Cyprus and Double Tax Treaties

Double Tax Treaties – An Overview

The main purpose of Double Tax Treaties is to avoid international double taxation, whereby the same profits are taxed in two or more states in respect of the same person or entity. Double tax treaties also clarify the scope of the taxing rights of each contracting state, allowing international business to be transacted with a degree of certainty and stability. This is why Double Tax Treaties are important tools for international tax planning, and constitute a substantive advantage for any jurisdiction which has entered into such arrangements. Moreover, Double Tax Treaties are significant for international business because they encourage investment from one country to another.

Double Tax Treaties are relevant for both income tax and corporation tax, providing relief in two principal ways. First, Double Tax Treaties allow the tax payable in one country as a credit against tax payable in the contracting state with respect to the same income. Second, the Treaties exempt certain classes of income from tax in one or the other contracting state. As a rule, treaties contain exemptions which provide that the enterprise of one territory will not be liable to tax on commercial or industrial profits made in the other territory unless it has a permanent establishment in that other territory. The majority of treaties determine the territory where the taxpayer resides as the appropriate territory where his total income should be assessed with relief given for certain types of income which are more appropriately taxed in the territory where they arise.

Double Tax Treaties – The Unique Position of Cyprus

The problem with accessing Double Tax Treaties via tax efficient jurisdictions is that countries which are primarily “onshore” in classification have little interest in concluding Double Tax Treaties with “offshore” jurisdictions, since the latter often levy no tax whatsoever (e.g. the British Virgin Islands or the Bahamas). High tax countries on the other hand, may contract with each other but here again, most entrepreneurs are hesitant in paying the high tax involved, albeit once. This is where Cyprus enjoys a competitive advantage. Cyprus is a low tax jurisdiction (the tax rate till 31.12.2002 being 4.25%) and has negotiated 32 Double Tax Treaties to date. Moreover, the rise in taxation brought about by the recently introduced legislation, still retains the tax rate at an attractive European low of 10%, and introduces various other fiscal benefits such as the exemption from taxation of any profits made from the sale of securities, thus in certain instances increasing the competitive advantages offered by Cyprus as an International Business Centre.

Anti Avoidance Provisions

Limitation of benefits articles feature in a number of Treaties concluded by Cyprus, and under the previous taxing regime, effectively excluded fiscally privileged companies from a number of benefits accruing thereto. The treaties concluded between Cyprus and Belgium, Canada, France, Germany, the United Kingdom and the United States all contain anti avoidance provisions the significance of which has been diminished or eliminated after the recent introduction of the unitary tax rate for international and local companies.

To give an example, the provisions in the Double Taxation Agreement between Cyprus and the United Kingdom in relation to dividends, interest and royalties do not apply if the recipient is a company liable to tax at a rate which is substantially lower than the rate usually imposed. This limitation of benefits article clearly targeted the Cyprus IBC which, till recently, and more specifically till 31 December 2002 enjoyed the preferential taxation of 4.25% instead of the 25% widely applicable for local companies. Therefore if a Cyprus International Business Company was in receipt of royalties from the United Kingdom, the reduced withholding tax would not kick in because of this article. As of 1 January 2003, this limitation no longer applies because all companies are taxed at a uniform rate of 10%.

Benefits of Double Tax Treaties - Cyprus

The conclusion or not by a territory of a network of Double Tax Treaties is a significant consideration in deciding a jurisdiction from which an entrepreneur or investor will carry out his or her business. Another significant consideration is the form of the Double Tax Treaties concluded. The majority of the treaties concluded by Cyprus follow the OECD Model Treaty which provides clear and consensual rules for the taxation of income and capital.

Among other benefits, most double tax treaties concluded by Cyprus entail:

- Elimination of double taxation in the Contracting State by way of a tax credit;
- Reduced withholding taxes or dividends, interests and royalties;
- Tax sparing provisions in the Contracting State for tax not imposed in Cyprus because of Cyprus tax incentives.

Tax Credits

As noted above the primary purpose of these treaties is the avoidance of double taxation of income earned in any of the treaty countries. This is usually achieved either through the allowance of a credit against the tax levied by the country in which the taxpayer resides for taxes levied in the other treaty country or through tax exemption in one treaty country on the income taxed in the other treaty country. The effect of these arrangements is normally that the taxpayer pays no more than the higher of the two rates.

Withholding taxes

The attached table gives a summary of the withholding taxes provided by the double tax treaties entered into by Cyprus with other countries.

Tax Sparing Credits

A number of Cyprus double tax treaties contain provisions for tax sparing credits. Tax sparing credit means the tax credit not only in respect of tax actually paid in Cyprus but also the tax, which would have been otherwise payable had it not been for the incentives granted in Cyprus which result in exemption or reduction in tax.

The Cyprus double tax treaties contain the following tax sparing credit provisions:

Canada

There are tax sparing credit provisions in Canada in respect of Cyprus tax, which would have been payable or deductible in Cyprus on profits or interest but for certain tax incentive exemptions or relief in Cyprus.

Czech Republic

In the Czech Republic, there are tax sparing credit provisions in respect of Cyprus tax which would have been payable on profits and interest in Cyprus but for tax incentive exemption or relief in Cyprus, and in respect of Cyprus tax which would have been deductible from any divided paid out of profits, granted such incentive exemption or relief.

Denmark

In Denmark, there are available tax sparing credits of 15% for dividends and 10% for interest from Cyprus, if for purposes of promoting the economic development of Cyprus there is an exemption from or reduction of tax below the above percentages.

Egypt

There are tax-sparing provisions in respect of tax which would have been payable but reduced or waived under the legal provisions of either contracting State for tax incentives.

Germany

In Germany, tax-sparing credits of 15% for dividends and 10% for interest are available, if there is an exemption from or reduction of tax below the above percentages, as a result of incentives for promoting economic development in Cyprus.

Greece

In both countries, tax sparing credits are available for the whole of any tax which would be payable, in respect of any profits or interest for which relief or exemption from tax is allowed as a tax incentive, and in respect of any tax, which would be withheld from any dividends, paid out of profits for which relief or exemption from tax is allowed as a tax incentive.

India

In both countries, tax sparing credits are available for the whole of any tax which would be payable, but for incentive relief designed to promote economic development. Withholding tax shall be deemed to have been paid on the gross amount of: dividends at 10% or 15%, as the case may be, interest at 10%, royalties and fees for included services at 15% and technical fee at 10%.

Ireland

In both countries, tax-sparing credits are available for profits, interest and dividends which are exempt from tax or taxed at reduced rates due to tax incentive provisions of each State. In addition, in Ireland there are taxes sparing provisions in respect of profits from the operation of ships under the Cyprus flag.

Italy

Contracting State shall be deemed to have been paid for tax credit purposes in the other State. In the case of Italy, these would include the full tax exemption in the case of operations of ships under the Cyprus flag and Cyprus international companies.

Malta

In both countries tax sparing credits are available for the whole of any tax which would be payable but for incentive relief. Withholding tax shall be deemed to have been paid on the gross amount of: dividend at 15%, interest and royalties at 10%.

Poland

In Romania, there are tax sparing credit provisions in respect of Cyprus tax which would have been payable in Cyprus on profits or interest but for tax incentive exemption or relief in Cyprus, and in respect of Cyprus tax which would have been deductible from any dividend paid out of profits granted tax incentive exemption or relief in Cyprus but for such tax incentive exemption or relief.

Romania

In Romania, there are tax sparing credit provisions in respect of Cyprus tax which would have been payable in Cyprus on profits or interest but for tax incentive exemption or relief in Cyprus, and in respect of Cyprus tax which would have been deductible from any dividend paid out of profits granted tax incentive exemption or relief in Cyprus but for such tax incentive exemption or relief.

Syria

In both countries tax sparing credits are available for the whole of any tax which would be payable but for incentive relief. Withholding tax shall be deemed to have been paid on the gross amount of: dividends and royalties at 15% and interest at 10%.

United Kingdom

In the UK tax sparing credits are available in respect of tax saved as a result of tax incentives given in Cyprus on interest paid, provided the loan was made for the purposes of promoting development and in respect of investment allowances on capital expenditure for specific types of investment.

Yugoslavia

There are tax sparing credit provisions in respect of tax, which would have been payable but reduced or waived under the legal provisions of either contracting State for tax incentives.

The Tie Breaker Clause

Another way in which Cyprus can prove an invaluable tax planning vehicle is through the tie breaker clauses introduced in the Double Taxation Treaties it has concluded.

Let us take the Cyprus – UK Treaty as an example.

The U.K. legislation (Section 249 - 251 FA 1994) regulates the tax treatment of U.K. registered dual resident companies. The Inland Revenue has ruled that in order for the dual residency provisions to apply, a Double Tax Treaty must contain a tie breaker clause for dual resident companies under which residency is awarded as being in the territory with which the UK has concluded the Treaty. A country which meets these criteria is Cyprus.

The Double Tax Treaty between Cyprus and the UK states in Article 4(i):

“For the purposes of this Convention, the term “resident of a contracting state” means any person who under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature".

On this basis, a UK company which establishes a branch in Cyprus and is managed and controlled from Cyprus will be dual resident as contemplated by Section 249 (i) FA 1994.

Article 4(3) of the Double Tax Treaty between Cyprus and the UK states “ Where.... a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident of the Contracting State in which its place of effective management is situated.”

Therefore, a UK company which establishes a branch in Cyprus and has its place of effective management in Cyprus is UK non resident for tax purposes and is resident for tax purposes in Cyprus. This structure is very popular as it combines the prestige and reliability associated with a UK entity with low corporation tax and access to a rich network of Double Tax Treaties as applicable in Cyprus.

Double Tax Treaties – The Future

Double Tax Treaties will no doubt continue to encourage investment between territories. As Cyprus continues to add to its panoply of fiscal incentives to attract foreign investment it will certainly continue negotiations for the expansion of its already rich network of Double Tax Treaties.

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