Cyprus tax laws and Cyprus-Ukraine tax treaties issues: peculiarities of application, optimization in taxation

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Foreign Direct Investment in Ukraine

Ukrainian State Statistics Committee – 1st half 2010 Data

- EU direct investment in Ukraine – USD40 billion

  (representing 78% of total direct investment in Ukraine)

<table>
<thead>
<tr>
<th>Country</th>
<th>Direct Investment (USD)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cyprus</td>
<td>USD9.1 billion</td>
<td>28.7%</td>
</tr>
<tr>
<td>Germany</td>
<td>USD6.6 billion</td>
<td>20.9%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>USD3.9 billion</td>
<td>12.4%</td>
</tr>
<tr>
<td>Austria</td>
<td>USD2.6 billion</td>
<td>8.2%</td>
</tr>
<tr>
<td>UK</td>
<td>USD2.2 billion</td>
<td>7.0%</td>
</tr>
</tbody>
</table>
Desired Attributes for Holding Company Location – A “Wish List”

- No or low tax on dividends, capital gains, interest or royalties and no withholding taxes imposed
- Ability to retain / efficiently redeploy cash
- Flexible / reliable with respect to advance tax agreements
- “Tried and tested”
- No local stamp duty, capital duty or other similar taxes (or acceptable planning to reduce / save these)
- Access to strong network of double tax treaties / EU Directives
- No CFC, or thin capitalization rules, functional currency issues, or exchange controls
- Sound and stable economy
- Qualified resources on the ground
Overview of Cyprus tax system
Overview of Cyprus tax system

- Existing legislation effective from 1 January 2003
- EU & OECD compliant
  - Cyprus was included in the OECD ‘white’ list of jurisdictions that have substantially implemented the internationally agreed tax standards.
- Uniform corporate tax rate @ 10%
  - No discrimination
  - Lowest in the EU
- Effective tax rate much lower due to:
  - Unconditional corporate income tax exemption on gains from ‘titles’
    - No minimum time holding or percentage shareholding requirements
  - Foreign dividends are exempt from taxation in Cyprus
    - Either emanating directly/indirectly from trading sources Or if profits of the dividend paying company are sufficiently taxed.
    - No minimum time holding or percentage shareholding requirements
  - Foreign PE trading (or sufficiently taxed abroad) profits also exempt from taxation
Overview of Cyprus tax system (continued)

✓ Group relief provisions
  ▪ 75% direct or indirect equity relationship between Cyprus tax resident companies
✓ No thin capitalisation rules
✓ Thin spread of interest in back-to-back arrangements
✓ No WHTs on payment of dividends, interest, royalties (unless right used within Cyprus)
✓ No exit costs
✓ No CFC rules
✓ Extensive double tax treaty network and benefit from EU Directives
✓ Tax free reorganisation provisions – EU Mergers Directive
✓ Tax losses may be carried forward indefinitely
✓ No transfer pricing rules BUT arm’s length principle is there
Residency rules

- A company is resident and therefore taxable if management and control (M&C) of the company is exercised in Cyprus.
- No M&C definition in tax law – OECD guidelines followed in practice.
- Resident company taxed on worldwide incomes.
- Non resident companies are taxed on incomes from sources in Cyprus.
Capital Gains Tax (CGT)

- Only on Real Estate (RE) situated in Cyprus and shares of non-listed companies that own these are subject to CGT
- Rate is 20%; there is indexation allowance and other exemptions (e.g. main residence)
- Does **not** depend on residence of alienator, but on location of the RE
Foreign dividends received by a Cyprus company
Participation exemption

- Foreign dividends exempt from Cyprus tax if **either:**
  - dividend emanates by at least 50% directly or indirectly from trading / active Income; **OR**
  - the foreign tax incurred by the dividend paying company is not significantly lower than the Cyprus tax rate (significantly lower is taken to mean less than 5%).

- If exemption does not apply then
  - Flat 15% tax
  - Tax credit available unilaterally on all foreign withholding tax and for EU on underlying tax
  - For non-EU, underlying tax credit if provided by DTT (e.g. Russia)
Foreign dividends received by a company
Participation exemption

Example

Cypriot HoldCo

Foreign HoldCo

Foreign HoldCo

Foreign Trading Co

Dividends

Dividends

Dividends

Participation exemption in Cyprus on dividend income as it is sourced out of trading activities

Low/No tax
Profit from Foreign Permanent Establishments
Participation exemption

- Same treatment as foreign dividend i.e. tax exempt
- Same minor limitations as foreign dividend
Interest received by a Cyprus resident company

- 10% corporation tax on net (after tax deductible expenses) “active” interest
  - interest relating to/closely connected to ordinary activity of company such as banking, finance, investment, insurance and interest on debtors a/cs and bank current accounts.

- 10% Special Defence Contribution (SDC) on gross “passive” interest (Jan 2009)
  - virtually limited to bank deposit a/c interest

- Option to apply for advance ruling to determine nature of interest income is available.

- Tax credit available unilaterally for foreign taxes paid on interest earned abroad.
Transactions in corporate ‘titles’
Participation exemption

- Rule: Gains arising on disposal of ‘titles’ is unconditionally tax exempt.

- ‘Titles’ are defined in the law as:
  - shares;
  - bonds;
  - debentures;
  - founder and other titles of companies or legal persons whether established in Cyprus or abroad and rights thereon.

- The list of qualifying “titles” has been extended by a circular issued by the Commissioner of Income Tax to also include futures / forwards / swaps on titles, depositary receipts, Repos, units in open or close C.I.S’s, ICIS, UCITS, Investment Trusts & Funds, Mutual Funds, REITS and units in Stock Exchange Indices.

- A tax ruling is possible to confirm whether any other instrument qualifies under the definition of ‘titles’.
Reorganisations

The following reorganisations, are exempt from most taxes:

- Merger
- Division
- Partial division
- Transfer of assets
- Exchange of shares
- Transfer of registered office

between companies which are resident and/or non-resident in Cyprus.

Currently not allowed to include non – EU companies under Cyprus Companies Law

Tax losses can be transferred to recipient company (where applicable)
## Withholding tax rates

<table>
<thead>
<tr>
<th></th>
<th>Cyprus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend</td>
<td>Nil</td>
</tr>
<tr>
<td>Interest</td>
<td>Nil</td>
</tr>
<tr>
<td>Royalty</td>
<td>Nil (^1)</td>
</tr>
<tr>
<td>CGT</td>
<td>Unconditional Exemption (^2)</td>
</tr>
</tbody>
</table>

1. 10% only when intangible used in Cyprus (subject to DTTs/EU tax directives)
2. Unless the company is not listed and has immovable property in Cyprus.
Taxation of individuals

**Income Tax**

All individuals tax resident in Cyprus are taxed on worldwide income.

Tax residency in Cyprus if an individual spends more than 183 days in Cyprus in the tax year / calendar year.

Non-Cyprus tax resident individuals are taxed only on certain incomes arising in Cyprus.

**Capital Gains**

- Only Real Estate situated in Cyprus (and shares of non-listed companies that own these) are subject to CGT.
- Rate is 20%; there is indexation allowance and other exemptions (e.g. main residence).
- Does **not** depend on residence, but on location of the property.

**Inheritance Tax**

None – Abolished 1 January 2001.
Income of a Cyprus Tax Resident Individual – worldwide Income

**Tax Rates**

- Dividend income: 15%
- Interest income: 10%
- Rental income: up to 26.25%
- Foreign Pension income: 5% flat (or option to tax as ‘other income’)
- ‘Other income’: up to 30%

- Double tax relief available either bilaterally or unilaterally on foreign tax suffered on same income.
Income of a Non – Cyprus Tax Resident Individual
Certain Cyprus sourced income only

- Cyprus Employment income
- Cyprus pension income
- Cyprus rental income
- Sports / entertainment performance in Cyprus

All at rates up to 30%
Other non-tax considerations
Other non-tax considerations

- No stamp duty on contracts relating to matters outside Cyprus.
  - General rate approx. 0.2% on the value of the agreement **but** capped to €17,086 per stampable agreement.

- All Cyprus registered companies required to prepare FS in accordance with IFRS as issued by IASB.

- No FS consolidation required at Cyprus level if consolidation at higher level under internationally recognised accounting standards.

- Re-domiciliation provisions – Company Law.

- Audited FS required for all CyCo’s.

- Legal environment.

- Banking / financial services environment.
Investment industry

- International Collective Investment Schemes Law
- Regulatory environment for fund business
- Under current legislation, funds can be set up as:
  i. fixed capital companies;
  ii. variable capital companies;
  iii. unit trusts;
  iv. partnerships.
- New Mutual Funds Legislation
- Tax incentives on Collective Investment Schemes:
  - Profits on disposal of CIS units exempt from income tax
  - Redemption of units not subject to SDC
  - Interest income of CIS – active interest
  - Reduction of the SDC rate on deemed dividends (on annual profits and on liquidations) from 15% to 3%
## Cyprus’ companies on AIM

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Date of joining</th>
<th>Money Raised (£m)</th>
<th>Countries of main operations</th>
<th>Industry</th>
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</thead>
<tbody>
<tr>
<td>AISI realty public ltd</td>
<td>8/1/2007</td>
<td>16.2</td>
<td>Ukraine</td>
<td>Real Estate Holding &amp; Development</td>
</tr>
<tr>
<td>Mirland development corp plc</td>
<td>12/18/2006</td>
<td>143.4</td>
<td>Russia</td>
<td>Real Estate Holding &amp; Development</td>
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<tr>
<td>IFR capital plc</td>
<td>11/15/2006</td>
<td>89.2</td>
<td>Germany, Austria, Switzerland, Slovenia, Chech Republic</td>
<td>Restaurants &amp; Bars</td>
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<tr>
<td>ASBISc Enterprises plc</td>
<td>10/25/2006</td>
<td>Introduction</td>
<td>Former Soviet Union, Central and Eastern Europe, Middle East, North Africa</td>
<td>Computer Hardware</td>
</tr>
<tr>
<td>Teleset networks plc</td>
<td>10/12/2006</td>
<td>Introduction</td>
<td>Russia</td>
<td>Fixed Line Telecommunications</td>
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<tr>
<td>XXI century investments</td>
<td>12/16/2005</td>
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<td>Real Estate Holding &amp; Development</td>
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<tr>
<td>Charalambides dairies</td>
<td>11/29/2005</td>
<td>Introduction</td>
<td>Cyprus</td>
<td>Food Processors</td>
</tr>
<tr>
<td>Urals energy public co</td>
<td>8/9/2005</td>
<td>64</td>
<td>Russia</td>
<td>Oil &amp; Gas - Exploration &amp; Production</td>
</tr>
<tr>
<td>Eastern mediterranean resources</td>
<td>5/9/2005</td>
<td>2.0</td>
<td>Eastern Europe, Caucasus, Cyprus</td>
<td>Gold Mining</td>
</tr>
</tbody>
</table>
Recent international developments
Recent international developments

✓ Recent development of Russia-Cyprus DTT

• A protocol has been agreed and signed

• OECD model wording on the exchange of information

• Official removal from "the black list" will take place simultaneously with the coming into effect of the protocol - expected to be 1 January 2011.

• No change on WHT’s
  - Dividends  5% / 10%
  - Interest    0%
  - Royalties   0%

• Up to 31 December 2014, only Cyprus has taxing rights on share disposals (4 year transitional period).

• 2015 onwards, Russia may have taxing rights on share disposals only if significant immovable property in Russia – planning opportunities
Recent international developments

✓ Recent development of Italy-Cyprus DTT

• A protocol has been signed

• OECD model wording on the exchange of information

• Official removal from the Italian “black list"
Recent international developments

Moldova - The treaty is effective as from 1st January 2009

✓ Applicable withholding taxes
  ❖ Dividend – 5%
  ❖ Interest – 5%
  ❖ Royalties – 5%

Qatar - A treaty with Qatar has been signed but has not been ratified yet.

✓ Applicable withholding taxes
  ❖ Dividend – 0%
  ❖ Interest – 0%
  ❖ Royalty – 5%*

* Qatar does not impose any withholding taxes based on its domestic legislation
<table>
<thead>
<tr>
<th>Country</th>
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<tr>
<td>Austria</td>
<td>Greece</td>
<td>Poland</td>
<td>Thailand</td>
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<td>Belarus</td>
<td>Hungary</td>
<td>Qatar</td>
<td>United Kingdom</td>
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<td>Belgium</td>
<td>India</td>
<td>Romania</td>
<td>United States</td>
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<td>Bulgaria</td>
<td>Ireland</td>
<td>Russia</td>
<td>Yugoslavia**</td>
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<tr>
<td>Canada</td>
<td>Italy</td>
<td>San Marino</td>
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<tr>
<td>China, P.R.</td>
<td>Kuwait</td>
<td>Seychelles</td>
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<td>Czech Republic</td>
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<td>South Africa</td>
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<td>France</td>
<td>Moldova</td>
<td>Soviet Union*</td>
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<td>Germany</td>
<td>Norway</td>
<td>Sweden</td>
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<tr>
<td></td>
<td></td>
<td>Syria</td>
<td></td>
</tr>
</tbody>
</table>

*Honoured by Armenia, Kyrgyzstan, Tadzhikistan and Ukraine

**Honoured by Montenegro, Serbia and Slovenia
Tax planning ideas involving Ukraine and Cyprus
Holding Company Structure

Parent
EU/Non-EU

CY Co.

Ukraine

Zero CGT/CT on gains
Zero WHT on dividends
Zero WHT on dividends
Zero WHT on dividends

*Tax free exit*

No Holding period required for dividend or capital gain exemption
Real Estate Structures

Plan

- Establish one Ukrainian company for each Real Estate unit held in Ukraine
- Establish one Cyprus holding company

Benefits

- Turn profit on disposal of Real Estate to profit on disposal of shares in Ukrainian companies = tax exempt in Cyprus
- Save taxes in the Ukraine where the Real Estate is situated
Establish a CyCo for each Ukrainian SPV

Plan

- Establish one Ukrainian company for each Real Estate unit held in Ukraine
- Establish one Cyprus holding company for each Ukrainian company
- Sell shares in CyCos

Benefits

- Turn profit on disposal of Real Estate to profit on disposal of shares in Cyprus companies = tax exempt in Cyprus
- Save taxes in the Ukraine where the Real Estate is situated
Cyprus Finance company
Basic Structure

Plan
- EU or Non-EU parent establishes Cyprus company to be the group finance company of Ukrainian operations.
- Capitalization with equity

Benefits
- Tax on profit 10%
- Access to Cyprus/Ukraine DTT re interest-nil WHT
- Interest deductibility in borrowing Ukraine company – 25%
- No WHT on dividends paid from Cyprus at all times
- Capital duty on equity may easily be minimised
Cyprus Finance Company
Thin Interest spread structure

- No WHT on interest payment to Cyprus – Cyprus / Ukraine DTT
- Interest expense deductible in the Ukraine @ 25%
- No Cypriot WHT on interest payment to offshore company
- Thin spread of income in Cyprus taxed at 10% - effectively as low as 1%
Cyprus – Ukraine Double Tax Treaty
New treaty?

- A renegotiated draft new DTT that provided for:
  - WHTs: 10% on interest and royalties; 5%/15% on dividends
  - Capital gains realised by Cypriot tax residents from sale of shares, which derive their principal value from immovable property located in Ukraine, to be subject to 15% WHT in Ukraine

has not completed approval procedures

- Therefore, the current DTT remains in force.
- Efforts are being made by Cyprus to renegotiate the above provisions.
Summary

• EU Access
• EU/OECD Approved system -stability
• Very efficient tax system ideal for pure holding, real estate holding, financing and royalty structures
• Excellent DTT applicable;
• Very good legal, professional and commercial infrastructure
• Tax structuring jurisdiction for over 30 years
Thank you!

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