# Cyprus – an ideal holding company location

Presented by Elias Neocleous, Olga Mikhailova and Jacob Kilcoyne-Betts of Andreas Neocleous & Co LLC

Despite being among the world's smallest countries, Cyprus has developed into one of its major financial and business centres. Cyprus has always been an excellent location for holding companies for a host of reasons that include its transparent legal system, excellent communications and world-class professional and banking services. It has a market economy and no restrictions on capital movements. It is a member of the EU and its tax system is fully compliant with EU and OECD requirements. It is on the OECD's April 2009 "White List" of compliant tax jurisdictions. Since joining the EU in 2004, Cyprus has consolidated its position as the ideal gateway for investment between the EU and the dynamic economies of Central and Eastern Europe, India and China. It continues to be the largest source of investment into Russia and is an increasingly important source of foreign direct investment into India, ranking second to Mauritius among traditional intermediate holding jurisdictions.

**The optimum participation regime**

From a tax perspective, a multinational group requires three things from a holding company:

- first, the holding company must be able to receive income streams from and the proceeds of sale of the operating company while suffering no, or at least the lowest possible, tax cost in the operating company's jurisdiction;
- secondly, dividends from and proceeds of sale of operating companies should not be taxed in the holding company jurisdiction;
- thirdly, it should be possible (and this has generally been the most difficult step) to extract dividends from the holding company without giving rise to any charge to tax in the holding company jurisdiction.

**How does Cyprus measure up against these benchmarks?**

In brief, the answer is "very well":

- Cyprus has an extensive network of double tax treaties and as an EU member state entitles resident companies to the benefits of the EU Parent-Subsidiary Directive;

- Any dividends that a Cyprus resident company receives are also exempt from tax in Cyprus, except in the case of dividends from abroad where:

  - more than 50% of the activities of the paying company result directly or indirectly in investment income; and

  - the paying company is subject to tax at 5% or less.

- the profits of a Cyprus company's permanent establishment in another jurisdiction are similarly exempt, subject to the same conditions as dividends;

- non-exempt dividend income is subject to defence tax contribution at the rate of 15%. Tax credits are available for taxes paid abroad;

- provided it is received in the ordinary course of business or closely connected to the ordinary course of business, interest is taxable at the standard rate after deduction of associated finance expenses. In practice, the liberal transfer pricing regime allows group debt finance to be routed through Cyprus subject to tax at 10% on only a small interest rate margin;

- mergers, acquisitions and other reorganisations may be effected without tax cost;

- the only withholding tax levied by Cyprus is (subject to treaty provisions) a 10% withholding tax on royalties derived from the use of a right or asset within Cyprus. All other dividend, interest and royalty payments made to non-residents may be made without deduction of tax.

- crucially, capital gains deriving from the disposal of shares and other securities are exempt from all forms of taxation in Cyprus providing the company whose shares are being sold does not hold Cyprus real estate;

- in addition, Cyprus's domestic corporate tax regime is extremely attractive, with profit taxed at 10%, the lowest rate in the EU, generous rules on the deductibility of expenses incurred in producing taxable income and the absence of any specific thin capitalisation regime.

**Recent developments**

The Cyprus government demonstrated its commitment to international standards of transparency and information exchange with the enactment of Law 72(I) of 2008 amending the Assessment and Collection of Taxes Law to allow the domestic tax authorities to disclose information to their overseas counterparts in order to fulfil their obligations under double taxation agreements. It has since focussed on concluding new double tax agreements and modernising existing ones in order to align them with current best practice.

The Protocol to the Russia – Cyprus agreement concluded in April 2009 is expected to come into force before the end of 2010. It has generally been greeted as a successful outcome for Cyprus, preserving the key benefits of the existing treaty while bringing certain features in line with OECD model treaty. In particular, it gives Cyprus "most favoured nation" status by providing that Russia will implement similar provisions in all its double tax agreements, and will amend the Protocol to match any more favourable terms it may agree with any other treaty partner.

It preserves the general rule that the right to tax income from the disposal of shares is given to the country of residence of the seller, but modifies it in certain specific circumstances in line with the OECD model treaty. In particular, the right to tax capital gains derived on the sale of shares in a property rich company will be vested in the country where the property is located. Accordingly, gains realised by a resident of one contracting state from the disposal of shares deriving more than 50% of their value from immovable property situated in the other contracting state may be taxed in that other state.

The withholding rates applicable to interest and royalties will be zero, and the rate for dividends 5%, subject to a minimum investment level of €100,000.

One of investors' greatest concerns about the Protocol, namely that the information exchange provisions would facilitate "fishing expeditions" by the Russian tax authorities, has proved to be unfounded. The Protocol contains robust safeguards for taxpayers, requiring enquiries to be specific and based on reasonable, properly documented grounds.

An important consequence of the Protocol was the removal of Cyprus from the so-called black list of jurisdictions that do not qualify for the Russian participation exemption. This development should see an increase in the use of Cyprus as a jurisdiction for Russian investment abroad and is indicative of Cyprus's global acceptance as a transparent low-tax jurisdiction, which was further demonstrated by the country's removal from all Italian blacklists in July 2010.

The acceptance of Cyprus's commitment to international standards of transparency has been key to its emergence as a source of investment into India, particularly for EU investors. The continuing travails of Vodafone in the Indian courts have focused tax managers' attention on the importance of undertaking cross-border transactions in jurisdictions with a robust tax treaty with India. Not only does Cyprus's commitment to global standards ensure residence is rarely challenged but Cyprus resident companies enjoy greater treaty benefits than their Mauritian counterparts for equity investments into India.

**The verdict**
These factors make Cyprus a highly attractive intermediate holding company jurisdiction as they offer the following benefits:

- groups investing outside Cyprus may flow-through income streams, which will generally be tax exempt in Cyprus and not suffer withholding tax as they leave;

- subsidiaries with scope for significant capital appreciation may be held in Cyprus and sold without any liability to tax on the gain;

- other assets (including, in certain circumstances, foreign real estate) with scope for significant capital appreciation may be placed in a Cyprus corporate wrapper and sold without any liability to tax on the gain;

- Cyprus's double tax treaty network and the EU Parent-Subsidiary directive offer a number of other tax planning opportunities to reduce withholdings from income paid to the Cyprus resident company;

- Cyprus allows payment of dividend, interest and royalties without payment of withholding tax.

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

To take full advantage of the Cyprus holding company regime, the holding company must both be tax resident in Cyprus and have a genuine reason for being. Tax residence is secured by ensuring that management and control is exercised in Cyprus by the directors.

If the company is no more than a tax-driven device without an economic function or substance in Cyprus, it may not to be able to benefit from the advantages of Cyprus's extensive tax treaty network and, in particular, may be caught by anti-avoidance rules imposed by operating company jurisdictions to withdraw the benefits of the Parent-Subsidiary Directive.

Cyprus's commitment to transparency ensures that it is not stigmatised as a tax haven, and will facilitate the growth of its already extensive network of double tax agreements. It has been removed from Italy's and Spain's so-called blacklist of tax havens and the conclusion of the Protocol has led to its removal from Russia's blacklist.

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

Elias Neocleous, Olga Mikhailova
Andreas Neocleous & Co LLC
Neocleous House, 195 Makarios III Avenue,
PO Box 50613, 3608 Limassol

**Tel** +357 25 110 000 **Fax** +357 25 110 001
**E-mail** info@neocleous.com
**Website** www.neocleous.com