



# UPDATE ON RECENT CYPRUS TAX DEVELOPMENTS

Alecos Papalexandrou  
Tax partner



# Amendments to the Income Tax Law

## ➤ Exemptions from personal income tax:

50% of employment income exempt from PIT for 5 years provided the remuneration exceeds Euro 100.000 and the employment started after 1 January 2012

As such the top rate is reduced from 35% to 17.5% and the effective tax rate is around or lower than 10%

Additional tax incentive for creating substance for Cypriot companies through secondment of management employees/directors with decision-making powers to Cyprus.

# Amendments to the Income Tax Law

- Deductibility of interest expense:
  - ✓ No interest expense restriction will apply in cases where shares are acquired directly or indirectly in a wholly owned subsidiary provided that this subsidiary does not own any assets which are not used in the business
  - ✓ If this subsidiary does own assets that are not used in the business, the restriction of interest will only correspond to the percentage of assets not used in the business
  - ✓ This amendment is effective in respect of interest incurred on borrowings used for the acquisition of shares acquired on or after 1 January 2012

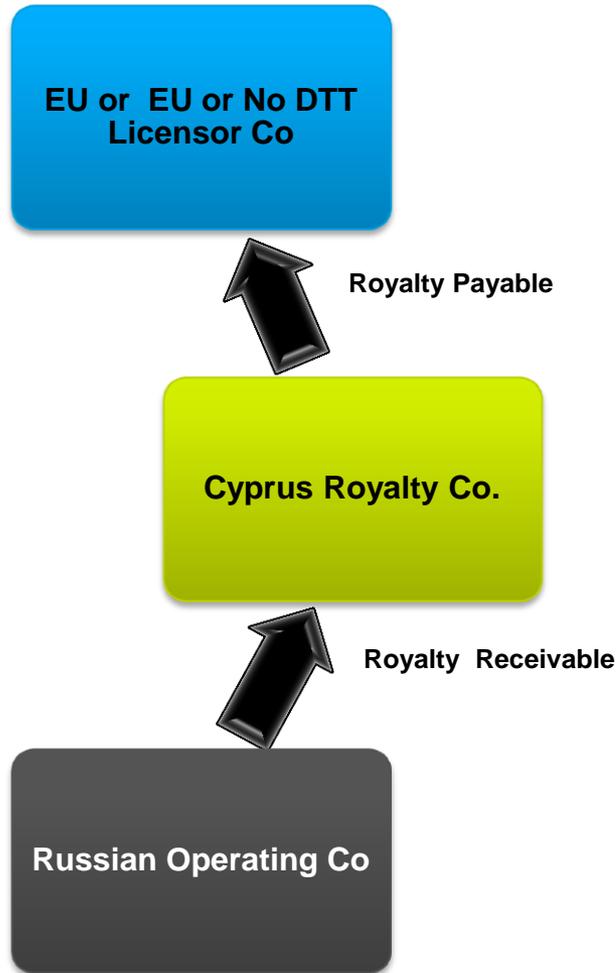
# Amendments to the Income Tax Law

## ➤ Deductibility of interest expense:

- ✓ This change is expected to make the Cyprus Holding Company much more attractive than before as interest will now be an allowable expense for tax purposes. Such interest expense can be used in group structures for group relief purposes
- ✓ Can also be used to replace back-to-back loan arrangements to mitigate the beneficial ownership risk

# Amendments to the Income Tax Law

## Intellectual Property Rights – Current structures



### Royalty Company (Inbound):

- Royalty premiums are deductible in Russia
- No WHT in Russia based on DTT
- Small margin taxed at 12,5% in Cyprus
- No withholding taxes on payments out of Cyprus
- As from 1/1/2012:
  - Cost of acquisition of IP can be amortised over 5 years
  - 80% of the profits from royalties, including the profit from disposal of the IP, exempt from 12,5% corporation tax in Cyprus

# Amendments to the Income Tax Law

## ➤ Intellectual property rights:

The meaning of patent rights and intellectual property (IP) rights has been amended to coincide with the definition in the Patent Rights Law of 1998, the Intellectual Property Law of 1976 and the Law regarding Trademarks. This ensures that all types of IPs will be covered by this new regime avoiding any uncertainty.

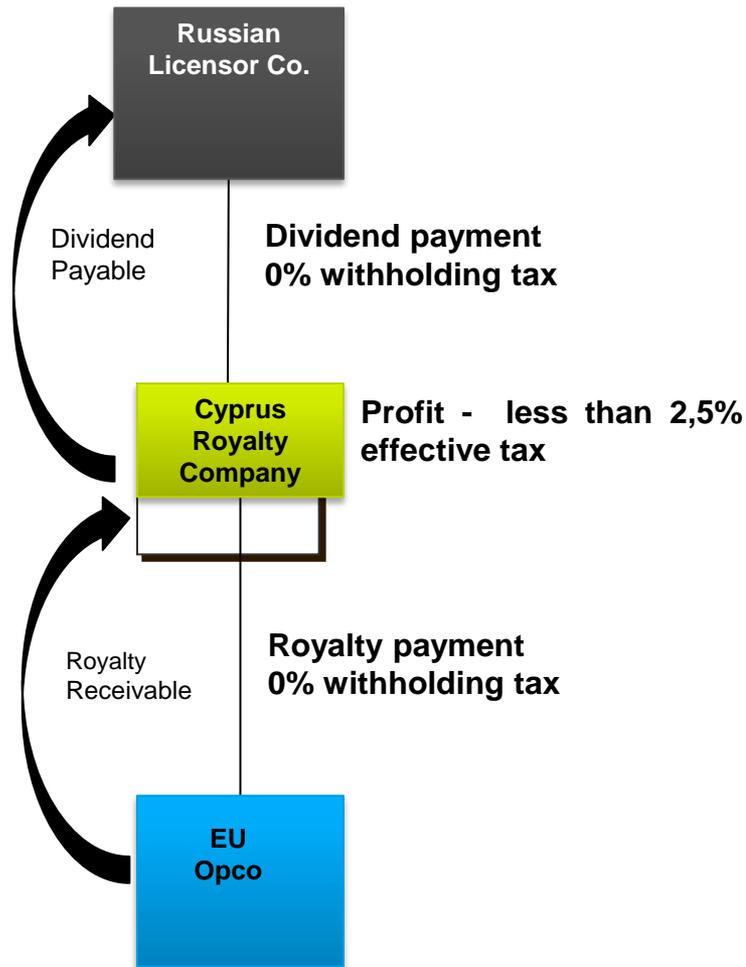
The new law provides for an 80% exemption on the net profit from the exploitation of such intangibles. The net profit is calculated after deducting from the licensing of the intangibles all direct expenses associated with the production of this income

The rate of capital allowances on such intangibles has been set at 20% of the cost of acquisition.

Any profit arising from the disposal of such intangibles will also benefit from the 80% exemption.

# Amendments to the Income Tax Law

## Intellectual Property Rights – Current structures



### Plan

- Russian investor establishes Cyprus company to be the owner of intellectual Property Rights. Capitalisation with equity (contribution or acquisition of the IP)

### Benefits

- Amortisation of cost of acquisition of IP over 5 years
- Tax on 20% of the profits from royalties, including profits from sale of the IP, at the rate of 12,5% (therefore, effective tax rate lower than 2,5%)
- Access to EU interest & royalty directive and DTT network of Cyprus – No withholding tax on royalties
- Royalty deductibility in paying company
- No withholding taxes on payments from Cyprus
- Credit relief in Cyprus for WHT in operating country if any

# Circulars issued by the Commissioner

## ➤ Securities:

The definition of “Securities”, the profits from disposal of which are exempt from corporation tax, was extended through a Circular issued on 17/12/2008 and includes the following:

- Ordinary shares
- Founder’s shares
- Preference shares
- Options on titles
- Debentures



# Circulars issued by the Commissioner

- Bonds
- Short positions on titles
- Futures/forwards on titles
- Swaps on titles
- Depositary receipts on titles such as ADRs and GDRs
- Rights of claim on bonds and debentures but not including rights on interest arising from such instruments
- Index participations only if they result in titles

# Circulars issued by the Commissioner

Participations in companies such as Russian OOO and ZAO entities, US LLCs provided such companies are themselves subject to tax on their profits, Romanian SAs and SRLs and Bulgarian AD and OOD entities

Units in open-end or closed-end collective investment schemes which have been established, registered and operate under the provisions of the law of the country in which they have been established

# Circulars issued by the Commissioner

Examples of such collective investments schemes are:

- Investment Trusts, Investment Funds, Mutual Funds, Unit Trusts, Real Estate Investment Trusts
- International Collective Investment Schemes (ICIS)
- Undertakings for Collective Investments in Transferable Securities (UCITS)
- Other similar investment organisation

Where a particular investment product does not explicitly fall within one of the above mentioned categories, an advance ruling request should be submitted for the Commissioner to decide

# Circulars issued by the Commissioner

## Tax treatment of currency exchange differences that arise directly or indirectly from the purchase and sale of “securities”

- Any exchange differences arising directly or indirectly from purchases and sales of “securities” (see Circular on “securities”), because of the fluctuations of currency in which the value of the security is determined, or because of value of the currency in which loans and other liabilities for the financing of the cost of acquisition of the “securities” are determined, form part of the profit or loss on disposal of those “securities” and as such they are not taxable/not tax deductible, respectively.
- Circular applies as from 1/1/2003

# Circulars issued by the Commissioner

## Deduction of losses and apportionment of expenses for the purposes of determining the taxable profit

- *Where a company has a mixture of taxable and tax exempt activities then:*
  - *All expenses relating directly or indirectly to the activity the income of which is exempt from taxation, or taxable at a special rate, should be deducted from that income*
  - *The general expenses (overheads) should be apportioned either based on gross turnover from each activity or based on the cost of acquisition of the assets used in each activity, provided that once a method is selected it will be consistently applied on a yearly basis*

# Circulars issued by the Commissioner

In addition the position of the Commissioner (NOT included in this Circular) is that interest on loans to acquire shares, or interest deemed to correspond to the cost of acquisition of shares, is not deductible for a 7 years' period

➤ **Actions required:**

*Wherever possible, to separate tax exempt (such as trading in shares, investing in shares, PEs abroad) with taxable activities through the use of different Cyprus companies*



# Circulars issued by the Commissioner

## ➤ Non-refundable capital contributions:

Normally, when a non-return capital contribution is made (i.e. when a company makes a capital contribution and no shares are issued in exchange) there is a risk of the arm's length implications (Section 33 of the Income Tax Law) being triggered (i.e. the Commissioner may consider this contribution as a financial assistance to the subsidiary on which deemed interest at the market rate may be imposed and taxed).

Following the letter issued by the Commissioner of Inland Revenue (dated 13/12/2010) to the Institute of Certified Public Accountants, under certain conditions such contributions when the contributing company is a Cyprus company and the recipient company is a foreign company, may not be subject to the provisions of Section 33 of the Income Tax Law.

# Circulars issued by the Commissioner

## ➤ Non-refundable capital contributions:

According to the above mentioned letter, the Income Tax Office accepts that the provisions of Section 33 should not be applied to the non-return capital contributions made by a Cyprus company to related foreign companies for as long as:

- The Cypriot contributing company **does not at any time have a legal right to claim/request repayment of the amount contributed.**
- These amounts can only be returned back to the Cypriot company through **capital reduction** or through **liquidation** of the related companies, a fact that needs to be substantiated with relevant appropriate supporting documentation.

# Circulars issued by the Commissioner

- In the case where such a contribution is granted by the Cypriot company in a certain tax year and is returned **within two years of the amount been granted**, either through a capital reduction or through liquidation, then the provisions of Section 33 will apply
- The aforementioned letter stipulates that the non-return capital contribution for the purposes of Section 11 of the Income Tax Law is considered as an asset not used in the business and therefore subject to interest restriction

# Advance rulings issued by the Commissioner

## Rulings on taxation of dividends

- If CypCo receives a dividend from a foreign subsidiary, distributed out of profits from disposal of shares in a sub subsidiary, that profit on disposal of shares will be considered as trading income if the company whose shares are sold carries out trading activities
- Dividend received by CypCo from ForeignCo, the activity of which is the renting of real estate in the course of carrying out a business activity, will be considered as derived from a trading activity and as such the dividend should be exempt from SDC

# Advance rulings issued by the Commissioner

## Rulings on taxation of dividends

- Dividend received by CypCo from ForeignCo, the activity of which is the exploitation of royalties, will be considered as derived from a trading activity and as such the dividend should be exempt from SDC
- **The above rulings were issued for specific cases, may not have general application and wherever deemed necessary a specific advance ruling should be obtained**



# Advance rulings issued by the Commissioner

## Rulings on taxation of interest

- Interest earned by a Cyprus financing company from a loan granted out of its own funds or from funds borrowed, is considered to be interest closely connected to the ordinary carrying on of a business activity and is exempt from SDC
- Interest earned by a Cyprus Partnership, the Partners of which are not tax residents of Cyprus, is not taxable in Cyprus provided the Partnership does not have a PE in Cyprus

# Advance rulings issued by the Commissioner

## Rulings on taxation of interest

- Interest earned from a bank fixed deposit account that is blocked as a security for a loan obtained is considered to be interest closely connected to the ordinary carrying on of a business activity and is exempt from SDC
- The interest free financing of a Foreign Branch by its Cyprus Head Office is not subject to the arm's length principle and as such no deemed interest can be imposed and taxed in the hands of the Cypriot company. However, any services rendered by the Cyprus Head Office to its Branch are subject to the arm's length principle

# Advance rulings issued by the Commissioner

## Rulings on taxation of interest

- Interest free loans granted to a Cyprus company from a foreign company which are subsequently waived, do not give rise to any Cyprus tax consequences

## **Rulings on liquidations/capital reduction distributions**

- Liquidation distributions receivable by a Cyprus company from a foreign company are not subject to SDC
- Capital reduction distributions receivable by a Cyprus company from a foreign company are not subject to SDC

# Advance rulings issued by the Commissioner

## Rulings on taxation of rental income

- Rental income attributable to a PE abroad of a Cyprus company is exempt from SDC in Cyprus if renting of properties is the only activity of the PE

# Advance rulings issued by the Commissioner

## Rulings on Investments in Mutual and other funds

- Following the Circular issued on “securities”, units in Funds are likely to fall under that definition and as such profits on their disposal will be exempt from corporation tax in Cyprus
- Distributions from a Fund treated as dividends and as such exempt from both corporation tax and SDC in Cyprus (the latter exemption applies if the Fund carries out more than 50% trading activities and/or is subject to tax at a rate higher than 6,25%). Generally accepted that Funds do carry out trading activities
- Advance rulings recommended in most cases

# Advance rulings issued by the Commissioner

## Rulings on back-to-back loans, interest deductibility and group relief provision

### Back-to-back loans

- Minimum margin of 0,35% should apply to the loan portfolio, even if the actual taxable margin is less. If the actual taxable margin is higher, the higher margin will be applied instead.

### Interest expenses

- The interest expense may be fully tax deductible, provided that the investments held by the company are in the shares of the wholly owned subsidiary, the only assets of which are business assets.

# Advance rulings issued by the Commissioner

## Rulings on back-to-back loans, interest deductibility and group relief provision

### Group relief provisions

- Tax loss of surrendering company arising from loan interest expense may be surrendered for relief against taxable profits of claimant company arising from loan interest income. Group relief should not reduce the minimum taxable margin (0,35%) of the claimant company.
- Exchange differences (realised or unrealised) should be ignored for the purposes of computing the net minimum taxable margin.
- Any simultaneous write off of loans payable or receivable, should not create any tax obligations for the Cyprus companies involved.

# Thank you for your attention!

## Contact Details



Alecos Papalexandrou

Deloitte Limited

Partner of Limassol Office  
Tax Services, Deloitte Cyprus

Maximos Plaza, Tower 1, 3rd Floor,  
213 Arch. Makariou III Avenue, CY-3030  
Limassol, Cyprus

Main: + 357 25 868686 | Fax: +357 25 868600 | Mob: : + 357 99 694668

[apapalexandrou@deloitte.com](mailto:apapalexandrou@deloitte.com) | [www.deloitte.com/cy](http://www.deloitte.com/cy)

## Contact Details

Ekaterina Anchugova



Deloitte Limited

Manager of Limassol Office  
Tax Services, Deloitte Cyprus

Maximos Plaza, Tower 1, 3rd Floor,  
213 Arch. Makariou III Avenue, CY-3030  
Limassol, Cyprus

Main: + 357 25 868686 | Fax: +357 25 763160

[ekanchugova@deloitte.com](mailto:ekanchugova@deloitte.com) | [www.deloitte.com/cy](http://www.deloitte.com/cy)



Deloitte refers to one or more Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see [www.deloitte.com/about](http://www.deloitte.com/about) for a detailed description of the legal structure of Deloitte Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries, with a globally connected network of member firms in more than 150 countries. Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte has in the region of 200,000 professionals, all committed to becoming the standard of excellence.

Deloitte Limited is the Cyprus member firm DTTL. Deloitte Cyprus is among the nation's leading professional services firms, with more than 500 professionals, operating out of offices in all major cities. For more information, please visit the Cyprus firm's website at [www.deloitte.com/cy](http://www.deloitte.com/cy).

Deloitte Limited is a private company, registered in Cyprus (Reg. No. 162812). Offices: Nicosia, Limassol, Larnaca.

This communications contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte network") is, by means of this communication, rendering professional advice or services. No entity in the Deloitte network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.