



Cyprus thrill

HOW TAX DEVELOPMENTS ARE CONTRIBUTING TO THE USE OF CYPRUS COMPANIES IN INTERNATIONAL STRUCTURING. BY PETROS RIALAS

RECENT INTERNATIONAL tax developments can affect international structures and render them unworkable if certain elements are not carefully considered. While being fully compliant with OECD, EU and other international regulations, Cyprus has addressed such challenges through solid legislative updates.

This article concentrates on how these developments facilitate the establishment of adequate business substance (including local effective management and control), and the beneficial owner of income received.

These two elements are of paramount importance in order to safeguard the use of a foreign company from a potential challenge by another jurisdiction seeking to treat it as a tax resident of that jurisdiction and/or denying tax treaty or EU Directive benefits.

At the same time, Cyprus is a tax-competitive, friendly, tested and workable jurisdiction – in, from or through which international investors can effect business.

TAXATION OF CYPRUS COMPANIES

The corporate income tax rate of a Cyprus-resident company is 12.5 per cent on its worldwide taxable profit, with unilateral credit for related foreign tax suffered. Further, there are no Cyprus withholding taxes on payments towards non-Cyprus residents. Often, the effective corporate tax rate is much lower, or even zero, due to certain tax exemptions and allowances.

Specifically, in the case of a pure holding company, there is no Cyprus tax leakage, as dividends, gains from disposal of shares and other capital gains are tax exempt. At the same time, there can be a significant tax advantage through access to the Cyprus double-taxation treaty network and relevant EU Directives. Cyprus has very attractive double-taxation treaties

with certain non-EU countries, such as Russia, Ukraine and South Africa.

In the case of interest, royalty and other revenue nature incomes, a Cyprus company can take advantage of the notional interest deduction (NID) provision that can significantly reduce the overall tax.

NID

NID is a notional expense available to Cyprus-resident companies (as well as non-resident companies with a permanent establishment in Cyprus) against their taxable profit resulting from application of new equity introduced in their share capital (whether in cash or in kind). The maximum NID claimed every year is restricted to 80 per cent of the relevant taxable profit.

NID is calculated by multiplying the new equity with a reference rate, and such NID is allowable every year that the new equity remains in place.

The reference rate is the higher of the yield of the ten-year government bond (as at 31 December of the year preceding the year of assessment) of the country in which the new equity is invested, increased by 3 per cent, and the equivalent Cyprus yield also increased by 3 per cent. Indicatively, the 2017 Cyprus reference rate is around 6.5 per cent, being the minimum NID that can be claimed. Hence, with proper planning, the corporate income tax rate can effectively be as low as 2.5 per cent.

BENEFICIAL OWNER OF INCOME

Further, the use of its own equity helps the Cyprus company to demonstrate that it is the beneficial owner of income it receives. This is because the acquisition of an investment, intellectual property or a loan provided by the Cyprus company is financed via own funds, as opposed to being funded through back-to-back

arrangements. Such arrangements tend to be adversely scrutinised when seeking tax treaty or EU Directive benefits, whereas, by using own funds, the demonstration of the beneficial ownership of income is easier.

SUBSTANCE

When it comes to establishing substance elements (like a fully fledged office with key staff and experienced directors), Cyprus has a competitive cost advantage compared to other prime EU jurisdictions. At the same time, Cyprus offers a legal framework based on common-law principles, which is often preferred by international investors. Various other equally important qualitative elements are available, which foreign ultimate beneficial owners (UBOs) and key staff (often along with their families) look for when considering a temporary or permanent move to another country.

Further, non-Cypriot nationals who decide to move to Cyprus can enjoy significant tax savings from Cyprus employment income (which can go up to a 50 per cent exemption), as well as other significant tax savings through the introduction of 'non-dom' status for Cyprus tax purposes, which, in effect, exempts such persons from tax on interest, dividends and gains from the sale of shares.

This means that a Cyprus company can establish and reinforce its needed substance in a relatively foolproof manner by also having key staff or UBOs working for the company while residing on the island.



PETROS RIALAS TEP IS DIRECTOR AND HEAD OF THE INTERNATIONAL TAX PLANNING DEPARTMENT AT TOTALSERVE MANAGEMENT