author of this article.

CYPRUS' TAXES

DIRECT TAXES

CORPORATION TAX

Who is subject to Cyprus Tax?

A company is subject to corporation tax in Cyprus provided it is managed and controlled in Cyprus. The same applies to permanent establishments (PEs) of non-resident Cyprus companies situated in Cyprus.

Tax rate

Corporation tax on income remains stable at a flat rate of 10%. Such tax applies on the worldwide taxable profit of a company resident in Cyprus and on the Cyprus-sourced profits of non-resident companies with a PE in Cyprus.

Taxable profits

A taxable profit includes trading profits, sale of goodwill, stock, interest earned, rent from real estate, royalties etc.

Reliefs on profits

Taxable profits are subject to major reliefs, including: trading expenditure incurred; capital allowances, credits for foreign tax paid, losses surrendered in the same year by other companies in a 75% group relationship; and unused losses brought forward from previous years. In addition, a Cyprus company may use the losses generated by its foreign branch against its profits within the same year. However, the losses used will be taxed eventually as soon as the branch becomes profitable. This option provides the possibility for deferral of the tax liability.

Non-taxable profits

Profits or other gains derived from the sale / trading of shares / securities, or dividend income received from foreign a company and capital gains from the sale of property situated abroad are excluded from taxation.

VALUE ADDED TAX (VAT)

Since Cyprus' accession to the European Union a standard 15% VAT rate applies on supplies of goods and services. Cyprus' rate on VAT remains the lowest rate in Europe, together with Madeira, offering a significant competitive advantage over suppliers registered elsewhere in the EU. Zero and reduced rates also apply to certain transactions.

SPECIAL DEFENCE CONTRIBUTION TAX (SDC)

On dividend income

SDC is only imposed on Cyprus residents and does not affect Permanent Establishments of foreign companies. Further, while dividend income of individuals

Cyprus' rate on VAT remains the joint lowest in Europe, offering a significant advantage over suppliers registered elsewhere in the EU.

resident in Cyprus is charged with SDC at 15%, all companies and foreign shareholders are exempt from SDC (subject to some easily met conditions). There is no SDC withholding requirement on dividends paid to non-residents whereas all Cyprus resident shareholders (physical persons) are taxed 15% SDC on dividends.

On interest income

Interest received by the company outside its ordinary course of business (principal activities) is subject to SDC at 10% on the gross amount of interest received. In such case the aforementioned income is exempt from corporate tax. Even though the SDC rate for interest income is 10%, the same as the corporate tax rate, it still is a disadvantage for the company since interest on SDC payable balance starts accruing much earlier than interest on corporate tax balance payable. It is therefore advisable to ensure that a company lends money only within the ordinary course of its business, which is accepted to include the capitalization of subsidiaries by holding and group finance companies; adding value therefore to the usage of a Cyprus company as the financial company of the group.

Transfer-pricing issues

For group financing companies specific guidelines, presented below, were provided by the Inland Revenue as to what constitutes acceptable charging interest rates by defining the profit margin on back-to-back loans:

- 0.35% for up to €50m loan
- 0.25% from €50m to €200m
- 0.125% for over €200m

CAPITAL GAINS TAX (CGT)

CGT is imposed at 20% on all gains from both:

- Disposals of immovable property situated in Cyprus.
- Disposals of shares of companies holding immovable property situated in Cyprus.

INDIRECT TAXES

STAMP DUTIES

Stamp duty is a tax on documents under the Stamp Duty Law of 1963 (it includes agreements and other executable deeds). A contract relating to property or a transaction in Cyprus cannot be produced as evidence in court unless stamp duty is paid. Stamp duty can be paid at any later stage, without any limitations, subject to a penalty.

Contracts ought to be stamped include sale/purchase of immovable property agreements, share purchase agreements, joint venture agreements, subscription and shareholder etc.

Stamp duty is calculated at progressive rates of the consideration stated on the face of the contract as follows:

- 0.15% for amounts up to €170,860
- 0.2% for amounts over €170,860 (€17,086 is the maximum stamp duty payable).

A contract relating to property or a transaction in Cyprus cannot be produced as evidence in court unless stamp duty is paid.

CAPITAL DUTY ON COMPANIES

Capital duty is payable at a set rate of 0.6% of the authorised share capital of all Cyprus companies. Such duty is payable both upon incorporation and upon any increase in authorised share capital of the company. A tax planning tip could be the issuing of shares at a nominal value but at a higher premium.

IMMOVABLE PROPERTY TRANSFER FEES

After the acquisition of any type of immovable property in Cyprus (land, house, apartment; residential or not), transfer fees are payable by the buyer once title deeds are issued by the Department of Land and Surveys and property is ready to be transferred to his/her/its' name.

Land transfer fees are charged at progressive rates on successive tranches of the sale/purchase price as follows:

- 3% for up to €85,430
- 5% from €85,430 to €170,860
- 8% for over €170,860.

THE CYPRUS TRUSTS

CYPRUS' INTERNATIONAL trusts, similarly to the Cyprus companies, enjoy all and even more tax advantages, providing significant tax planning possibilities to international investors. The following tax-related advantages are what such trusts can offer, at a summary:

- The income of a Cyprus international trust (also referred to as an 'offshore' trust whose assets are, and income derives from, outside of Cyprus) is wholly exempted of taxation as it is not accrued, derived or received in Cyprus.
- Cyprus income tax laws exempt Cyprus international trusts from any income tax, capital gains tax and estate duty tax, making such trusts a very attractive tax planning vehicle for the non-resident investor.
- A foreign settlor of a Cyprus international trust who also retires in Cyprus is still exempt from tax if all the property settled and income earned is abroad, even if he is a beneficiary as well.
- A trust is not subject to tax on its own as an entity.

The essential elements of an international trust are:

- The settlor/investor is not a permanent resident of Cyprus (a Cyprus company will qualify as a settlor which may also belong to the same person);
- The beneficiary is likewise not a permanent resident;
- The trust property does not include any immovable property in Cyprus;
- A minimum of one trustee is resident in Cyprus (a Cyprus company will qualify as a resident trustee which may also belong to the settlor / investor).

THE CYPRUS FUNDS MARKET

The Funds Market in Cyprus consists of:

1. The 'Private' International Collective Investment Schemes (Private ICIS); and
2. The Open Ended Undertakings for Collective Investments in Transferable Securities (UCITS).

PRIVATE ICIS OR PRIVATE FUNDS

ICIS is a private fund that is formed under the laws of Cyprus and regulated by the Central Bank.

ICIS can have up to one hundred (100) investors (the unit-holders). There is increasing interest in registration of private ICIS due to the European membership and Cyprus can easily adapt to the European rules for non-UCITS funds because it has a long-standing industry with experience. Cyprus has been a prominent location for the activities of ICIS. During the last ten years, ICIS's established in international jurisdictions such as the Cayman Islands or Luxembourg have repeatedly utilised Cyprus, extensively investing billions of US Dollars into Eastern European countries, especially Russia and – more recently – India. Structures such as the 'Feeder Fund' or 'Two-Tier Fund' have proved quite successful via Cyprus.

Cyprus private ICIS' benefit from significant tax incentives. A private ICIS is treated identically to any other Cypriot entity and, accordingly, enjoys a 10% corporate income tax. In addition, the following tax advantages are especially significant:

- Exemption from tax on profits from sale of shares and other financial instruments
- Exemption on profits on disposal of units
- Exemption from tax on foreign dividends received
- No withholding on interest and dividend payment made from Cyprus abroad
- A wide network of double tax treaties with more than 45 countries.

Finally, Cyprus offers additional benefits specific to hedge funds, such as low cost of legal fees for setting up a fund (compared to Luxembourg costs, Cyprus costs can be even lower than 50%). The Cypriot regime also permits accountants with experience of the process to represent a fund to the regulator rather than requiring direct client presence with the regulator as in Luxembourg. Costs on fund administration and custodial services are also cheaper than in other centers.

UCITS

Under the UCITS law 200(I)/2004, local UCITS may take the legal form of mutual funds or variable capital investment companies. We will not elaborate any further on this type of Cyprus funds as they are not yet available for registration. More information can be provided upon request.

The above is intended to provide a brief summary; for more detailed information please contact the author directly.

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