ARTICLE NO.11

The Role of Cyprus in the Economic Arena after joining the EU

Introduction

Effective as of 1 January 2003, Cyprus introduced a new EU-compliant and OECD-approved tax legislation in view of its accession to the European family 16 months later. The new regime has not only boosted the popularity of Cyprus for the consolidation of underlying subsidiaries but has also served to complement the tax regimes of existing holding jurisdictions by providing an effective exit route for non EU-destined dividends.

As will be demonstrated in the article below, significant tax advantages accrue to companies that choose to structure their holdings via a Cyprus company rather than directly. The new regime has not only boosted the popularity of Cyprus as a jurisdiction for holding companies at the expense of traditional rivals such as Denmark and the Benelux but also complemented the holding regimes of these jurisdictions by providing an effective solution for the exit route of dividends from these jurisdictions.

At the same time, accession to the EU helped eradicate the island's somewhat unfavorable reputation in the shipping sector and also further boosted its popularity in the fiduciary services sector.

Last but not least, the all-important services and tourism sectors continue to be the main contributors of the island's GDP with 77.6%. Construction and industry contribute an additional 19.2% to the GDP. In terms of numbers, the Cypriot economy continues to outperform the EU average by a substantial margin and in 2007 grew by 4%.

Cyprus

The Republic of Cyprus is the third largest island in the Mediterranean and represents a stepping stone to three continents: Europe, Africa and Asia through the Middle East.

Cyprus has been a full member of the European Union since 2004, while on 1 January, 2008 the island adopted the Euro, the single European currency. The island is serviced by two international airports, has excellent telecommunications, a relatively low cost of living, bonded and warehouse facilities and a service-oriented economy that is highly skilled and internationally reputable. Last but certainly not least, Cyprus enjoys an extensive Double Tax Treaty network both with capital exporting countries and emerging markets. All of the above earned the island the distinction of being one the world's most attractive international business centres.

The Cypriot economy continues to outperform the EU average by a substantial. Growth is being driven by demand in construction and services sectors while the all-important tourism sector continues to recover at a slow but steady pace.

The Cyprus Holding Company

Effective as of 1 January 2003, Cyprus has introduced a new tax legislation in order to comply with the acquis communautaire of the European Union. The new holding regime of Cyprus signals the advent of the zero tax Cyprus holding since it is now possible to achieve zero taxation through a Cyprus corporate holding structure. Here is how:

1. Firstly, the Cyprus company can extract dividends from foreign subsidiaries at zero foreign withholding tax if such subsidiaries are within the EU and the Parent/Subsidiary Directive provisions are met. Where the provisions of the Parent/Subsidiary Directive are not met or where anti-avoidance provisions are in place, the Cyprus holding company can rely on the island's extensive network of double taxation treaties. To its credit, Cyprus now has Double Tax Treaties with 43 countries and is currently negotiating with many more, including Luxembourg, Spain, Portugal and The Netherlands.

2. Secondly, Cyprus can receive incoming dividends and benefit from an exemption on taxation on such dividends subject to the fulfillment of a couple of easily satisfied requirements. Specifically, the Cyprus company must own **at least 1%** of the share capital of the paying subsidiary, and this exemption does not apply if (a) more than fifty per cent (50%) of the paying company's activities result directly or indirectly in investment income **and** (b) the foreign tax burden on the income of the company paying the dividends is substantially lower than the Cypriot tax burden. The conjunction "and" implies that both criteria have to be met for the exemption not to apply.

   So for example, if a Cyprus company owns more than 1% of a BVI trading company and the BVI company pays a dividend to the Cyprus company then this dividend will be exempt from the special contribution tax of 15% because although the tax rate of the paying company is substantially lower than the tax burden of the Cyprus company it is a trading company so criterion (a) above is met.

   Criterion (a) would also be met and the dividend exemption granted even in the case where the BVI company is a holding company receiving funds emanating from an active trading subsidiary down the chain structure.

   In the case where a dividend suffers Cyprus tax then this tax could be reduced or even eliminated via credit relief on the related foreign withholding tax. Credit may also be available on the underlying tax if this is provided in the relevant Double Tax Treaty or if the dividend is received by a company resident in another EU Member State. It should be noted that the credit claimed would be granted on the basis that the Cyprus tax authorities are presented with relevant supporting documentation evidencing the foreign tax claimed as credit against the resulting Cyprus tax.

3. Thirdly, there is no withholding tax on dividends paid from a Cyprus company to non-resident shareholders (companies and individuals).

4. And finally, any gain resulting from disposal of shares is specifically exempt from Cyprus taxes provided the company whose shares are disposed does not own immovable property situated in Cyprus. It should be noted that there are no minimum holding period criteria for this exemption to apply.

   The holding regime should be viewed in conjunction with the rest of the "perks" introduced by the recent tax changes. The recently introduced legislation still retains the tax rate at an attractive European low of 10%, and consequently cancels the limitation of benefit articles introduced into certain treaties in countries such as the UK and the US.

Fiduciary Services

After the introduction of the International Trusts Law of 1992, it was recently revealed that trust and company service providers in Cyprus will be regulated before the end of the year, representing yet another landmark in the trust business in Cyprus. The development is expected to boost the role of Cyprus in another increasingly important sector, that of Fiduciary Services.

The bill, titled Regulation of Fiduciaries, Company Directors and Corporate Services Consultants Bill of 2008 establishes minimum criteria for licensing and among other things, empowers the law's Supervisory Authority, the Central Bank of Cyprus, to investigate Fiduciary Services providers and report its findings to the newly-formed Financial Reporting Unit established under the "Complicity and Money Laundering Arising from Criminal Offences Law of 2007."

The establishment of internationally endorsed criteria for administering fiduciary services will boost the island's competitiveness and further increase its influx of related business. The security it offers to clients and the guarantee that their interests will be protected by law, eliminates even the slightest reservations of doing business in Cyprus.

Shipping

The Cypriot government completely harmonized its shipping legislation by ratifying all important international shipping conventions and by implementing all relative directives of the European Union.

Two years after the island's full entry to the EU, the results of the efforts are evident and the long-time efforts have flourished. Cyprus is now attracting more and better ships and the local shipping industry is growing. The Cyprus flag has long been removed from the 'black list' and ships are no longer seized at ports. Cyprus is now taking full advantage of the bilateral and multilateral agreements concluded by the European Union with third countries except for Turkey which still refuses to allow ships bearing the Cyprus flag to enter its ports, despite EU directives.

Conclusion

In conclusion, it can be said that Cyprus has achieved to remove discriminatory practices and ring fencing of the local market, thus complying with its EU obligations, whilst retaining and in certain instances, such as in the case of tax-exempted dividend income, increasing its attractiveness as an international business centre.

All of the above developments have already instilled more confidence into the minds of interested people, especially professionals, and are further strengthening the island's already robust reputation of being an attractive international business center.

The island has an important role to play in the EU. Being a stepping stone to three continents, it acts as a bridge between Europe and the Middle East. At the same time, its extensive network of Double Taxation Treaties makes the island an obvious link between Europe, the Balkans and Eastern European countries.

Last but not least, Cyprus has managed to further fortify its reputation of being a beautiful, fun, safe and friendly place to visit.

Authored by: Peter G. Economides, FCCA
Chairman
TOTALSERVE MANAGEMENT LTD
P.O. Box 54425, 3724 Limassol, Cyprus
Tel. + 357 25866000, Fax. + 357 25866001
economides@totalservecy.com
www.totalservecy.com