

Cyprus Business Headlines

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CHANGES TO TAX AND COMPANY LAW

The Cyprus Parliament has passed a series of measures to increase various taxes and impose a levy on companies incorporated in Cyprus. These form part of an austerity package aimed at reducing the budget deficit, which also includes an increase in government employees' pension contributions and a two-year special levy on salaries and pensions paid to national and local government employees. Further steps to reduce the government deficit are expected to be taken over the next few months, focussing on cutting government spending and providing tax incentives and other measures for promoting growth.

The principal changes in the tax and company legislation are outlined below.

Increase in the top rate of personal income tax to 35%

A 35% income tax rate has been introduced for taxable income in excess of €60,000. The tax bands and rates for 2011 and subsequent tax years are now as follows:

Income band from	Income band to	Tax rate	Cumulative tax at top of band
0	€19,500	0	0
€19,500	€28,000	20%	€1,700
€28,000	€36,300	25%	€3,775
€36,300	€60,000	30%	€10,885
€60,000	and above	35%	

Individuals taking up residence and employment in Cyprus

For the first three calendar years following the start of their employment, individuals taking up residence and employment in Cyprus are entitled to an annual allowance of the lower of €8,543 or 20% of their remuneration. A modification of this arrangement has been made for highly-paid employees, in order to attract highly-qualified individuals to relocate to Cyprus. With effect from the 2012 tax year, if income from employment exceeds €100,000 per annum, a 50% deduction is allowed for the first 5 years of employment.

Increase in the rate of SDC tax on interest

The rate of SDC tax on interest received has been increased from 10% to 15%. The reduced rate of 3% payable by provident funds and individuals whose total income for the year does not exceed €12,000 is unchanged.

Most companies will be unaffected by the change, since interest they receive is not subject to SDC tax, but to corporate income tax.

Increase in the rate of SDC tax on dividends

The rate of SDC tax on dividends received by Cyprus-resident individuals is increased from 15% to 17%. Companies are generally exempt from SDC tax on dividends. The same increase in the rate applies to deemed dividend distributions.

Effective date for SDC tax increases

The increased rates of SDC tax will apply to all interest and dividends received after the date the amending law is published in the Official Gazette.

Immovable Property Tax

The threshold for payment of immovable property tax, which is payable by individuals and companies on the aggregate value of property owned in Cyprus, has been reduced and the rates have been increased. Assessments continue to be based on 1980 values.

Value of property as at 1 January 1980	Rate	Cumulative tax at top of band
From To		
0 €120,000	0	0
€120,000 €170,000	0.4%	€200
€170,000 €300,000	0.5%	€850
€300,000 €500,000	0.6%	€2,050
€500,000 €800,000	0.7%	€4,150
€800,000 and above	0.8%	

The changes will be effective from 1 January 2012.

VAT relief for purchase of principal private residence

The current relief, which provides a refund of VAT of up to €17,000, will be replaced by the introduction of a reduced VAT rate of 5% on the costs of purchase or construction of the first 200 square metres of a house or flat of up to 300 square metres in total area for use as a principal private residence.

Annual levy on companies

For 2011 and subsequent years an annual levy of €350 will be payable to the Registrar of Companies by all companies incorporated in Cyprus. Dormant companies, companies which do not own any assets and companies owning property in the occupied areas of Cyprus are exempt. For groups of companies there is a ceiling of €20,000.

The levy for 2011 is payable by the end of the year; for subsequent years the levy is payable by 30 June.

Penalties will be imposed in the event of late payment. If the levy is paid no later than two months after the due date a penalty of 10% will be charged. If the levy is paid between two and five months after the due date, a penalty of 30% will be charged. Companies which have not paid after five months from the due date may be struck off the register. They can be restored to the register only by paying an increased levy of €500 per year if they are restored within two years or €750 per year if they are restored to the register after more than two years.

Further information: [Elias Neocleous](#)

PROTOCOL TO THE RUSSIA-CYPRUS DTT SENT TO RUSSIAN DUMA FOR RATIFICATION

The Protocol to the Russia-Cyprus double tax agreement, which was initialled in 2009, was approved by the Russian Prime Minister in September 2010 and signed by the Russian President during his visit to Cyprus the following month. It will take effect once it has been ratified by both countries and notifications of ratification have been exchanged. We understand that the protocol has now been submitted to the Russian State Duma for ratification. No official announcements have been made regarding the timetable but it is understood that the aim is for ratification procedures to be completed before the end of the year so that the Protocol will enter into effect from the beginning of 2012. Certain provisions of the Protocol relating to taxation of real estate and disposal of interests in property-rich companies will enter into force four years later.

The exchange of instruments of ratification should lead to formal removal of Cyprus from the Russian Finance Ministry's List of States and Territories Which Grant Preferential Tax Treatment and do not Require the Disclosure and Provision of Information in Relation to Financial Operations Carried Out (commonly known as the blacklist). This will enable dividends paid by Cyprus companies to qualify for tax exemption in Russia.

Negotiations on the Protocol have continued since signature of the draft and a number of detailed changes have been proposed. The outcome of the negotiations and the final text of the Protocol will not be known until ratification is complete. We shall issue a full analysis of the final agreed Protocol as soon as it is published.

Further information: [Olga Mikhailova](#)

DEDUCTION OF SDC TAX AT SOURCE FROM RENTAL PAYMENTS

With effect from 1 July 2011, companies, partnerships, and national or local government bodies which pay rentals to Cyprus-resident landlords are required to deduct SDC tax from rental payments and remit it to the tax authorities. The amount to be deducted and paid over to the tax authorities is 3% of 75% (i.e. 2.25%) of the gross rental amount.

The tenant must remit the amount deducted to the tax authorities before the end of the month following the month in which the deduction was made using form IR601A. In the event of non-payment or delay in payment penalties and interest may be imposed.

At each 30 June and 31 December the tenant must provide the landlord with a statement of tax withheld on form IR614A REC. Tenants must also submit with their annual tax return a list of the landlords from which SDC was withheld. Persons or companies receiving rents are responsible for ensuring that the amount of SDC withheld and shown on form IR614A REC is correct.



They must pay any further SDC due (for example, in the event of under-deduction or on rents paid by individuals) by self assessment on 30 June and 31 December. They must attach a copy of forms IR614A REC to each year's tax return.

There is no requirement to withhold and account for SDC tax on rents paid to non-residents subject to the landlord providing the tenant with the necessary confirmation of non-residence on forms IR614A Q and IR 614A DECL.

Further information: [Philippos Aristotelous](#)

PUBLICATION OF INLAND REVENUE DEPARTMENT GUIDANCE ON INTEREST RATE MARGINS ON LOANS BETWEEN CONNECTED ENTITIES

Section 33 of the Cyprus Income Tax Law allows the tax authorities to adjust a company's taxable profit in the event that transactions between related companies are undertaken other than on an arm's length basis.

In 2009 the tax authorities gave informal guidance on the parameters to be observed in arriving at the acceptable margin of taxable interest which should apply in transactions involving Cyprus entities as intermediary financing vehicles in back-to-back financing arrangements. This guidance has now been formalised in correspondence between the Department of Inland Revenue and the Institute of Certified Public Accountants of Cyprus. For tax years beginning 1 January 2008 onwards the following minimum profit margins have been confirmed as acceptable.

Amount of loan	Interest bearing loans	Interest free loans
Less than €50 million	0.35%	0.35%
Between €50 million and €200 million	0.25%	0.35%
More than €200 million	0.125%	0.35%

If loans are made on an interest-free basis, taxation will be calculated on the basis of a rate of 0.35% regardless of the amount of the loan.

For earlier years which are still open, the minimum profit margin is 0.30% irrespective of the loan amount and whether it is interest bearing or not.

These margins apply to Cyprus companies borrowing funds and using them within a period of six months to finance related or connected entities via loans. The margins apply to funds borrowed from another related or connected party, or from a bank where the facility is guaranteed by a related or connected party. Each financing arrangement will be considered separately.

Professional advice should be obtained in relation to financing transactions so as to ensure tax certainty. In particular, taxpayers may apply to the revenue

authorities for an advance ruling in relation to a proposed financing arrangement confirming that it will not trigger any adjustments.

Further information: [Philippos Aristotelous](#)

DELAY IN IMPOSITION OF TAX PENALTIES

The December 2010 budget introduced a number of new penalties for late payment and late filing of returns, which were due to take effect on 30 June 2011.

The Inland Revenue Department has now announced a delay of three months in the introduction of the new penalties, aimed at encouraging taxpayers to bring their compliance obligations up to date immediately. The new penalties will now come into effect from 30 September 2011.

Further information: [Philippos Aristotelous](#)

CLARIFICATION OF RUSSIAN WITHHOLDING TAX EXEMPTION ON SALE OF SHARES IN "PROPERTY-RICH" COMPANIES

The taxation of capital gains derived by foreign legal entities from the sale of Russian shares or financial instruments has been clarified by Russian Federal Law No. 132-FZ, which amends Article 309(1)(5) of the Russian Tax Code establishing the Russian withholding tax regime applicable to capital gains.

Prior to the enactment of the new law, proceeds from the sale of shares in Russian companies which derived more than 50% of their value from immovable property located in Russia (commonly referred to as "property-rich companies") were subject to withholding tax in Russia. The only exception was sales on foreign stock exchanges of securities traded on those exchanges. However, the Tax Code did not provide any detailed rules what shares qualified for the exemption, resulting in significant uncertainty.

Federal Law No. 132-FZ provides that securities qualify for the exemption provided that they satisfy all the following requirements:

- ≡ they have been admitted for trading by at least one market which possesses the right to do so in accordance with its national legislation;
- ≡ information on their prices is published in the mass media (including by electronic means);
- ≡ a market quotation is calculated for the securities during the last three months preceding the transaction date, if this is provided for by the relevant national legislation.

Federal Law 132-FZ was published on 8 June 2011 and applies retrospectively from 1 January 2011.

It should be noted that under the Cyprus-Russia double tax agreement capital gains derived from sale of shares of property-rich companies are currently exempt from



Russian tax and will remain so until four years after the Protocol to the Cyprus-Russia double tax agreement takes effect.

Further information: [Olga Mikhailova](#)

TAX DEVELOPMENTS IN UKRAINE AND RUSSIA

A number of recent tax developments in Ukraine and Russia underline the need for proper planning, documentation and execution of transactions in the light of the tax authorities' increasingly sophisticated and rigorous scrutiny of tax mitigation structures.

Ukraine guidance on tax disputes

Recent guidance issued by the Higher Administrative Court of Ukraine to subordinate courts giving guidance on the application of the Tax Codes in disputes coming before the courts stresses the importance of verifying recorded transactions, and instructs courts to focus on the substance, rather than the form of the transaction. Courts are required to satisfy themselves that the transaction actually took place as claimed and is not merely a "paper-trail". In addition the transaction must have a business purpose. In order to be deductible for tax (and for VAT to be recovered) expenses must be genuinely incurred and properly documented. This is particularly relevant with regard to intra-group transactions such as recharges of administrative and personnel costs, and management, consultancy and licence fees. Care should be taken that there is a logical and defensible basis for such charges, and complete supporting documentation.

The ZAO Stik decision

This decision of the Federal Arbitration Court of the Moscow District gives further confirmation that the Russian tax authorities are becoming more experienced and sophisticated in addressing the issue of whether companies have a permanent establishment in Russia. They have started to examine transactions in detail, with particular attention to the identities of signatories of documents, their location at the time of signing and their role and function in the transaction itself and in the business undertaking it.

The case concerned a Russian company, ZAO Stik, which had borrowed funds from Cyprus companies under loan agreements. The loan agreements were signed on behalf of the lenders by two employees of a Russian company affiliated with the borrower, under powers of attorney. The tax authorities argued that the Cyprus companies were carrying commercial activities in Russia through "dependent agents" (the individuals who signed the loan agreements), and that these activities gave rise to permanent establishments of the Cyprus companies. They claimed additional tax, fines and penalties from ZAO Stik.

In this case the court found that in fact the individuals had merely performed a mechanical function, namely

signing the agreements. They were not involved in negotiating the terms of the agreements and did not participate in meetings between the parties. As a result, their activity should be treated as merely supporting and auxiliary, and they were not "dependent agents" of the Cyprus companies. The court therefore ruled that the Cyprus companies had no permanent establishment in Russia.

Although this case ended with a decision in favour of the taxpayers it clearly illustrates the need for detailed planning and consideration at every stage of a transaction, precise implementation of the agreed plan, and comprehensive documentation of every stage of the transaction.

New Russian transfer pricing law

In July 2011 the Russian President formally signed Law 227-FZ, which substantially amends Russia's transfer pricing legislation, bringing it into line with the OECD Transfer Pricing Guidelines. The new law will enter into force on 1 January 2012. Taxpayers will be required to maintain specific transfer pricing documentation (and may be required to produce it to the tax authorities) showing:

- ≡ the structure and terms of the transaction, the parties involved and their roles;
- ≡ the pricing methodology, including a description of the transfer pricing method adopted, the reason for choosing it and the sources of information used;
- ≡ information on other factors that might affect the price (eg competition); and
- ≡ information on adjustments to the tax base.

These developments underline the importance of maintaining complete and accurate records in order to achieve tax relief for expenses. It should be borne in mind that, for their part, the Cyprus authorities are prepared to give advance rulings on the tax treatment of proposed transactions.

Further information: [Philippos Aristotelous](#)

THE REGULATION OF THE INNOCENT PASSAGE OF SHIPS IN THE TERRITORIAL SEA LAW OF 2011

The passage of vessels through Cyprus territorial waters has recently been regulated by the enactment of The Regulation of the Innocent Passage of Ships in the Territorial Sea Law of 2011 (Law 28(I)/2011), which entered into force on 18 March 2011.

Territorial waters are defined as such part of the sea adjacent to the coast of the Republic of Cyprus as is considered part of its territory and is subject to the sovereignty of the Republic and extending to a breadth up to a limit of 12 nautical miles from the baselines (generally the coastline).



Passage means navigation through the territorial sea for the purpose of: (a) traversing that sea without entering internal waters or calling at a roadstead or port facility outside internal waters; or (b) proceeding to or from internal waters or a call at such roadstead or port facility. Fishing operations do not fall within the definition of passage.

Passage must be continuous and expeditious, provided however that passage includes stopping and anchoring in so far as these are incidental to ordinary navigation or are rendered necessary by force majeure or distress or for the purpose of rendering assistance to persons, ships or aircraft in danger or distress. Passage is innocent so long as it is not prejudicial to the peace, good order or security of the Republic of Cyprus and it must be performed in conformity with applicable international conventions (particularly the United Nations Convention on the Law of the Sea) and international law. The Law further prescribes a series of activities that are deemed to be prejudicial to the peace, good order or security of the Republic.

The Law defines the circumstances in which the Republic of Cyprus may exercise its criminal or civil jurisdiction in relation to ships passing through the territorial sea and persons aboard them.

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.

"Ring fencing" provisions of the Tonnage Tax Law
Circular 21/2011 draws attention to the "ring fencing" provisions of the Merchant Shipping (Fees and Taxing Provisions) Law of 2010 (Law 44(I)/2010) ("the Tonnage Tax Law").

These provisions forbid the transfer of income or expenses between affiliated persons engaged in activities subject to tonnage tax and income tax, so as to ensure that only profits from qualifying activities are subject to tonnage tax and that profits from other activities are not sheltered within tonnage tax.

To this end, section 41 of the Tonnage Tax Law requires transactions between two parts of the same corporate structure (whether in Cyprus or abroad) to take place on arm's length terms and prices, as if the two parties involved were independent from each other and not part of the same corporate group. Similarly, under section 42 of the Tonnage Tax Law qualifying shipping activities of a person subject to tonnage tax must be segregated from non-qualifying activities carried out by the same person and

accounted for on an arm's length basis. Where transactions subject to section 41 or 42 have taken place other than on arm's length terms the tax authorities may make an appropriate adjustment to the taxable profits under section 33(1)(b) of the Income Tax Law of 2002.

Section 43 of the Tonnage Tax Law requires taxpayers to whom the provisions of section 41 apply to notify any potentially affected person of the possible application of the provisions of section 33 of the Income Tax Law in relation to transactions between them. Failure to comply with this obligation may give rise to criminal liability under section 136 of the Cyprus Criminal Code. According to section 43, notification must take place within 90 days of entry into the tonnage tax scheme, but the retrospective application of the scheme makes this timescale impossible and so the following arrangements apply instead.

For qualifying owners of Cyprus ships, notification must take place no later than 1 September 2011 in respect of ships which are currently registered in the Register of Cyprus Ships and no later than 90 days from the date of registration of each additional vessel. For other persons or companies subject to tonnage tax (owners or charterers of foreign ships or ship managers) the period of 90 days will run from 15 July 2011, the cut-off date for the Department of Merchant Shipping to decide on eligibility for the tonnage tax scheme. Accordingly, notification must take place by 15 October 2011.

Taxpayers are required to maintain adequate records to demonstrate that transactions have taken place on an arm's length basis and to produce them to the authorities on request. If the terms differ from normal market terms, adequate reasoning must also be given.

The Department of Merchant Shipping has undertaken to provide details regarding implementation of the arm's length principles and the sanctions for non-compliance and we will cover these in a future edition.

Digital publications aboard Cyprus flag ships

Circular 17/2011 notified interested parties of the Department of Merchant Shipping's decision to authorise the use of nautical publications (such as sailing directions, lists of lights, notices to mariners, tide tables and other publications necessary for their intended voyage) in digital format aboard Cyprus flag ships and to accept such publications as meeting the requirements specified in SOLAS Regulation V/27.

A number of conditions must be observed if digital publications are used. In particular there must be an adequate stand-by system in case of failure or unavailability of the primary system.

In the event that the changeover to digital publications takes place other than during an annual or renewal survey related to the ship's safety certificate, the master

should record in the ship's log the date when the change took place and the implementation should be verified during the first annual or renewal survey thereafter.

Following the installation and commissioning of the digital system, any nautical publications which are in a printed form should be stored so as to avoid being easily accessible and should be clearly marked as being "out of use".

Further information: [Costas Stamatou](#)

NEWS ABOUT OUR FIRM

"Real Estate, Living and Doing Business in Cyprus"

Andreas Neocleous & Co LLC has entered into an innovative project aimed at providing advice and assistance to businesses and individuals considering relocating to Cyprus. In partnership with Antonis Loizou & Associates Limited, a leading local firm of Chartered Surveyors, and KPMG, the international accounting firm, we are developing a new website called "Real Estate, Living and Doing Business in Cyprus" which will provide all relevant real estate, tax and legal information in one convenient location, in English, Russian and Chinese. The site will provide information relevant to businesses, including tax and employment information, and to individuals, including sections on health, education and banking. It will include links to detailed reference sources including the websites of government departments and other organisations. There will also be a facility for visitors to the site to contact the relevant expert direct in order to answer questions.

Further information: [Christos Vezouvios](#)

Updating of the International Trusts Law of 1992 - giving Cyprus an international trusts law for the twenty-first century

Throughout the firm's existence Andreas Neocleous & Co LLC has helped shape Cyprus's transparent and robust legal system, and promote the island as a leading international business centre offering the highest standards of integrity with smart regulation. The firm is now at the forefront of an initiative to update Cyprus's International Trusts Law, which dates back to 1992. The proposed changes to the law will considerably increase the investment options for trustees and remove a number of restrictions which are no longer required, making Cyprus one of the most attractive trust jurisdictions in the world.


Trusts & Trustees, the leading specialist journal for the trusts sector, recently published an article by Elias Neocleous and Toby Graham, the editor of Trusts and Trustees, outlining the proposed changes. See below for details.

Further information: [Elias Neocleous](#)

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 Joint Ventures" - 2nd Edition](#)
- ≡ [Cyprus chapter of "Enforcement of Foreign Judgments", edited by Louis Garb and Julian Lew, QC](#)
- ≡ [Cyprus chapter of "Cross-border Restructuring and Insolvency 2011"](#)
- ≡ [Cyprus chapter of "International Franchising"](#)
- ≡ [Cyprus chapter of "International Secured Transactions"](#)
- ≡ [Cyprus chapter of "Tax on Transactions 2011-12"](#)
- ≡ [Cyprus chapter of "Dispute Resolution Handbook 2011-12"](#)
- ≡ [Cyprus chapter of "International Agency and Distribution Law"](#)
- ≡ [Cyprus international trusts - a giant leap forward: the proposed amendments to the International Trusts Law 1992](#)



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