SUMMARY OF CYPRUS' TAX INCENTIVES

Tax costs play a significant role in investment decisions. Investors aim in maximizing after tax return on investment. Therefore investment structures, which have the least tax leakage, are preferred by investors and are recommended by the advisors. As such, a Cypriot investment vehicle can in many cases collect income, which is a charge against high tax income. Foreign withholding tax is eliminated or reduced under double tax treaties or under EU directives. Rate of tax in Cyprus is low. The income can then be repatriated in any form the investor wishes without any Cyprus withholding tax.

This investment vehicle is suitable both for EU inbound or outbound investments. There are no investment activities that are inappropriate for the Cypriot tax environment. However there are investment activities which are indeed ideally suited to Cypriot tax environment such as:

- Holding Companies
- Finance Companies
- Royalty Companies
- Investment funds

European enlargement and the accession of Cyprus opened up a new gate to investors. Cyprus is no longer just the traditionally strong link of investments in and out of Central and Eastern Europe and Russia, but it is also a strong connection link of investments in or out of the EU.

Summary of Incentives

Cyprus has a significantly upgraded image as a jurisdiction since its EU Accession on 1.5.2004.

With the enactment of its New Tax Legislation on 1.1.2003 and the abolition of the "offshore regime", Cyprus has put a simplified, effective and transparent tax system in place that is fully EU and OECD compliant.

The result is a stable EU, "non-offshore" tax-competitive jurisdiction with exciting planning potential for EU and non EU clients alike.

- In summary, Cyprus is the "lowest-tax EU jurisdiction" that is not offshore. The standard corporate tax rate of 10% is the lowest in the European Union. Cyprus is now a premier holding, finance, royalty and trading company jurisdiction.

- However, Cyprus's biggest asset is its friendly and investor-friendly Tax Authorities who are always keen to help foreign investors. And their long and stable history of doing so.

- Thin spreads of profit are acceptable and so it is possible that a lot of legal tax-planning strategies can be effectively and easily employed in order to lower Cyprus tax, even at levels significantly lower than 10%.

- Invoices from offshore companies are acceptable in Cyprus companies' books and payments to offshore companies bear no withholding tax (tax planning point).

- Possibility to obtain Advance Tax Rulings from Tax Authorities.

- Absence of strict transfer pricing rules.

- No specific substance requirements.

- There is added commercial value and monetary benefits due to the ability to register for EU VAT in Cyprus.

- Trading in securities is essentially a tax-exempt activity as any profit from the disposal of securities, irrespective of whether this profit forms part of a company's trading activity or is of a capital nature, is exempt from Cyprus tax.

- The foreign beneficial owners of Cyprus companies, branches and partnerships are not liable to additional tax on dividends or profits over and above the amount paid or payable by the respective legal entities.

- The "out-of-Cyprus profits" of Cyprus non-resident companies are not taxable – escape tax altogether in Cyprus – (Cyprus companies with management & control exercised outside Cyprus) – in other words an "EU offshore vehicle".

- Low personal tax rates.

- Low social insurance contributions.

- No capital gains tax or net worth taxes except with respect to real estate situated in Cyprus.

- Beneficial use of EU Directives that have been transposed into the Cyprus Tax Legislation.

- Wide and exceptionally beneficial Double Tax Treaty Network.

- Mergers, Takeovers and other re-organizations can take place within groups with no tax consequence.

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- Unilateral tax-relief is granted to all Cyprus companies for foreign tax suffered irrespective of the absence of a double tax treaty.

- Tax losses are carried forward indefinitely and can also be surrendered as group relief.

- Interest deduction for borrowing costs provided.

- Low duties – taxes on the establishment of companies.

- As we are moving forward in time from EU Accession we are seeing more and more clients preferring Cyprus as a holding jurisdiction to other traditional jurisdictions.

- Beneficial use of EU Directives (Parent/Subsidiary Directive, Interest/Royalties Directive, Merger Directive) enacted into Cyprus Law (effectively "copied" – transposed into Cyprus Law and their benefits extended to residents of Third Countries).

- Cyprus's has a wide and beneficial double-tax treaty (DTT) network. It has to be noted here that Cyprus has fewer DTTs than some competing EU jurisdictions but in many cases more beneficial than its competitors' treaties.The existence of these treaties, combined with the low overall tax paid by Cyprus companies, offer significant possibilities for international tax planning through Cyprus.

- A significant number of double tax treaties concluded by Cyprus lower or eliminate foreign withholding taxes on dividends, interest and royalties or capital gains paid out from / arising in the contracting states and some also include particularly beneficial tax sparing credit provisions for dividends, interest and royalties. A "tax sparing credit" is a tax credit available to the recipient, which is higher than the actual tax paid in Cyprus.

Cyprus Holding Companies

Apart from the generic features of the tax system, the DTT Network and the adoption of EU Directives, other important features of the tax system beneficial to **Cyprus Holding Companies** are the following:

- Participation exemption: Foreign dividends are tax-exempt. This exemption does not apply if the non-resident company paying the dividend carries on, directly or indirectly, more than 50% of investment activities – passive income – AND the overseas tax burden is significantly lower than the Cyprus tax burden (practically interpreted by the Tax Authorities to mean less than 5% "headline tax"). No capital gains tax is payable on the sale or transfer of securities and the gains are exempt from Income Tax (except gains from disposal of shares in companies owning real estate situated in Cyprus – only to the extent that the gain relates to the particular Cyprus real estate). Also, profits from a

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permanent establishment (PE) outside Cyprus are tax-exempt and its losses can be set-of against Cyprus income (this exemption also does not apply if the PE carries on more than 50% of investment activities – passive income – AND the overseas tax burden is significantly lower than the Cyprus tax burden). This exemption (PE) in conjunction with the use of some of Cyprus DTTs can result in PE profits avoiding tax altogether.

- Simple rules and no need for additional and sometimes complex and expensive tax structuring to circumvent anti-avoidance provisions, as it usually is the case with other jurisdictions in the case of dividends or capital gains.

- Low or no withholding taxes on outgoing dividends, interest and royalties (no withholding tax on dividends and interest irrespective of the country or residence of the recipient (even offshore jurisdictions) or the existence of a Double Tax Treaty, no withholding tax on royalty payments for use of the rights outside Cyprus, 10% if the rights will be used in Cyprus (subject to DTT & EU Directives) and 5% on films (subject to DTT & EU Directives). We note here that, compared to other "key" holding company jurisdictions, Cyprus has 0% dividend withholding tax (DWT) – so no need for complex and expensive "structuring out" of DWT. THIS IS AN IMPORTANT COMPETITIVE ADVANTAGE OF CYPRUS compared to other holding company jurisdictions.

- No capital gains or income tax on the liquidation of participations or the liquidation of the Cypriot Holding Company itself.

- No net worth taxes (and as mentioned before no capital gains taxes) during the life of the Cypriot Holding Company.

- Tax losses are carried forward indefinitely and can also be surrendered as group relief.

- Mergers, Takeovers and other re-organizations can take place within groups with no tax consequence.

- Unilateral tax-relief is granted to all Cyprus companies for foreign tax suffered irrespective of the absence of a double tax treaty.

- No thin capitalization rules.

- Limited anti-avoidance provisions.
- Absence of strict CFC legislation.

- Attractive Permanent Establishment (PE) rules and generous PE provisions available in the DTT Network.

- No obligation for the holding company (or right) for VAT registration & compliance.
- Low duties – taxes on the establishment of companies.
- Absence of "strict" transfer pricing rules.

In conclusion, the Cyprus tax system enables:

a) the extraction of foreign sourced dividends at mitigated or zero rates of foreign withholding tax (owing to the use of the Parent Subsidiary Directive or the Use of Double Tax Treaties if the Directive is not applicable).

b) the receipt of foreign dividends at zero rates of corporation tax or special defence contribution (local withholding tax) or any other local taxes (subject to conditions – anti avoidance provisions that are easy to satisfy), i.e. "an EU holding company with no domestic tax leakage on holding activities".

c) the distribution of available profits to non-resident shareholders at zero rates of dividend withholding tax, irrespective of jurisdiction or the absence of a DTT (even to offshore jurisdictions) and

d) allows for the realization of capital gains from the disposal of shares in foreign companies at zero rates of corporation and capital gains tax on the gains", irrespective of holding period and shareholder percentage AND no capital gains tax on the liquidation of the holding company itself.

Cyprus (Group) Finance and Royalty Companies

Apart from the generic features of the tax system, the DTT Network and the adoption of EU Directives, other important features of the tax system beneficial to Cyprus (Group) Finance & Royalty Companies are the following:

Important features of **Cyprus (Group) Finance Companies:**

- Absence or reduction (under a Double Tax Treaty or the Interest and Royalty Directive) of interest withholding tax;
- Low overall tax burden;
- Possibility of deducting interest expenses from taxable income;
- Absence of thin capitalization rules;
- Absence of interest withholding tax in connection with interest paid on loan financing irrespective of jurisdiction or the absence of a DTT (even for interest payments to offshore jurisdictions);
- Reasonable level of "margin" required by tax authorities.

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Important features of **Cyprus Royalty Companies:**

- Absence or reduction (under a Double Tax Treaty or the Interest and Royalty Directive) of withholding tax on royalties paid to Cyprus company.

- Low overall tax burden.

- Tax deduction of royalty payments.

- Effective tax depreciation of investments in intellectual property.

- Absence of withholding tax on royalty payments irrespective of jurisdiction or the absence of a DTT (including to offshore companies) for rights used outside Cyprus – the usual case.

- Neutral VAT treatment.

- Reasonable level of “margin” required by tax authorities.

- Effective protection of intellectual property rights by Legislation and participation of Cyprus in international agreements.