

Cyprus reinforces its position as premier holding centre for international business

December 2009

On 22 October 2009 legislation was enacted which amends the existing tax laws and enhances the tax advantages for portfolio investors using a Cyprus corporate vehicle for their equity participations. The legislation was enacted with retroactive effect from 1 January 2009 and is expected to encourage the use of Cyprus as a tax competitive jurisdiction for portfolio holdings in both Cypriot but particularly foreign funds.

Taxation of Dividend Income

Prior to the recent amendments, the participation exemption for receipt of dividends from non Cyprus companies required a 1% holding in the company distributing the dividend irrespective of whether the other two alternative exemption criteria (subject to tax or not passive income in over 50% of activities) were met. The amendments abolish the minimum holding criterion enabling access to the participation exemption of portfolio investors whose stakes do not reach 1%.

Taxation of Interest Income

Prior to the recent amendments, interest income earned by a Cyprus tax resident company which was not considered to be derived in the ordinary course of business or closely connected to the ordinary course of business was subject to 10% defence contribution tax and 50% of the interest income was subject to corporation tax at 10%, i.e. the interest income was effectively taxed at a combined rate of 15%. The new legislation provides that interest income will be either included in the taxable income of the company and be subject to 10% corporation tax (if it is considered to be derived in the ordinary course of business or closely connected to the ordinary course of business) less any permissible expenses or be subject to only 10% defence tax in all other case (i.e. the interest income will have a maximum cap ceiling of 10% in both cases).

Taxation of Collective Investment Schemes or Funds

In a circular issued in December 2008, the Cyprus tax authorities clarified that participations or units in open or close-ended collective investment schemes or funds fall within the definition of "titles" and therefore gains from disposals of such participations or units are exempt from taxation.

The recent amendments to the tax legislation now further clarify that a buy back or redemption of participations or units in such schemes or funds will also be considered a disposal of titles and therefore also be tax free. Moreover, dividends received by a Cyprus resident shareholder from a collective investment scheme established in Cyprus will be subject only to 3% defence contribution tax instead of the hitherto applicable rate of 15% (non Cyprus resident shareholders are not subject to any tax altogether).

Liquidation of Collective Investment Schemes or Funds

The proceeds from the liquidation of a Cyprus based collective investment scheme will be subject to 3% defence contribution tax for resident unit holders but exempt in the case where the unit holders are not tax residents of Cyprus. The proceeds from the liquidation of non-Cyprus based collective investment schemes or funds are tax exempt in Cyprus, even if their shareholder is a tax resident of Cyprus, but it is advisable that an advance tax ruling should be sought to confirm this position on the particulars of each case.

Overview of Tax Position for Portfolio Investors

The recent amendments come to add to an existing competitive panoply of tax advantages for investors choosing to structure their holdings through Cyprus. The following are some of the advantages offered by Cyprus holdings:

1. Extraction of dividends from underlying subsidiaries at low or zero withholding tax rates due to the Parent/Subsidiary Directive intra-EU and/or the double tax treaty network outside the EU or where the participation exemption criteria are not met.
2. Generous participation exemption for receipt of dividends.
3. No withholding tax on dividends, interest and royalties paid to non resident shareholders.
4. No capital gains tax (other than on the disposal of immovable property based in Cyprus or shares representing immovable property based in Cyprus).
5. No tax on trading profits from the disposal of "titles", which term includes shares, securities, bonds, debentures, futures, units and other participations.
6. Generous implementation of the Merger Directive permitting tax free reorganizations through Cyprus.
7. Transfer of corporate domicile into and out of Cyprus without re-incorporation or exit duties/taxes or fees.

If you require further information about these issues please contact Head of Tax & Regulatory Emily Yiolitis (emily.yiolitis@harneys.com).

The foregoing discussion and analysis is for general information purposes only and not intended to be relied upon for legal advice in any specific or individual situation