Cyprus Business Headlines

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THE COVERED SECURITIES LAW, 130(I) OF 2010

The Covered Securities Law, 130(I) of 2010, which was enacted in December 2010, establishes the legal framework for issuance of covered bonds in Cyprus complying with Directive 2009/65/EC (the UCITS Directive) and Directive 2006/48/EC (the Capital Requirements Directive).

The new law empowers all credit institutions incorporated in Cyprus, including cooperative credit institutions, to issue covered bonds, provided they register with and are authorised by the relevant supervisory body (see below).

It regulates the eligibility of assets for inclusion in the cover pool, the issuance model (the cover pool assets remain separately identifiable in the issuer's balance sheet rather than being transferred to a special purpose vehicle) and the registration in Cyprus of foreign covered bonds in case of a cross-border merger involving the absorption of an issuing credit institution incorporated under EEA law by another credit institution incorporated in Cyprus. The Central Bank of Cyprus is the designated body for registration and supervision of eligible issuers and covered bonds where the issuer is a bank, and the Cooperative Societies Supervision and Development Authority is the supervisory body where the issuer is a cooperative credit institution. In the event of the issuer's insolvency, holders of covered bonds have priority on the proceeds of the cover pool over all other creditors, both secured and unsecured.

A number of detailed implementation issues, including the assessment of the adequacy and quality of the cover pool, the Capital Requirements Directive compliance of the covered bonds, and disclosure requirements on the part of issuers, are dealt with in a separate Directive issued by the Central Bank of Cyprus.

Further information: **Stephanos Evangelides**

THE REGULATION OF FIDUCIARIES, ADMINISTRATION BUSINESSES AND COMPANY DIRECTORS LAW

The Cyprus Securities and Exchange Commission ("CySEC") has circulated a further draft of the Regulation of Fiduciaries, Administration Businesses and Company Directors Law for comment by interested parties. The first draft was issued for consultation in 2006 by the Central Bank of Cyprus and a number of amendments have been made in the intervening period in order to arrive at an effective law meeting the needs of stakeholders. In addition, responsibility for the law and for regulation of fiduciary service providers has passed from the Central Bank of Cyprus to CySEC.

The latest draft law excludes registered legal firms, auditors and banks from its scope unless they opt to be regulated under it. This change is in response to representations from such organisations that they are already subject to their own rigorous regulatory arrangements and that a further layer of regulation would be unnecessary and burdensome. The application process has been simplified and the application fee set at €2,000. CySEC may request further information on an applicant if it considers it appropriate. The main regulatory focus will be the prevention of money laundering. CySEC will not publish authorisations but will maintain a register of approved service providers.

The consultation period ended on 1 February 2011 and it is hoped that the current draft will be enacted and come into force in the next few months.

Further information: **Elias Neocleous**

THE NEW DOUBLE TAXATION AGREEMENT BETWEEN CYPRUS AND GERMANY

Cyprus and Germany have signed a new Agreement on the Avoidance of Double Taxation, which, when ratified, will replace the existing agreement of 1974 ("the 1974 agreement").

Most of the changes brought about by the new agreement merely reflect changes to the OECD Model Tax Convention (for example, there is no longer an article covering personal services) or updating of definitions (for example, the 1974 agreement referred only to income tax in Cyprus, whereas the new agreement specifies all the taxes covered). However, a number are more substantial.

Permanent establishment

Article 5(3) of the new agreement extends the definition of a construction or installation project to include supervisory activities, but no permanent establishment arises until after 12 months' activity. (Under the 1974 agreement a permanent establishment arose after six months).

Article 5(5) provides that the exercise of activities on behalf of an enterprise by a representative other than an independent agent may create a permanent establishment, even though there is no fixed place of business.

Shipping, inland waterways transport and air transport

Article 8 has been updated to reflect the current OECD wording, which includes inland waterways transport (the 1974 agreement referred only to shipping and air transport). As Cyprus has no navigable inland waterways this is unlikely to be material in practice.

More significant is the removal of article 8(3) of the 1974 agreement, which allowed Germany to tax profits of Cyprus resident companies or partnerships engaged in international shipping with greater than 25% foreign ownership in certain circumstances.

The Protocol to the new agreement makes clear that profits of third party shipmanagement companies (enterprises which perform the various tasks of operating a ship for shipping enterprises, such as crewing, technical and commercial management) are included within the definition of profits from the operation of ships for the purposes of Article 8.

Associated enterprises

In line with the latest OECD Model Convention, Article 9 includes a provision stating that where taxable profits in one country are increased to bring them onto an arm's length basis a corresponding downward adjustment must be made in the other country.

Dividends

The maximum tax charge in the country of residence of the paying company is 5% as long as the recipient is the direct beneficial owner of 10% of the paying company's capital. For holdings below the 10% threshold the maximum rate is 15%. Under the 1974 agreement the maximum rate was 10% and the minimum holding threshold was 25%. Furthermore, no tax will be imposed on dividends paid where a company resident in one contracting state derives income or profit from the other contracting state, unless the dividends or the holding in respect of which they are paid are connected with a permanent establishment in that other contracting state.

Interest

Interest arising in one country which is beneficially owned by a resident of the other country is taxable only in the country of residence of the recipient. The 1974 agreement provided that tax of up to 10% could be imposed by the country in which the interest arose. Penalty charges for late payment are not regarded as interest for the purposes of the new agreement.

Royalties

Royalties arising in one country which are beneficially owned by a resident of the other country are taxable only in the country of residence of the recipient unless the recipient has a permanent establishment in the other country, and the royalties are derived from that permanent establishment.

The term "royalties" includes any kind of payments for the use or the right to use a person's name, picture or any other similar personality rights and payments received as consideration for the registration of entertainers' or sportsmen's performances by broadcasting media.

Business profits for partnerships

Article 7 of the new agreement provides that, in the case of partnerships, business profits includes the remuneration received by a partner from the partnership for activities in the service of the partnership and for the granting of loans or the provision of assets.

Capital Gains

In line with the current OECD Model Convention, Article 13 includes a provision that gains from disposal of shares or similar rights in companies which derive more than 50% of their value directly or indirectly from immovable property may be taxed in the country where the property is situated. Similarly, gains from disposal of ships and aircraft are taxable in the country in which the place of effective management is situated.

Elimination of double taxation

The 1974 agreement included a complicated mix of methods to eliminate double tax but in the new agreement double taxation is eliminated by the credit method in both countries.

Exchange of information

Article 25 of the new agreement goes a little further than

the corresponding article of the current OECD Model Convention in allowing the use of information gathered for purposes outside the normal scope, if both countries' laws permit it. Otherwise it mirrors the OECD text. The Protocol to the new agreement provides safeguards for taxpayers, requiring personal data to be appropriately protected, irrelevant data to be removed, and holding the authorities liable for any unlawful damage resulting from the exchange of information.

Definition of "place of effective management"

The Protocol to the new agreement defines "the place of effective management", which is a term of increased importance in the context of all OECD Model based treaties, as "the place where the key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made" in line with the current Commentary on the Model Tax Convention.

Procedural rules for taxation at source

The new agreement includes a new Article 26 regarding imposition of tax at source and setting out provisions for the relevant amounts to be refunded.

Entry into force and effective date

The new agreement will enter into force when ratified by both countries and take effect from the following 1 January, on which date the 1974 agreement will cease to apply.

Further information: **Philippos Aristotelous**

NEW DOUBLE TAXATION AGREEMENTS WITH UNITED ARAB EMIRATES AND ARMENIA

Cyprus has signed new double taxation agreements with the United Arab Emirates and with Armenia. The agreements have not yet been ratified, and have not taken effect.

The agreement dated 29 November 1982 between Cyprus and the USSR, which was adopted by Armenia on independence, will remain in effect between Cyprus and Armenia until the new agreement is ratified by both countries.

Further information: **Olga Mikhailova**

DETAILS OF BANK LEVY

Legislation was enacted in April requiring credit institutions operating in Cyprus to pay a levy of 0.095% on their customer deposits from 2011 onwards. For the first two years, seven-twelfths of the amounts raised by the levy will be used to reduce the government deficit and the remaining five-twelfths will be used to fund a financial stability fund. From 1 January 2013, the entire amount raised by the levy will be credited to the financial stability fund.

The amount payable in any year 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 be payable by:

- Cyprus banks in respect of their banking activities in Cyprus (overseas branches and subsidiaries will not be subject to the levy);
- the Cyprus operations of foreign (EU and third-country) banks and credit institutions; and
- co-operative credit institutions.

The levy will be limited to 20% of the taxable profit for the year in which it is paid. It will not be deductible for the purpose of calculating taxable profits but it will 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. For 2011, the declaration must be submitted and the first instalment paid by 31 May 2011.

The Commissioner of Income Taxes has the power to raise assessments for the levy and to collect it from banks.

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% limit must be refunded within a month after the issue of the final income tax assessment.

At this stage the regulations for the establishment and operation of the Financial Stability Fund have not been finalised. They must be issued within six months from the date the law comes into force, failing which any levy collected must be returned to the credit institutions concerned.

The cost of the levy is intended to fall on banks, not their customers, and the law introducing the levy includes provision for a fine of up to €100,000 to be imposed on credit institutions which are found to have passed the cost onto their customers.

Further information: **Philippos Aristotelous**

NEW UKRAINIAN LIST OF DESIGNATED OFFSHORE JURISDICTIONS DOES NOT INCLUDE CYPRUS

The Ukrainian government has published the list of designated offshore jurisdictions under the Ukrainian Tax Code, which took effect on 1 April 2011. Payments by Ukrainian residents for the benefit of entities registered in these jurisdictions are not fully tax-deductible.

Cyprus is not included on the list of designated offshore

jurisdictions, making payments to beneficiaries in Cyprus fully deductible.

Further information: **Olga Mikhailova**

FURTHER SUSPENSION OF LIMITATION PERIODS

Limitation periods in Cyprus are set out in the Limitation of Actions Law, Cap 15, which dates back to the time when Cyprus was a British colony. The principal time limits range from two to 15 years, depending on the nature of the claim. In relation to causes of action not expressly provided for by the Limitations Law or not expressly exempted, the limitation period is six years from the date when the cause of action accrued.

The Limitations Law was suspended in 1964 following inter-communal disturbances and it has effectively remained suspended ever since.

The Suspension of Limitation Period (Provisional Provisions) Law (Law 110(I) of 2002) provided that the Limitations Law would re-enter into force with effect from 1 June 2005, except in relation to any immovable or movable property situated in areas now occupied by Turkish troops (or property which was situated there at the time of the Turkish invasion), but its entry into force has been postponed by a succession of laws passed in the interim, each temporarily extending the suspension. The latest of these, enacted in March 2011, extends the suspension for a further nine months until the end of 2011.

Further information: **Chrysanthos Christoforou**

NOTIFICATIONS UNDER THE TONNAGE TAX LAW

The Department of Merchant Shipping ("DMS") has issued a number of Notifications giving guidance on its interpretation of certain aspects of the Merchant Shipping (Fees and Taxing Provisions) Law of 2010 ("the Tonnage Tax Law").

Deadline for applications to be included in the tonnage tax scheme for 2011

Qualifying Cyprus tax-resident owners of foreign ships, charterers and ship managers may opt to be taxed under the tonnage tax scheme in respect of any particular fiscal year under the provisions of section 7, section 19 and section 29 respectively of the Tonnage Tax Law.

In order to do so they must submit a completed Application for Approval of the Option to be taxed under the Cyprus Tonnage Tax System on form MS TT 1 to the Director of the Department of Merchant Shipping, with a copy to the Commissioner of Income Tax, no later than thirty days before the beginning of the relevant year.

The Department of Merchant Shipping will review the application and its supporting documentation and will notify the applicant and the Commissioner of Income Tax within thirty days whether the applicant qualifies or not. If the application is approved, the option will be effective as from the date of receipt of the application and will remain in force until it expires, or is subsequently withdrawn by the owner, charterer or ship manager, as the case may be. A notice of withdrawal given during the course of any year will take effect from the last day of the year. If early withdrawal takes place otherwise than as a result of the disposal of the ships, termination of the charters or cessation of all ship management activities, the tax liability will be recalculated as if the option to be included in the tonnage tax scheme had never been exercised, and the taxpayer will be required to pay any shortfall.

Taxpayers wishing to be included in the scheme for 2011 were unable to do so within the time allowed by the Tonnage Tax Law since the necessary subsidiary legislation for implementation of the Law was not in place at the time. Accordingly, the Department of Merchant Shipping has set a deadline of 31 May 2011 for receipt of applications from owners of foreign ships, charterers and ship managers wishing to be taxed under the tonnage tax system for the fiscal year 2011. If the application is approved, the option will be effective from 1 January 2011.

Definition of "Community ship"

The definition of the term "Community ship" is contained in section 2 of the Tonnage Tax Law, and is further explained in the Tonnage Tax (Definition of Community Ships) Notification of 2010, issued by the DMS in July 2010 ("the July Notification").

According to section 2 of the Tonnage Tax Law, a Community ship is a ship registered in a Member State which flies the flag of a Member State in accordance with its legislation, and is determined by Notification, in compliance with the applicable guidelines on State aid to maritime transport adopted from time to time by the European Commission.

In the light of this, the DMS considers that there are two concurrent prerequisites for a ship to qualify as a Community ship, namely; it must be registered in a Member State; and it must fly the flag of a Member State in accordance with its legislation.

The July Notification contains a list of qualifying Registers. It does not include the Registers of overseas territories of Member States such as the Dutch Antilles Register and the Cayman Islands Register.

However, "Community ship" must be interpreted to include the term "Cyprus ship" which, according to section 2 of the Tonnage Tax Law, includes foreign registered ships registered in the Special Book of Parallel Registration, under the provisions of Part VA of the Tonnage Tax Law. Accordingly, a ship registered parallel

-in under the Merchant Shipping (Registration of Ships, Sales and Mortgages) Laws of 1963 to 2005 (Law 45 of 1963 as amended), is considered by the DMS to be registered in Cyprus and flying the Cyprus flag, and so constitutes a Cyprus ship and a Community ship.

Furthermore, the DMS regards a ship registered parallel -out under Law 45 of 1963 as amended as a Cyprus ship (and by analogy a Community ship), even though it may temporarily be flying a foreign flag. However, a ship which has no registry connection with Cyprus (either as underlying register or as flag register) is deemed by the DMS not to be a Cyprus ship or a Community ship because its bareboat charter registration is not effected according to Cyprus law.

In order to avoid any eventual discrimination as a result of the specific treatment of the status of Cyprus ships DMS may also interpret the term "Community ship" to include cases where the underlying register is a Community ship Register other than the Cyprus Register and the vessel is temporarily flying a non-Community flag, if it is evidenced that for tax purposes and for the whole duration of the bareboat charter the ship is considered by the legislation of the relevant Member State (the underlying registry) to be a ship of the Member State concerned.

Calculation of Community-flagged share percentage

Section 15 of the Tonnage Tax Law allows owners of mixed fleets, comprising Community-flagged ships and non-Community-flagged ships to benefit from inclusion in the tonnage tax scheme provided that:

- at least 60% of the fleet in terms of tonnage comprises Community ships; or
- part of the fleet comprises Community ships; and
  - the percentage share of the fleet in tonnage terms represented by Community-flagged ships is not reduced for three years from the date of entering the tonnage tax scheme; and
  - the commercial and strategic management of the fleet is carried out from the territory of the EEA.

Sections 25 and 35 of the Tonnage Tax Law include similar provisions for charterers and managers respectively of mixed fleets, apart from the requirement for the ships to be managed from the EEA.

Failure to maintain the percentage share of the fleet represented by Community-flagged ships results in the imposition of surcharges and disqualifications.

In December 2010 the DMS issued the Tonnage Tax (Special Provisions for the Calculation of the Community Flagged Share) Notification of 2010 which sets out the detailed method for calculation of the relevant percentages and includes illustrative calculations.

Reference date for calculation of the Community-flagged share

For the purposes of calculating the Community-flagged share for a given fiscal year only the net tonnage of the ships owned, chartered or managed as at 31 December of that year will be taken into account.

The Department of Merchant Shipping will carry out a calculation of the Community-flagged share at the end of the third year (on 31 December) after entry into the tonnage tax system and every three years from that date for as long as the tonnage tax scheme is in place. A company which opted to enter the tonnage tax system on 1 January 2011 will be assessed on 31 December 2013 and every three years thereafter. A newly established company which opted to enter the tonnage tax system on 13 May 2011 (upon establishment) will be assessed for the first time on 31 December 2014 and every three years thereafter.

31 December is also the reference date for calculating the minimum percentage set out in section 33 of the Tonnage Tax Law regarding the economic link between the managed ships and the Community.

Minimum share of the fleet in ownership

Section 47 of the Tonnage Tax Law allows charterers to enter the tonnage tax scheme only if the total net tonnage of ships chartered-in and included in the tonnage tax scheme is no more than 75% of the total net tonnage of all ships chartered-in or operated by the charterer and included in the tonnage tax system. The limit is increased to 90% provided that every chartered-in ship flies an EEA flag or is entirely managed from within the EEA. Temporary increases in the chartered-in percentage after entry are permitted but if the percentage of net tonnage chartered-in reaches 100% (i.e. no vessels are owned or bareboat chartered) the charterer will be ineligible for tonnage tax and will be taxed under the Income Tax Laws.

The share of the fleet in ownership in a given fiscal year is calculated on the basis of the net tonnage of each ship chartered-in or operated as at 31 December which is included in the tonnage tax system, on a pro rata basis according to the number of days chartered-in or operated.

Further information: **Costas Stamatiou**

RECENT CIRCULARS FROM THE DEPARTMENT OF MERCHANT SHIPPING

The Cyprus Department of Merchant Shipping (DMS) has recently issued the following circulars: to owners, managers and representatives of ships under the Cyprus flag and to owners, masters and representatives of foreign ships calling at ports in Cyprus.

European Union Commission Decision 2010/769/EU of 13 December 2010

Circular 40/2010 draws attention to the adoption of

European Union Commission Decision 2010/769/EU of 13 December 2010. This applies to LNG carriers calling at ports in the EU which, in order to reduce sulphur emissions, use as fuel a mixture of marine fuel oil and boil-off gas. These vessels are required to comply with the calculation parameters set out in the Annex of the Decision and to be equipped for continuous metering and monitoring of consumption of marine fuel and boil -off gas. They are also required to maintain detailed records in the ship's logbook regarding the type and quantity of fuels used on board and to make these records available for examination.

New list of countries recognised under STCW 1978

The DMS has issued an updated list of countries whose certificates of competency are accepted for the issue of endorsement attesting the recognition of non Cyprus certificates of competency under the International Convention on Standards of Training, Certification and Watchkeeping for Seafarers 1978, as amended.

Georgia has been removed from the list in accordance with the decision of the European Commission dated 22 November 2010 which withdrew the recognition that had been granted according to article 18(3c) of Directive 2001/25/EC. The DMS will no longer issue Cyprus endorsements attesting the recognition of Georgian certificates of competency but endorsements already issued will remain valid until they expire. The DMS will reissue Cyprus endorsements attesting the recognition of Georgian certificates to masters and officers only on the basis of approved seagoing service on board Cyprus flagged ships, involving performance of duties appropriate to the certificate held, for an accumulated period of at least one year during the preceding five years.

Provision of Port State Control information

Circular 41/2010 deals with technical issues relating to notification of proposed ship calls to port authorities in Cyprus under the Port State Control Directive (2009/16/EC).

Further information: **Costas Stamatiou**

THE THIRD EDITION OF NEOCLEOUS'S INTRODUCTION TO CYPRUS LAW IS NOW AVAILABLE

When it was first published in 2000, our Introduction to Cyprus Law was widely acclaimed as a unique, authoritative, comprehensive guide to the Cyprus legal order. In the decade since publication it has become recognised as the "bible" on the subject of Cyprus law, and an essential tool for lawyers and anyone else doing business in or through Cyprus.

A third edition has now been published, taking account of all legal developments of the past decade, including entry into the EU and the Eurozone. The original material has been completely revised and new chapters have been added on energy, environmental law, immigration law, information technology and competition law.

For further details please click here.

RECENT PUBLICATIONS

The following are a selection of our publications since the previous edition of this newsletter. They may be viewed by following the links below or by visiting the publications section of our website.

- Cyprus chapter of "International Corporate Law Compendium"
- Cyprus chapter of "PLC Insurance & Reinsurance handbook "
- Cyprus chapter of "Comparative Legal Guide to: Employment & Labour Law 2011"
- Cyprus section of "European Holding Regimes 2011"
- Cyprus chapter of "Encyclopedia of International Commercial Litigation"
- Cyprus chapter of "International Securities Law and Regulation"
- Cyprus chapter of "Private Client Handbook 2010/11"
- Cyprus chapter of "Investment Funds Handbook 2011"

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