

# Cyprus

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## **Introduction**

Cyprus, an island of 9,251 square kilometres in the Eastern Mediterranean at the crossroads of Europe, Asia, the Middle East, and Africa, is ideally located as an international business and financial centre.

In addition to its strategic geographical location and a most attractive climate, Cyprus offers an excellent commercial infrastructure, numerous tax incentives, and a high standard of living. Its time zone is seven hours ahead of New York, two hours ahead of London, and seven hours behind Tokyo.

Cyprus is an independent, sovereign republic with a presidential system of government and a written constitution which safeguards the rule of law, human rights, and the ownership of private property. It is a member of the European Union and the Eurozone, and also a member of the United Nations, the British Commonwealth, and the Council of Europe.

The legal system has been largely modelled on the English common law system since independence in 1960, and legislation is harmonised with the *acquis communautaire* of the EU. Cyprus is a signatory to a large number of international conventions and treaties, including an extensive network of double-taxation treaties.

## **Tax Regime and Classification as No-Tax or Low-Tax Jurisdiction**

### **Tax Regime**

#### *Tax System and Reform*

The tax system was substantially reformed in 2002. It is administered by the Director of Inland Revenue who also is the Commissioner of Income Tax, responsible for tax policy and tax collection.

The reforms created a fair and straightforward tax system adapted to the current economic realities with incentives to reflect development priorities.

The distinction between local companies and ‘international business companies’ which had previously existed was abolished and there is now:

- A single corporation tax rate of 10 per cent, the lowest standard rate in the EU, for all companies managed and controlled in Cyprus;
- No geographical limitation on the exercise of a company's activities; its income may be derived from any source including a Cyprus-based source; and
- No restriction on the ownership of a company's shares.

In 2010, a tonnage tax regime was introduced for individuals and companies engaged in international shipping activities. This is outlined at the end of this chapter.

#### *Forms of Business Enterprise*

The main forms of business enterprise are partnerships, companies, and branches, all of which are easily available to both Cypriots and foreigners and, except in strategic sectors such as real estate, tertiary education, public utilities, media airlines, and banks, there are no restrictions on foreign ownership.

#### *Low-Tax Status*

Cyprus is a low-tax jurisdiction, not a tax haven. Cyprus is on the OECD's 'white list' of jurisdictions complying with the global standard for tax co-operation and exchange of information.

Its fiscal and regulatory regimes are fully aligned with the *acquis communautaire* and the Code of Conduct for Business Taxation of the EU and the requirements of the OECD, the FATF, and the FSF.

#### *Types of Taxes*

**In General.** The main tax laws which have been enacted in Cyprus and which are currently in force are those relating to:

- Income tax;
- Special Contribution for Defence;
- Capital gains tax;
- Value added tax;
- Social insurance;
- Immovable property tax;
- Fees on transfer of immovable property;
- Capital duty;
- Stamp duty; and
- Professional tax.

There are no succession taxes in Cyprus.

**Income Tax.** The Income Tax Law of 2002<sup>1</sup> regulates the tax charged on the income of individuals and companies.

The tax year is the calendar year, and liability to tax is based on residence.

*Individuals.* Cyprus residents are taxed on the basis of worldwide income, irrespective of whether the income is remitted to Cyprus. Husband and wife are taxed separately. Persons who are not resident in Cyprus are subject to income tax on income accruing or arising from sources in Cyprus in respect of:

- Profits or other benefits from a permanent establishment situated in Cyprus or from any office or employment exercised in Cyprus;
- Pensions in respect of past employment exercised in Cyprus;
- Rent from property situated in Cyprus;
- Consideration in respect of goodwill of a trade in Cyprus reduced by the cost of such goodwill; and
- Gross income derived by an individual from the exercise in Cyprus of any profession or vocation, the remuneration of public entertainers, and the gross receipts of any theatrical, musical, or other group of public entertainers.

Individuals are deemed to be resident if they are present in Cyprus for more than 183 days in the relevant year. Days of departure and arrival are treated as follows:

- Day of departure from Cyprus counts as a day of residence outside Cyprus;
- Day of arrival in Cyprus counts as a day of residence in Cyprus;
- Arrival in and departure from Cyprus on the same day counts as one day of residence in Cyprus; and
- Departure from and return to Cyprus on the same day counts as one day of residence outside Cyprus.

Personal income tax rates are currently (autumn 2012) as follows:

Income band	Tax rate
Below €19,500	0
€19,500 to €28,000	20 per cent
€28,000 to €36,300	25 per cent
€36,300 to €60,000	30 per cent
Above €60,000	35 per cent

Relief is allowed for professional and trade union subscriptions, life insurance premiums, contributions to pension, social insurance, and welfare funds, and donations to approved charities. Relief also may be available under a double-taxation treaty.

<sup>1</sup> Law Number 118(I) of 2002.

For the first three complete calendar years following the start of their employment, individuals taking up residence and employment in Cyprus will be entitled to an annual allowance of the lower of €8,543 or 20 per cent of their remuneration. With effect from the 2012 tax year, if income from employment exceeds €100,000 per annum, a 50 per cent deduction is allowed for the first 5 years of employment.

A 20 per cent deduction is allowed from rental income received to cover expenses. The full amount of interest paid on loans for the acquisition of the let property is allowed as a deduction. Subject to certain conditions, expenditure on maintaining buildings subject to a preservation order may also be deductible. Annual writing-down allowances are available against plant, machinery, and other assets used in a trade or profession. The following are not tax deductible:

- Contributions to the Social Cohesion Fund (see text, below);
- Private motor vehicle expenses;
- Immovable property tax;
- Interest paid in respect of the acquisition of non-business assets or of private motor vehicles (even if used for business purposes); and
- Business entertainment costs in excess of the lower of €17,086 or 1 per cent of gross income.

Losses incurred in a trade or profession may be offset against other income and any unrelieved balance may be carried forward for relief against income of future years. If the business is subsequently converted into a limited-liability company, any unrelieved losses may be used by the company. A number of exemptions are available, namely:

- Interest and dividends;
- Lump sums received on retirement or commutation of pension or as a result of bodily injury or death;
- Capital sums from approved life assurance policies and provident or pension funds;
- Income from employment services provided abroad to a non-resident employer or an overseas permanent establishment of a resident employer for a period exceeding 90 days in the tax year;
- Profit from the sale of shares (if the shares are of an unlisted company owning real estate in Cyprus, the gain may be subject to capital gains tax; see text, below);
- Certain pensions, such as widow's pension;
- Salaries of officers and crew of ships owned by a Cyprus shipping company that sail under the Cyprus flag and operate in international waters; and
- Income from a qualifying scholarship, exhibition, bursary, or similar educational endowment.

Foreign pensions may be taxed either on the normal basis set out above, or on an alternative basis, under which the first €3,420 per annum of the foreign pension is free of tax and the excess over that amount is taxed at 5 per cent. The taxpayer may choose which basis to adopt in any particular year. Income from interest, dividends, and rents is subject to a special defence contribution (SDC tax), which is described below.

A self-assessment system is in place, except for employees paid entirely under PAYE. On 1 August each year, individuals must submit a provisional tax return for the year, accompanied by a remittance for one-third of the estimated tax liability. The taxpayer may amend the provisional return at any time during the tax year. The remaining balance must be paid in equal instalments by 30 September and 31 December. Taxpayers whose gross income from a trade or profession is less than €70,000 and who are consequently exempt from the requirement to submit audited financial statements to support their tax return must submit their final tax return, accompanied by a remittance for any tax due, within six months after the end of the tax year.

Taxpayers whose gross income from a trade or profession exceeds €70,000 are required to submit audited financial statements to support their tax return. They must pay their final tax liability no later than 1 August following the end of the tax year and submit a final tax return no later than the following 31 December.

Relief or credit may be available under a double-taxation treaty for tax paid abroad. Where no double-taxation treaty is in place, the Cyprus tax authorities normally allow unilateral relief for foreign tax paid.

There is a separate tonnage tax system for qualifying international shipping and ship management activities carried on by individuals or companies, described below.

*Companies.* Liability to corporate income tax is based on residence. Cyprus-resident companies are liable to tax on worldwide income and non-resident companies are liable to tax on any Cyprus-source income.

For companies, the test for residence is the locus of management and control. A company is regarded as resident in Cyprus if it is managed and controlled in Cyprus. Mere registration or incorporation in Cyprus may not be enough to render a company liable to tax in Cyprus. A majority of resident directors on the board establishes a *prima facie* rebuttable presumption of management and control being exercised in Cyprus as far as the Cyprus tax authorities are concerned.

In practice the revenue authorities treat any company incorporated in Cyprus as tax resident and require it to register with them within 60 days of incorporation. Only on production of a tax residence certificate from another jurisdiction will the company be considered as non-resident.

Cyprus branches of foreign companies are subject to tax on worldwide income if the locus of management and control of the branch is in Cyprus. If the locus of

management and control is overseas, the branch is liable to corporation tax on profits accruing or arising in Cyprus. A company resident in Cyprus is taxable on its worldwide income derived or accruing from:

- Gains or profits from any trade or business;
- Interest or discount (subject to exemptions; see text, below);
- Rents, royalties, premiums, or other profits arising from property; and
- Any other income, eg, gain on sale of goodwill.

All expenses wholly and exclusively incurred for the production of the relevant income are deductible, with the following exceptions:

- Contributions to the Social Cohesion Fund (see text, below);
- Private motor vehicle expenses;
- Professional tax;
- Immovable property tax;
- Interest paid in respect of the acquisition of non-business assets or of private motor vehicles (even if used for business purposes); and
- Business entertainment costs in excess of the lower of €17,086 or one per cent of gross income.

Where the income consists of both taxable and non-taxable income, expenses directly incurred in earning the non-taxable income are not allowed and indirect expenses are apportioned on the basis of the income earned. Tax is charged at 10 per cent on the profits of a company's business and gains on trading in immovable property in Cyprus.

Trading losses may be carried forward and set against trading profits from the same business without time limit. Trading losses incurred by one group company may be set off against trading profits of another group company to give group relief, provided that the losses and profits accrued in the same year of assessment and both companies were resident in Cyprus and members of the same group for the whole of the tax year concerned.

Two companies are deemed to be members of a group if one is the 75 per cent subsidiary of the other or both are 75 per cent subsidiaries of a third company. The phrase '75 per cent subsidiary' means holding at least 75 per cent of the voting shares with beneficial entitlement to at least 75 per cent of the income and 75 per cent of the assets on liquidation.

The following exemptions are available:

- Profit from the sale of securities;
- Dividends;
- Income of any company formed exclusively for the purpose of promoting art, science, or sport, and of certain educational and charitable companies;

- Profits earned or dividends paid by a Cyprus shipping company which owns ships under the Cyprus flag and operates in international waters;
- Income of any approved pension or provident fund; and
- Profits from a permanent establishment situated entirely outside Cyprus, unless the permanent establishment directly or indirectly engages more than 50 per cent in activities which lead to investment income and the foreign tax burden is substantially lower than the tax burden in Cyprus.

Interest arising from the ordinary activities of the company or closely related to the ordinary activities of the company is subject to corporate income tax at 10 per cent on the interest received, less the costs (including finance costs) necessarily incurred in earning it. Interest on loans to group or related companies is included under this category. Other interest is exempt from corporate income tax but subject to SDC tax (see below).

Royalties or any other payments to a non-resident for intellectual or industrial property rights are liable to a 10 per cent withholding tax, subject to relief under any applicable double-taxation treaty. No tax need be withheld if the rights are used exclusively outside Cyprus. Rental payments made to a person not resident in Cyprus in respect of films shown in Cyprus are subject to withholding tax at 5 per cent of the gross amount. There is a separate tonnage tax system for qualifying international shipping and ship management activities carried on by individuals or companies.

Transfers of assets and liabilities can be made without giving rise to a tax liability within the framework of a reorganisation (including mergers, demergers, partial divisions, share exchanges, and transfers of seat), and any tax losses can be carried forward by the receiving entity.

With effect from 1 January 2012, Cyprus introduced a package of incentives and tax exemptions relating to income from intellectual property rights, aimed at stimulating investment in research and development.

A number of other countries, including Luxembourg, the Netherlands, Ireland, and the United Kingdom, have already introduced such schemes, which have come to be known as an intellectual property box ("IP box").

Four-fifths of the profit earned from the use of intangible assets (including any compensation for improper use) is disregarded for tax purposes. In addition, four-fifths of any profit resulting from the disposal of relevant intangible assets is disregarded for tax purposes.

The net effect of the new scheme is that the rate of tax on income from the exploitation of intellectual property will be two per cent or less. Since there are no taxes on dividends paid to non-resident shareholders, a Cyprus company can be used to generate royalties under licensing or similar arrangements with third parties and distribute profits to its shareholders by way of dividends with minimal tax leakage.

Cyprus's effective tax rate of two per cent or less on income from the exploitation of intellectual property compares very favourably with the competition: the United Kingdom's new "patent box" regime gives an effective rate of 10 per cent on relevant income; the Irish scheme is more complex, and it is not possible to directly compare rates, but it will generally produce an outcome close to the UK rate, and the Luxembourg and Netherlands schemes give an effective rate of 5.76 per cent and five per cent respectively, more than double the Cyprus rate.

The new regime provides very attractive opportunities for structuring the exploitation of IP assets through Cyprus and in particular through the use of Cyprus-resident IP owners, especially in the context of Cyprus's extensive network of double-tax treaties under which foreign withholding taxes on royalty income are either eliminated altogether or substantially reduced.

On 1 August each year, companies must submit a provisional tax return for the year, accompanied by a remittance for one-third of the estimated tax liability. The remaining balance must be paid in equal instalments on 30 September and 31 December. The final tax liability must be paid no later than 1 August following the end of the tax year and a final tax return must be submitted no later than the following 31 December.

Relief or credit may be available under a double-taxation treaty for tax paid abroad. Where no double-taxation treaty is in place, the Cyprus tax authorities normally allow unilateral relief for foreign tax paid.

**Additional Contribution on Earnings and Pensions:** For 2012 and 2013, a special contribution is payable on earnings and local-source pensions at progressive rates of up to 3.5 per cent, borne equally by the employer and the employee.

**Special Contribution for Defence.** Special Contribution for Defence (SCD Tax) tax is payable by Cyprus-resident (determined in the same way as for income tax) individuals and companies on interest, dividends, and rentals received at the following rates:

Nature of income	Rate
Dividends	20 per cent
Interest	15 per cent
Rents	2.25 per cent

Dividends received by a resident company or a permanent establishment of a non-resident company from a non-resident company are exempt from SDC tax with no minimum shareholding requirement in accordance with the EU Parent-Subsidiary Directive and applicable local law. There are no Controlled Foreign Company (CFC) provisions under Cyprus law and the only limitation to the exemption for dividends received from abroad is where both limbs of the following test ("Passive Dividend Rules") apply, namely where:

- The investment income is more than 50 per cent of the paying company's activities; and
- The foreign tax burden on the income of the paying company is substantially lower than the Cyprus tax burden.

If both limbs of the test are satisfied, then dividends received are subject to SDC tax. Dividends received by one resident company from another are exempt from SDC tax. Dividends paid to a foreign shareholder (individual or company) by a resident company also are exempt, giving Cyprus a real advantage over other European holding company regimes, which generally impose a withholding tax, even when reduced by a double-taxation treaty, of at least five per cent.

Redemptions of units in Collective Investment Schemes do not constitute a distribution for the purposes of SDC tax and so are exempt. As noted above, interest arising from the ordinary activities of the company or closely related to the ordinary activities of the company is subject to corporate income tax. There is no liability to SDC tax. Other interest is exempt from corporate income tax but subject to SDC tax on the gross income, with no deductions.

Rents are subject to SDC tax at three per cent on 75 per cent of the gross rent, giving an effective rate of 2.25 per cent. No deduction for expenses is allowed. Companies, partnerships, and central and local government bodies paying rents are required to withhold SDC at source and pay it to the tax authorities.

If a Cyprus-resident company does not distribute a dividend within two years after the end of a tax year, a 'deemed dividend distribution' is calculated, being 70 per cent of post-tax profits for that tax year, reduced by any dividends that have been paid out of those profits.

SDC tax is charged on the proportion of the deemed dividend distribution that is applicable to Cyprus-resident shareholders. When an actual dividend is paid after the deemed dividend distribution, then SDC tax is payable only on any dividend paid over and above the deemed dividend distribution.

Companies are generally required to submit an annual return on form IR 623 for the purpose of calculating deemed dividends. In cases where the entire share capital of a Cyprus resident company is ultimately owned by non-residents, the directors of the company may make a declaration to this effect, have it certified by the company's auditors or lawyers, and forward it to the tax authorities. Once the declaration has been accepted by the tax authorities, the company will no longer be required to make returns for deemed distribution purposes.

If part of the share capital is ultimately owned by Cyprus residents, an annual return must still be submitted, but the profits ultimately attributable to non-resident shareholders will be excluded.

Collective Investment Schemes enjoy reduced rates of SDC tax payable on deemed distributions, whether in respect of income or on liquidation. In either case, the rate payable by Collective Investment Schemes is three per cent, rather than the standard rate of 20 per cent.

Any person or company paying a dividend or interest is required to deduct SDC tax and pay the SDC tax to the Inland Revenue department with a statement of tax deducted. SDC tax on deemed distributions must be paid within two years and one month after the end of the accounting year.

SDC tax on rentals and on interest and dividends received without deduction of SDC tax is payable on 30 June for the first six months of the year and on 31 December for the second six months. Relief or credit will be allowed in respect of any foreign tax paid, either under a double-taxation treaty or by way of unilateral relief.

**Capital Gains Tax.** Net gains from the disposal of immovable property in Cyprus and of shares of unlisted companies owning immovable property in Cyprus are taxable at 20 per cent, except where trading in such assets is part of the company's normal trading activity, in which case the gains are subject to corporation tax at 10 per cent. All other gains are exempt. The following categories of disposals of real estate are exempt from capital gains tax:

- Transfers by reason of death;
- Gifts between relatives up to the third degree of kindred;
- Gifts to family companies (limited companies whose only shareholders at the time of the gift and for the entire period of five years thereafter are members of the family of the donor);
- Gifts by family companies to their shareholders, but only in cases where the property given was originally acquired by the company as a gift;
- Gifts to charitable institutions or to the Republic of Cyprus;
- Exchanges of immovable properties; and
- Compulsory acquisitions.

In assessing the gain the following are deductible from the price received:

- The market value of the property at 1 January 1980, or, if it was acquired after that date, the price paid or the consideration given for the acquisition of the property;
- The cost of any major improvements;
- The subsequent increase in the value of the property due to inflation, calculated by reference to the Retail Price Index issued every month by the Department of Statistics; and
- The expenses related to the acquisition and disposal of the property, such as transfer fees and legal costs.

Individuals may deduct from the resultant gain the following lifetime exemptions:

- In the case of sales of agricultural land by farmers, the first €25,629 of the sale price, provided that the farmer was residing in the same area at the time of the sale;

- In the case of sales of property used as a residence by the vendor, the first €85,430 of the sale price, provided that the property has been used as the vendor's residence for at least five years prior to the sale; and
- In the case of any other disposal, the first €17,086 of the sale price.

The tax is payable within one month from the date of disposal. Interest at nine per cent<sup>2</sup> is payable on any tax remaining unpaid after one month from the date of the disposal. If the sale proceeds are payable by instalments, the tax also may be paid by instalments with interest. Interest at nine per cent is payable when excess tax is refunded.

Many of Cyprus's double-taxation treaties tax capital gains only in the country of residence of the company or individual disposing of the asset. The exemption from capital gains tax in Cyprus could therefore lead to complete elimination of any tax liability, for example, in the case of a capital gain made by a Cyprus-resident company from a sale of its foreign subsidiary's shares, which will be exempt from tax both in Cyprus and in the country where the subsidiary and the shares are based.

**Value Added Tax.** The VAT registration threshold is €15,600 *per annum*. Cyprus's standard rate of 17 per cent is among the lowest in the EU and reduced rates of five per cent and eight per cent apply to certain goods and services. VAT returns must be submitted quarterly and any tax due paid by the tenth day of the second month following the quarter-end date.

If input tax is greater than output tax, the difference may be refunded or carried forward to the next return. Companies that do not have trading activities within the EU need not register for VAT, but of course they will be unable to recover input tax. Companies receiving services may be obliged to register, but companies which are purely holding companies cannot register as they are not deemed to have an economic activity.

**Social Insurance.** Under the Social Insurance Scheme, the employer and employee each contribute 6.8 per cent of the employee's earnings up to a current maximum of €4,442 (adjusted annually) per month, a total of 13.6 per cent, and the government pays a further 4.3 per cent making an aggregate of 17.9 per cent.

A self-employed person contributes 12.6 per cent and the government pays 4.3 per cent on income within a lower earnings threshold that varies according to the nature of the trade, but with the same upper earnings limit of €4,442 per month. Voluntary contributions may be paid at 14.8 per cent on insurable income; the contributor pays 11 per cent and the government pays 3.8 per cent. An individual who is ordinarily resident in Cyprus but who is working abroad for a Cyprus-resident employer may pay voluntary contributions of 13.6 per cent. In this case, the government contributes 4.3 per cent.

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2 The rate of interest charged is set by statute and is not subject to periodic fluctuations.

Employers also must pay 1.7 per cent of their employees' earnings up to a maximum of €4,442 per month to the Industrial Training Fund and Redundancy Fund and two per cent (with no upper earnings limit) to the Social Cohesion Fund, which is used to make social grants.

Contribution rates are reviewed at five-year intervals, with the next scheduled review due to take place in 2014. Apart from contributions to the Social Cohesion Fund, social insurance contributions are deductible for income tax purposes.

**Immovable Property Tax.** A tax is levied on all immovable property situated within Cyprus, and the amount is based on the assessed value of the immovable property as at 1 January 1980. Certain immovable properties are exempt, including:

- Property used exclusively for the purposes of a charitable institution;
- Agricultural land owned by a farmer;
- Property of a municipal corporation or a public utility body if the Council of Ministers so decides; and
- Property owned by a foreign state and used as an Embassy or Consulate or as an official residence of its diplomatic representative (under reciprocal concessions).

The tax is progressive. The rate applied to each tranche of value is as follows:

Tranche	Rate
First €120,000	0
Between €120,000 and €170,000	0.4 per cent
Between €170,000 and €300,000	0.5 per cent
Between €300,000 and €500,000	0.6 per cent
Between €500,000 and €800,000	0.7 per cent
Above €800,000	0.8 per cent

Immovable property also is subject to small charges for local services.

**Real Estate Transfer Tax.** Real estate transfer tax is imposed by the Land Registry Office on the transfer of title of real estate situated in Cyprus. The transferee is responsible for the payment of the tax, which is based on the value of the consideration given or, if such consideration is not accepted, on the market value of the property.

The fee is calculated at progressive rates on each tranche of the purchase price or market value, as follows:

Tranche	Rate
First €85,430	3 per cent
Between €85,430 and €170,860	5 per cent
Above €170,860	8 per cent

No transfer fees are payable in respect of company reorganisations. Exemptions and reductions are available in respect of transfers between family members, and between family members and family companies.

**Capital Duty.** Capital duty of €103 plus 0.6 per cent of the authorised capital is payable to the Registrar of Companies on incorporation of a registered company. Subsequent increases in authorised share capital are liable to capital duty at 0.6 per cent. If the first issue of shares is at a premium, a flat charge of €17.09 is payable.

Subsequent issues, whether at par or at a premium, are subject to a flat charge of €17.09. As no capital duty is payable on share premium, capital duty can be minimised by issuing a reduced nominal value of shares at a premium.

**Stamp Duty.** Stamp duty is payable on contracts relating to property or business in Cyprus. On the first €170,860, the rate is €0.02 per €17.09 or part thereof and, on any excess above €170,860, the rate increases to €0.03 per €17.09 or part thereof. Stamp duty is capped at €17.086 per document. Where no amount is specified in the contract, the stamp duty is €34.

A number of categories of documents are exempt from stamp duty, including documents relating to corporate reorganisations (which are exempt from all forms of taxation) and ship mortgage deeds or other security documents.

**Professional Tax.** The Municipal Corporation Law provides for the maximum amount of tax that can be fixed for professional tax, and the various municipalities and improvement boards fix the amounts to be imposed on companies located within their boundaries (individuals are no longer liable to professional tax) by regulations published in the *Official Gazette*.

**Bank Deposit Levy.** Credit institutions operating in Cyprus are required to pay a levy of 0.095 per cent on their customer deposits. Each year's levy will be calculated on the basis of customer deposits as at 31 December of the preceding year. No levy will be imposed on inter-bank deposits.

The levy will not be deductible for the purpose of calculating taxable profits. It will, however, reduce the amount of profits subject to deemed dividend distribution. The declaration of taxable deposits on the preceding 31 December must be made by 31 March each year, and the levy will be collected in four equal instalments at the end of each quarter, starting 31 March. The declaration of taxable deposits may be revised up to 31 December.

The Commissioner of Income Taxes has the power to raise assessments for the levy and to collect it from banks. The levy is limited to 20 per cent of taxable profits for the year in respect of which it is paid. The tax authorities are required to issue final income tax assessments within six months from the date the corporate income tax return is submitted, and any overpayment above the 20 per cent limit must be refunded within a month after the issue of the final income tax assessment.

## **Impact of Tax Treaties**

### **In General**

Cyprus has concluded an impressive number of double-taxation treaties. The overall purpose of the double-taxation treaties is the avoidance of double taxation of income earned in the treaty countries.

Usually, this is 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 tax-payer pays no more than the higher of the two rates.

### **Treaty States**

Cyprus has concluded double-taxation treaties with the following countries:

- Armenia;
- Austria;
- Azerbaijan;
- Belarus;
- Belgium;
- Bulgaria;
- Canada;
- China (People's Republic);
- Czech Republic;
- Denmark;
- Egypt;
- France;
- Germany;
- Greece;
- Hungary;
- India;
- Ireland;
- Italy;
- Kuwait;
- Kyrgyzstan;
- Lebanon;
- Malta;
- Mauritius;
- Moldova;

- Montenegro;
- Norway;
- Poland;
- Qatar;
- Romania;
- Russia;
- San Marino;
- Serbia;
- Seychelles;
- Singapore;
- Slovakia;
- Slovenia;
- South Africa;
- Sweden;
- Syria;
- Tajikistan;
- Thailand;
- Turkmenistan;
- Ukraine;
- United Kingdom;
- United States; and
- Uzbekistan.

Treaties are under negotiation, or awaiting ratification, with many other countries, including Algeria, Bahrain, Brazil, Estonia, Finland, Georgia, Iceland, India, Indonesia, Iran, Jordan, Kazakhstan, Latvia, Libya, Lithuania, Luxembourg, Malaysia, Morocco, Netherlands, Portugal, Spain, Sri Lanka, The United Arab Emirates, and Vietnam.

### **Treaty Objectives**

All the double-taxation treaties concluded by Cyprus were drafted on the basis of the Organisation of Economic Co-operation and Development (OECD) model treaty. As with all double-taxation treaties, the primary objectives of the Cypriot treaties are to:

- Clarify and determine the taxing rights of each contracting state;
- Reduce or avoid the impact of international juridical double taxation; and
- Introduce anti-avoidance provisions and mechanisms to prevent tax evasion.

### Status as Treaty Haven

Although there are limitation-of-benefits provisions in some of the Cypriot treaties, the treaties and the nil or reduced tax rate on dividends, interest, and royalties make Cyprus a tax-incentive country, offering possibilities for international tax planning.

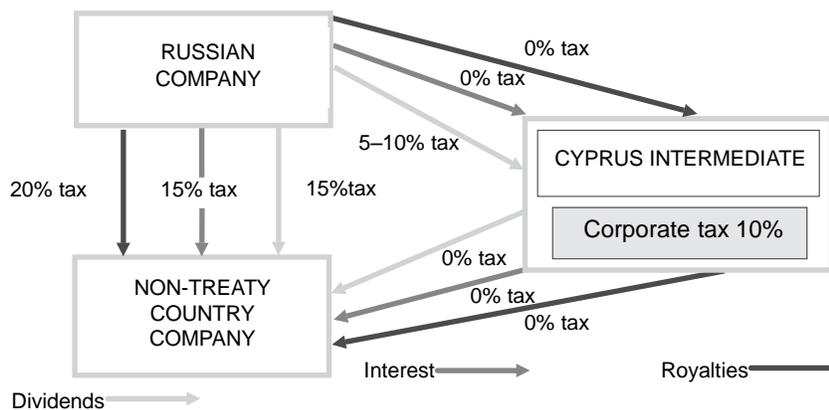
Cyprus is a prime example of a 'low-tax jurisdiction' country or, as it is better defined, a 'treaty haven' since it combines a low-tax regime with an extensive network of double-taxation treaties and only a few anti-treaty shopping provisions.

### Eastern European Countries

Few tax treaties with the Eastern European countries contain anti-avoidance provisions and, consequently, a Cypriot legal entity can legally reap the advantages of the treaties and can be used to extract profits from these countries at reduced tax or no tax.

This is particularly applicable in the case of dividends from joint ventures, interest, royalties, business profits, and shipping profits as can be seen in the following sketch:

#### Interposing a Cyprus Company to Gain the Benefits of the Cyprus – Russia Tax Treaty



### Holding Companies

Its wide network of double-taxation treaties, combined with the taxation and other incentives, makes Cyprus particularly attractive for the establishment and operation of a holding company.

For a foreign corporation whose activities and investments are based on an international level, Cyprus is one of the best holding company regimes in the world, for both EU and non-EU subsidiaries, as it combines benefits in the country where the investment is made (by eliminating or substantially reducing withholding taxes), in Cyprus itself (by avoiding or paying tax at a low rate of 10 per cent), and in the home country of the organisation by avoiding or reducing tax and, in some cases, enjoying tax-sparing credits.

## **Sourcing Income within Cyprus**

### **In General**

A foreign investor has numerous options available for organising business operations in Cyprus. This may be achieved either by forming a locally incorporated limited-liability company or trading through a branch of a foreign entity.

A non-resident corporation or individual also may conduct business through Cyprus with a general or limited partnership or through a representative or agency office. There may also be situations where the most suitable way to carry out business in Cyprus is by trading as a sole proprietor.

### **Taxation of Income and Gains from Assets**

The OECD model treaty gives a contracting state in which immovable property is located the right to tax income derived from that property accruing to a resident of the other contracting state. Profits from the operation of ships or aircraft in international traffic are taxable in one state only, namely, the state where the effective management of the enterprise is situated.

The OECD model treaty provides that gains derived from the alienation of property, with these exceptions, may be taxed only in the state of which the alienator is resident.

### **Treaty Shopping**

The substantial tax advantages provided by Cyprus, combined with the wide network of Cypriot double-taxation treaties, makes Cyprus a particularly attractive place for 'treaty shopping' and effective tax planning.

### **Business Profits and Capital Gains**

Since business profits, in the absence of a permanent establishment in the other double-taxation treaty country, are only taxable in the country of residence of an enterprise, the extraction of business profits from a country with which Cyprus has a double-taxation treaty can be a major tax-planning benefit.

Capital gains are not taxable in Cyprus, except in the cases of immovable property and of shares in a company whose assets include immovable property situated in Cyprus.

**Other Factors**

Cyprus tax reliefs or exemptions which enjoy tax-sparing credit treatment in various double-taxation treaty countries might lead either to full tax exemption in both Cyprus and the other treaty country or to substantially reduced tax in one or both of them.

**Vehicles Available for Achieving Favourable Tax Status***In General*

Attracting foreign investment is a priority area for the Cyprus government since it contributes to economic development and prosperity.

As a result of the introduction of wide-ranging measures and procedures aimed at stimulating and promoting the development of Cyprus as a centre for international business and financial activities, Cyprus has established itself as one of the world's leading international business centres, and a natural portal for investment between the EU and the rest of the world. A variety of international businesses operate in Cyprus.

*Holding and Investment Companies*

**In General.** As explained earlier, use of a Cyprus holding or investment company can provide significant tax savings. For a holding company that is resident, ie, managed and controlled, in Cyprus, the benefits include:

- A corporation tax rate of 10 per cent;
- A participation exemption for domestic and foreign dividends from the 20 per cent special defence contribution, if the dividends are paid out of profits which have suffered tax elsewhere;
- No tax on profits made from the disposal of its shares, provided that the company does not own immovable property in Cyprus; and
- No thin capitalisation (debt: equity ratio requirement) rules, so that a Cyprus-resident holding company can be primarily financed by debt and pass on the funds to foreign subsidiaries by way of loans rather than equity capital. Interest paid in the course of a company's normal trading activities, including the acquisition of business assets, is an allowable deduction unless that company makes advances to related parties; in such a case, interest at 9 per cent on those advances or the actual interest if lower must be added back, because such advances are not considered as 'expenses incurred for the purpose of the production of income'. There is no withholding tax on interest payable to non-residents.

Under the domestic participation exemption, dividends payable by a Cyprus-resident subsidiary to its Cyprus parent are exempt from taxation and are not included in the taxable income of the parent, regardless of the extent and the holding period of the shareholding in the subsidiary.

**Anti-Abuse Provisions.** The foreign participation exemption applies to foreign dividends, provided that the Passive Dividend Rules do not apply, ie, if:

- Investment income, direct or indirect, is less than 50 per cent of the paying company's activities; and
- The foreign tax burden on the income of the paying company is not substantially lower than the tax burden on the Cyprus-resident parent company.

The exemption applies regardless of the holding period of the shareholding in the subsidiary. It also applies to any capital gains realised by a Cyprus-resident company on a sale of shares in a foreign subsidiary, regardless of the Passive Dividend Rules.

'Investment income' is defined as any income which is not derived or does not accrue from any business, employment, pension, or annuity paid by reason or in connection with past employment. The term 'substantially lower' has not been defined or interpreted but may indicate an effective corporation tax rate of 5 per cent or less.

The Passive Dividend Rules are intended to prevent non-resident companies, over which domestic taxpayers have a controlling or substantial interest, from converting passive income into exempt dividend income, while adhering to the principle that anti-avoidance measures should be used only to maintain the equity and neutrality of national tax laws in the international environment.

The Passive Dividend Rules target only passive income not derived from genuine business activities. They do not extend to activities such as production, normal rendering of services, or trading by companies engaged in real industrial or commercial activity, and they are not applicable to countries in which the taxation is comparable to that of the country of residence of the taxpayer. Generally, they do not adversely affect holding companies based in Cyprus because such companies are not taxed on income derived from their foreign shareholdings until the subsidiaries start to distribute dividends, whereupon the exemption becomes available.

**Liquidation.** If a holding company is liquidated and funds or assets are returned to shareholders, the profits for the final three years which have not been distributed, nor deemed to have been distributed, are deemed to have been distributed and the shareholders are deemed to have received the dividends, which will be subject to SDC tax at 20 per cent. The deemed dividend distribution may not exceed the sum (or the value of the assets) paid to the shareholders. For Collective Investment Schemes, the SDC tax rate is three per cent.

This deemed distribution does not apply to the liquidation of a company for the purpose of a qualifying reorganisation, nor to companies in insolvent liquidation. The advantageous tax treatment of such companies and the use of double-taxation treaties also are of particular importance and, with effective tax planning, may be beneficially used in other, non-treaty states.

### Finance Companies

The Cyprus tax authorities have recently issued a circular setting out the minimum margin of taxable interest which should apply in transactions involving Cyprus entities as intermediary financing vehicles in back-to-back financing arrangements.

Amount of loan:	Acceptable taxable margin:
Less than €50 million	0.35 per cent
Between €50 million and 200 million	0.25 per cent
More than €200 million	0.125 per cent

If loans are made on an interest-free basis, taxation will be calculated on the basis of the 0.35 per cent rate, irrespective of the amount of the loan.

### Taxation of International Shipping Activities

#### *In General*

Since Cyprus joined the EU in 2004, Cyprus resident shipping and ship management companies had enjoyed the most benevolent shipping taxation regime in Europe, with significant exemptions and the option for ship management companies to elect between a preferential corporate income tax rate of 4.25 per cent or a tonnage tax regime.

The Merchant Shipping (Fees and Taxing Provisions) Law of 2010 (“the Tonnage Tax Law”), which was enacted on 29 April 2010 and has retroactive effect from 1 January 2010, abolishes the old preferential corporate income tax rate but significantly extends the availability of the tonnage tax basis for Cyprus-resident shipping and ship management companies, simplifying and reducing the tax burden.

It extends the benefits of the tonnage tax regime and exemptions from income tax, which were previously restricted to owners, operators, and managers of Cyprus-flag ships, to owners and charterers of non-Cyprus-flag vessels and widens the range of exempt gains to include profits on the disposal of vessels, interest earned on funds, and dividends paid directly or indirectly from shipping-related profits, in addition to profits from shipping operations.

#### *Qualifying Persons, Activities, and Vessels*

In order to be eligible for the tonnage tax regime, a “qualifying person” must be carrying out “qualifying activities” in relation to “qualifying vessels”. Qualifying persons are tax-resident owners or charterers (bareboat, demise, time, and voyage) of Cyprus ships, of Community ships, or of fleets of ships comprising Community and non-Community ships, and ship managers providing technical or crewing services or both.

Ship managers are required to maintain a functioning office in Cyprus staffed by a sufficient complement of appropriately qualified personnel. At least 51 per

cent of onshore personnel must be citizens of the European Economic Area (“EEA”) (comprising the EU together with Iceland, Liechtenstein, and Norway) and at least two-thirds of the total tonnage under management must be managed within the EEA.

For owners or charterers of Cyprus ships, the tonnage tax scheme is mandatory. Other owners or charterers and ship managers may opt for taxation based on profits or tonnage tax, but, having opted for the tonnage tax scheme, they must remain within it for 10 years unless the vessel is sold, or a charter or management agreement is terminated. For a fleet to qualify for the scheme, at least 60 per cent of its tonnage should comprise Community ships. If this requirement is not met, the non-Community vessels may still qualify if certain criteria are met, but surcharges may be payable.

For owners and charterers, qualifying activities are maritime transport of goods or people between Cyprus ports and foreign ports or offshore installations, or between foreign ports or offshore installations, including towage, dredging, and cable laying. For ship managers, qualifying activities are the provision of services under a written agreement to a ship owner or bareboat charterer in relation to crew management, technical management, or both.

A qualifying vessel is a sea-going vessel that has been certified in accordance with international principles and legislation of the flag country and is registered in the register of a member country of the International Maritime Organisation and International Labour Organisation. Vessels which transport humanitarian aid are included in the definition, but the following vessels are excluded:

- Fishing and fish factory vessels;
- Vessels used primarily for sport or recreation;
- Vessels constructed exclusively for inland waterway navigation;
- Harbour, estuary, and river ferries and tug boats;
- Fixed offshore installations which are not used for maritime transport;
- Non-self-propelled floating cranes;
- Non-ocean-going tug boats;
- Stationary vessels employed for hotel and/or catering operations (floating hotels or restaurants); and
- Vessels employed mainly as casinos or gambling facilities.

#### *Tax Exemption*

The Tonnage Tax Law replaces taxes based on profits with a tax calculated on the net tonnage of the vessels concerned. For owners and charterers, the tax exemption covers profits from the use of a qualifying vessel, dividends paid out of those profits at all levels of distribution, and interest income relating to the financing, maintenance, or use of a qualifying vessel and the related working capital, excluding interest on capital used for investments.

Profits from the disposal of a qualifying vessel or any share or interest in it and profits from the disposal of shares in a ship-owning company are also exempt from tax. In order to qualify for the exemption at least 25 per cent of the net tonnage of vessels subject to tonnage tax must be owned or bareboat chartered. The percentage can be reduced but for not more than three consecutive years. The qualifying percentage is reduced to 10 per cent if all the vessels of the charterer are registered or managed in the EEA.

Ship managers may elect to pay tonnage tax at one-quarter of the rates applicable to ship owners and charterers, in which case profits earned from the provision of technical and crewing services are exempt from tax in respect of qualifying vessels, together with dividends paid out of those profits at all levels of distribution. Profits from commercial management are not covered by the tonnage tax scheme and remain taxable under corporation tax.

Section 46 of the Tonnage Tax law contains an “all or nothing” provision. Qualifying owners, charterers, and ship managers opting to enter the tonnage tax system must include all qualifying ships. If a company which is part of a Cyprus tax-resident group of companies enters the tonnage tax scheme, then all other qualifying members of the group must simultaneously enter the scheme.

#### *Tonnage Tax Rates*

Tonnage tax is charged on a sliding scale on net tonnage. The initial rates charged to owners and charterers are as follows:

<b>Tonnage tax rate per tonne</b>	
First 1,000 tonnes	€0.3650
Next 9,000 tonnes	€0.3103
Next 15,000 tonnes	€0.2008
Next 15,000 tonnes	€0.1278
Each tonne above 40,000	€0.0730

By way of example, the annual tonnage tax on a ship of 50,000 tonnes would be €8,816.70. Cyprus-flag ships are also subject to an annual registry maintenance fee of €300. For ship managers and ship management companies, the rates are one-quarter of those set out in the table above.

#### *Other Provisions*

The Tonnage Tax law contains “ring-fencing” provisions to prevent exemption being gained in respect of ineligible activities. Separate accounts must be maintained in respect of qualifying and non-qualifying activities, and transactions with related parties who are not in the tonnage tax system must be made at arm’s length.

The tonnage tax system is administered by the Department of Merchant Shipping and taxpayers within its scope will receive an annual certificate, a copy of which will be sent to the income tax authorities.

The Department of Merchant Shipping will maintain records of all Cyprus flag vessels and their owners which are not deemed to carry out a qualifying activity, and of all ship managers, ship owners, or charterers of foreign-flag vessels who do not carry out a qualifying activity or have not opted for the tonnage tax system.

Following enactment of the Tonnage Tax law, section 19 of the Income Tax Laws of 2002 – 2010,<sup>3</sup> which gave ship managers the option on a year-by-year basis of paying corporate income tax at a reduced rate of 4.25 per cent on net earnings instead of tonnage tax, has been repealed by the Income Tax (Amendment) Law of 2010.<sup>4</sup>

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<sup>3</sup> Law 118(I) of 2002, as amended.

<sup>4</sup> Law 41(I) of 2010.

