Webcast

Cyprus tax developments in a Ukrainian business context

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Introduction

Webcast

Cyprus-Ukraine

- Long established relationship based on solid foundations
- Both countries are willing to strengthen and develop this relationship

Webcast objectives

- Update on the recent Cypriot corporate and individual tax developments
- Analyze the recent changes to the tax treaty between Cyprus and Ukraine
- Analyze how the recent developments are relevant in structuring Cypriot-Ukrainian business

Cyprus Tax Developments

Introduction

Cyprus tax developments

Introduction

An initiative to formulate changes in the tax laws **commenced in 2014** in a common effort from both the public and the private sector: Cyprus Investment Promotion Agency, Institute of Certified Public Accountants of Cyprus and Ministry of Finance.

The amendments mainly aim to:

- improve Cyprus' competitiveness in attracting foreign investments
- harmonize the Cyprus tax laws with EU legislation
- deal with practical issues and inconsistencies of the existing laws; and
- introduce anti-avoidance measures

Cyprus tax developments

Introduction (cont'd)

Tax law changes

On **9 July** as well as **10 December 2015**, the House of Representatives **enacted** into laws a number of significant tax law proposals. The laws were **published** on **16 July** and **17 December 2015** respectively.

Key amendments were made to:

- the Income Tax Law (ITL);
- the Capital Gains Tax (CGT) Law;
- the Special Contribution for Defence (SDC) Law;
- the Department of Lands and Surveys (Levy and Duties) Law

Major amendments

Amendments to Income Tax Law

Amendments to Income Tax Law

Notional Interest Deduction (NID) on qualifying equity

- Companies resident in Cyprus and companies not resident in Cyprus which maintain a PE in Cyprus are entitled to a NID on equity, which **is effectively a tax allowable deduction** against the taxable profits of the company.

- The NID is calculated by **multiplying the "new equity"** held and used by the business in the carrying on of its activities with the **"reference interest rate".**

- **"Reference interest rate"** is the yield of the 10 year government bond of the state in which the new equity is invested plus a 3% premium, having as a minimum rate the 10-year Cyprus government bond yield as at 31 December of the tax year preceding the relevant tax year, plus a 3% premium.

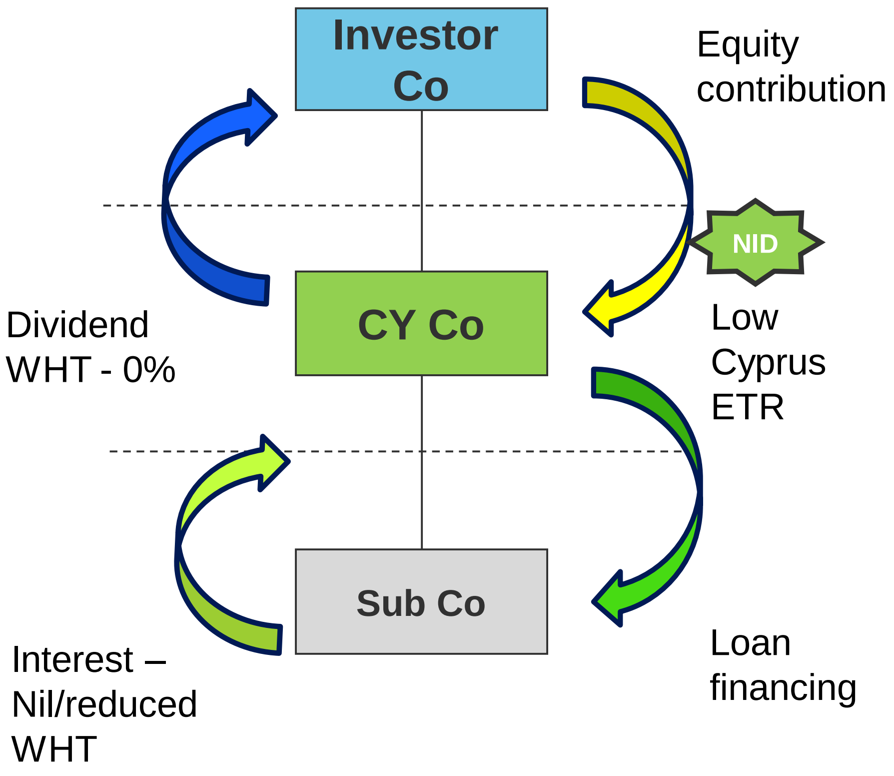
- **"New equity"** is the equity introduced in the business on or after 1 January 2015 in the form of issued share capital and share premium (provided that these are fully paid) and does not include amounts that have been capitalized and which were derived from revaluation of movable or immovable property.

- NID **should not exceed 80% of the taxable income** before its application. In the case of a loss NID is not granted.

- The above provisions have come into effect **on 1 January 2015**.

Amendments to Income Tax Law

Notional Interest Deduction (NID) on qualifying equity (cont'd)



- **NID available** (reducing taxable profit of CY Co by up to 80%) for the introduction of new equity. **May decrease ETR to as low as 2.5%.**
- Equity contribution may **safeguard beneficial ownership challenges.**
- **Tax credit** in Cyprus for any foreign WHT.
- **Nil or reduced WHT on interest** income paid to CY Co depending on jurisdiction of the interest paying Sub Co (under EU IRD / DTTs).
- **No WHT** on dividend payments by CY Co to Investor Co.
- **No Cyprus tax on exit** (sale of Sub Co or CY Co shares or on liquidation of CY Co).
- **Tax Neutrality on FX difference**

Amendments to Income Tax Law

Tax neutral treatment of FX differences

- According to the amended ITL, **any (realized or unrealized) FX differences (gains or losses) will be tax neutral**, except for gains/losses arising from trading in FX.
- Thus **FX gains** will not be taxable and **FX losses** will not be tax deductible regardless of their nature (revenue or capital), with the exception of FX gains/losses arising from FX trading.
- For persons trading in FX, the law introduces an option to make an **irrevocable election to be subject to tax only on realized FX differences**.
- This amendment is effective from **1 January 2015**.

Amendments to Income Tax Law

Downward TP adjustments

Prior to the amendment

- The ITL provided only for **upward TP adjustments to taxable profits**, in cases where transactions between related parties were not at arm's length.

Following the amendment

- Where the Commissioner proceeds with an upward adjustment to the taxable profit, then the other party involved in the transaction will be **eligible for a corresponding downward TP adjustment**.
- The tax treatment of the downward TP adjustment will be subject to the provisions of the ITL, with regards to its deductibility.
- This amendment is effective from **1 January 2015**.

Amendments to Income Tax Law

Enhanced group relief provisions

Prior to the amendment

- Only a Cyprus tax resident (CTR) company could surrender losses to another CTR company.

Following the amendment

- Losses may be surrendered to a CTR company by a company tax resident **in another Member State** (MS) of the EU provided that such company has exhausted all the possibilities of carrying forward or surrendering its losses in its resident state or in another MS where an intermediary holding company is based.

- In establishing whether two CTR companies are eligible for group relief, the interposition of a non-CTR company will not affect their group relief eligibility as long as the interposed non-CTR company is tax resident in an EU country or in any other country with which Cyprus has signed either a bilateral or multilateral tax treaty or an exchange of information agreement.

- This amendment is effective from **1 January 2015.**

Amendments to Income Tax Law

Restriction of losses arising from the licensing and/or sale of IP rights

- Under the IP regime, only 20% of the net profit from the exploitation/disposal of qualifying intangibles is taxable. The net profit is calculated after deducting from the license income/gains from disposal, all direct expenses associated with the production of this income.

- According to the amendment, in cases of a taxable loss, **only 20% of such loss will be eligible to be surrendered (via group relief) and/or carried forward to subsequent years.**

- The above provisions have a retrospective effect from **1 January 2012.**

Amendments to Income Tax Law

Taxation of dividend from hybrid instruments

Prior to the amendment

- Dividend income was **unconditionally exempt from income tax**.

Following the amendment

- Where a Cyprus resident company or a PE situated in Cyprus of a non-Cyprus resident company receives dividend income, the **income tax exemption shall not apply** to the extent that such **dividends are deductible from the taxable income of the dividend paying company.**

- Dividends that do not qualify for the income tax exemption are **not considered as dividends for SDC purposes.**

- This amendment is effective from **1 January 2016.**

Amendments to Income Tax Law

Extension of employment income tax exemptions – 20% exemption

Prior to the amendment

- Individuals taking up employment in Cyprus, who were residents outside Cyprus before the commencement of their employment in Cyprus **were eligible to claim 20%** of their employment income earned in Cyprus to be exempt from income tax, up to a maximum of €8.550.

- The exemption applied for a period of **3 years** from the 1 January following the year of commencement of employment.

Following the amendment

- The **exemption period** for the **20%** income tax exemption is **extended from 3 years to 5 years** provided the employment started during or after 2012.

- This exemption applies for tax years up to **2020** and it is then abolished.

- The provisions are effective from **1 January 2015.**

Amendments to Income Tax Law

Extension of employment income tax exemptions – 50% exemption

Prior to the amendment

- Individuals taking up employment in Cyprus, who were residents outside Cyprus before the commencement of their employment in Cyprus **were eligible to claim 50%** of their employment income earned in Cyprus to be exempt from income tax.

- This exemption applied for a period of **5 years** commencing from the first year of the employment, provided that the annual income of the employee **was in excess of €100.000 per annum.**

Following the amendment

- The **exemption period** for the **50%** income tax exemption is **extended from 5 years to 10 years.**

- For an individual commencing employment from 1 January 2015, in order to be eligible to the exemption, he/she should **not have been a Cyprus tax resident**:
  i. for at least 3 out of the last 5 years immediately prior to the year of commencement of employment **AND**
  ii. in the tax year immediately prior to the year of commencement of employment.

- These provisions are effective from **1 January 2015.**

Amendments to Special Defence Law

Amendments to SDC Law
Introduction of “domicile” concept

Prior to the amendment

- A Cyprus tax resident individual **spending more than 183 days** in Cyprus **was subject to SDC** on dividend, interest and rental income.

Following the amendment

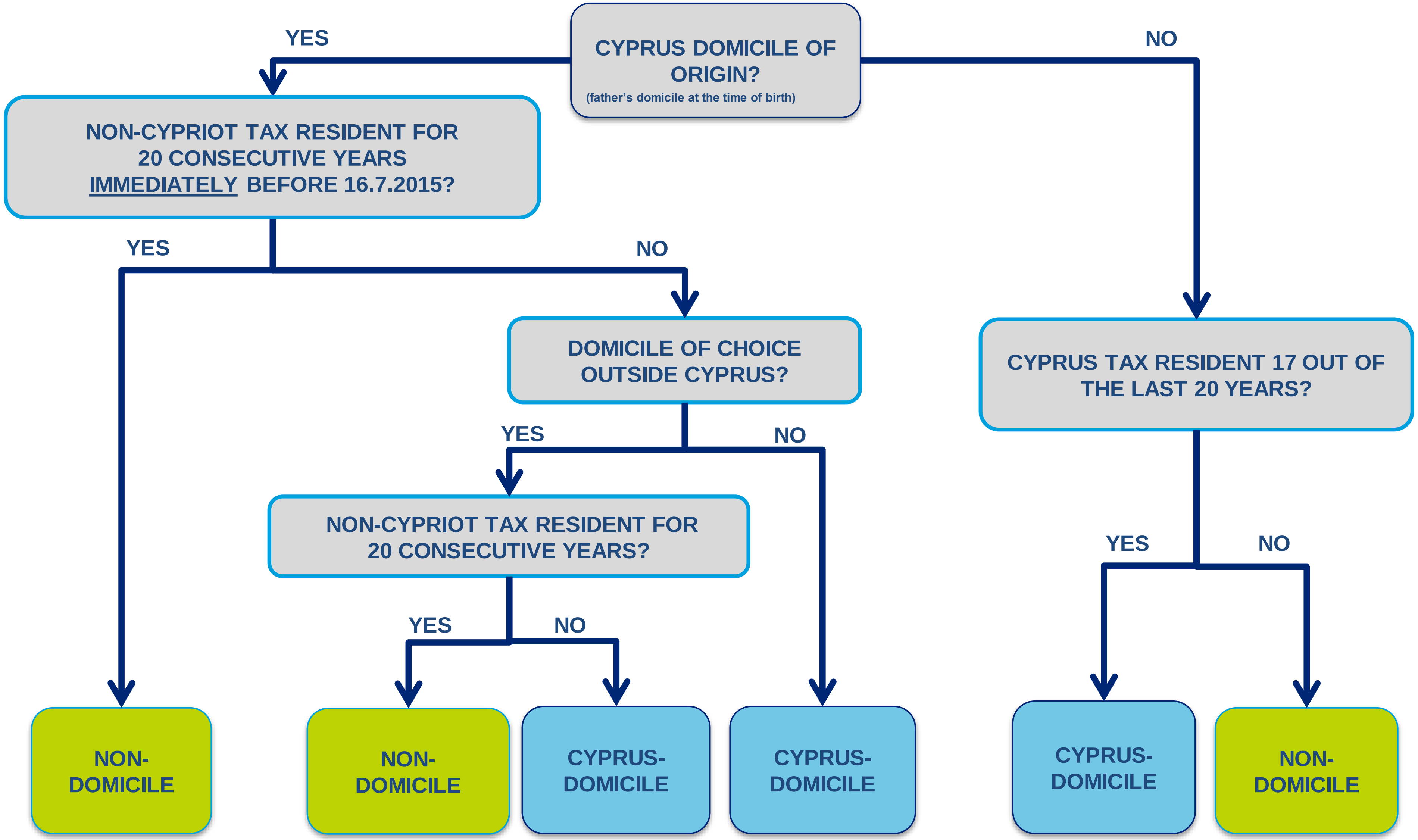
- An individual is **subject to SDC** if he/she **spends more than 183 days** in Cyprus in a tax year **AND** he/she is **domiciled in Cyprus.** Therefore, under the new “non-domicile” rules, **Cyprus tax resident individuals who are not domiciled in Cyprus are exempt from SDC** on dividend, interest and rental income.

- For the purposes of the SDC Law, an individual has a “**domicile in Cyprus**” if he/she has a domicile of origin in Cyprus subject to the following exceptions:
  i. an individual who has acquired and **maintains a domicile of choice outside Cyprus** provided that he/she has not been resident in Cyprus for any period of at least 20 consecutive years before the relevant tax year, **OR**
  ii. an individual who was **not a Cypriot tax resident for a period of at least 20 consecutive years** immediately prior to the entry into force of the provisions of this Law, **i.e. 16 July 2015**.

- It is provided that regardless of the domicile of origin, any individual who is resident in Cyprus, for at least 17 out of the last 20 years prior to the relevant tax year, will be **deemed domiciled in Cyprus.**

Amendments to SDC Law

Introduction of “domicile” (cont’d)



Global compliance matters

Global compliance matters

Cyprus legislative initiatives

Cyprus Response to BEPS

Cyprus
BEPS Scorecard

Cyprus BEPS Scorecard

Focus on establishing economic substance

Holding investments

Introduction of more specific criteria for granting Cyprus tax residency status to a corporate taxpayer (Questionnaire)

Enhancement of PIT incentives attracting MNLs to relocate key personnel to Cyprus, (non-domicile rules & extension of existing tax exemptions)

Financing

An alternative to B2B loan structures, NID, has provided a new tax efficient way to fund business operations

Anti-avoidance provisions for hybrid instruments have been voted in line with the changes to BEPS-driven EU PSD

Intangibles and R&D

Anticipated introduction of a cut-off date for new entrants to the IP regime (in line with the requirements of the EU/OECD)

Planned amendments to Cyprus IP tax regime in order to align it with the parameters of BEPS Action 5 stipulating for nexus approach

Trading

Enhancement of PIT incentives attracting MNLs to relocate key personnel to Cyprus, (non-domicile rules & extension of existing tax exemptions)

Business-oriented approach of civil service

Residency Requirements

Residency requirements

Tax residency questionnaire

Prior to the Circular published in October 2015

- Tax residency certificates (TRC) issued relied on tax return and confirmations received from the directors.

Following the Circular

- Detailed questionnaire must be completed covering amongst others the following:
  - ✓ Composition of the board, the place where board meetings take place and minutes kept
  - ✓ Who exercises control over kay management and commercial decisions
  - ✓ Where do shareholder meetings take place
  - ✓ Existence of Powers of Attorney (PoA), general or specific
  - ✓ Where books and records and company seal are kept

- Depending on the responses the tax authorities will determine whether a TRC can be issued.

Residency requirements

Tax residency questionnaire (cont'd)

Best practice

- Majority of directors are Cypriot tax residents **AND** majority of board meeting are held in Cyprus

Critical factors

- Cyprus tax authorities can refuse to issue a TRC if there are no Cyprus tax resident directors **OR** general PoAs are in place.

- In such cases, a TRC still may be issued if:
  - ✓ a company secretary is tax resident in Cyprus **AND**
  - ✓ the company's offices and employees are in Cyprus (copies of rental agreement and employees' return may be requested to confirm this),

  provided the majority of the board meetings of the company are held in Cyprus **AND** the company confirms that its BoD exercises control and make key management and commercial decisions in Cyprus.

Intellectual Property Regime

Intellectual Property (IP) Regime

Ministry of Finance Announcement

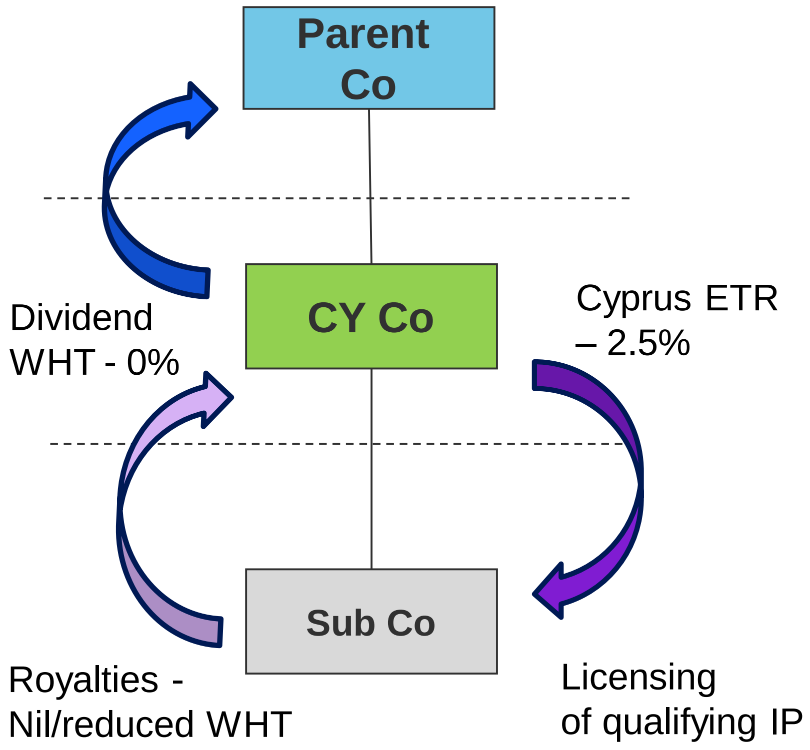
- The Ministry of Finance announced on 30 December 2015 the upcoming **amendment of the IP tax regime**. The said amendment will incorporate the recommendations of BEPS Action 5 as well as the Conclusions of the ECOFIN Council adopted on 8 December 2015.

- The approach of the **Action 5 (nexus approach)** requires the existence of material activity which includes the clear interconnection between the rights which create the income and the activity which contributes to that income.

- The intention of the Cyprus Authorities is to proceed with the amendment of the IP tax regime in order for **it to be aligned with the parameters of Action 5** and at the same time to provide for the maximum transitional arrangements that can be included within the revised framework.

Intellectual Property (IP) Regime

Current provisions



- **80% deemed deduction* on net profits** from the exploitation of IP (decreases ETR to 2.5%).
- **Tax credit** in Cyprus for any foreign WHT.
- **Nil or reduced WHT on royalty income** paid to CY Co depending on jurisdiction of the royalty paying Sub Co (under EU IRD / DTTs).
- **No WHT** on dividend payments by CY Co to Parent Co.
- **80% deemed deduction* on profits from disposal of IP.**

Cyprus-Ukraine: DTT and local legislative developments

Cyprus-Ukraine DTT
The previous and effective tax treaties

- **Cyprus-USSR (applicable to Ukraine) double tax treaty (1982)**
  - effective for payments made before 1 January 2014;
  - 0% withholding tax for passive income;
  - non-standard capital gain clause.
- **Cyprus-Ukraine double tax treaty (2012)**
  - Effective since 1 January 2014 (technical mistake in Ukrainian translation amended by the Letter of the Ministry for Foreign Affairs of Ukraine No 72/14-612/1-3330**,** dated 10 October 2013);
  - Withholding tax rates for passive income:
    - ✓ Dividends – 5% (20% ownership **or** €100,000 investment), 15% (in other cases);
    - ✓ Interest – 2%;
    - ✓ Royalty – 5% (applies to copyright of scientific work, a patent, trademark, secret formula, process or information concerning industrial, commercial or scientific experience) or 10% (other cases);
  - Non-standard capital gains clause.

Cyprus-Ukraine DTT

New Protocol to the tax treaty

Cyprus – Ukraine DTT Protocol (2015)

- On **11 December 2015** Cyprus and Ukraine signed a Protocol amending the existing double tax treaty (2012).
- The Protocol will come into effect not earlier than **1 January 2019** provided Ukraine and Cyprus will finish necessary ratification procedures timely. The official text of the protocol is not available at the moment.
- Key changes (according to the information of official press release of the Ministry of External Affairs of Ukraine):
  - Withholding tax rates for passive income:
    - ✓ Dividends - 5% (20% ownership **and** €100,000 investment amount) or 15% (in other cases);
    - ✓ Interest - 5% (increased);
    - ✓ Royalty - 5/10% (no changes);
  - Capital gains clause is OECD standard based;
  - A most favored nation clause has been adopted for taxes on interest, dividends royalties and capital gains.

Other legislative developments & trends

Various matters

- **Ukraine-OECD relations**

  Ukraine considers OECD membership. Steps undertaken:

  - translation of Commentary to OECD Model Convention (2014) to Ukrainian (license provided by OECD to State Fiscal Service of Ukraine);
  - Action Plan on Cooperation for 2013-2016;
  - Agreement on Mutual Understanding (2014).

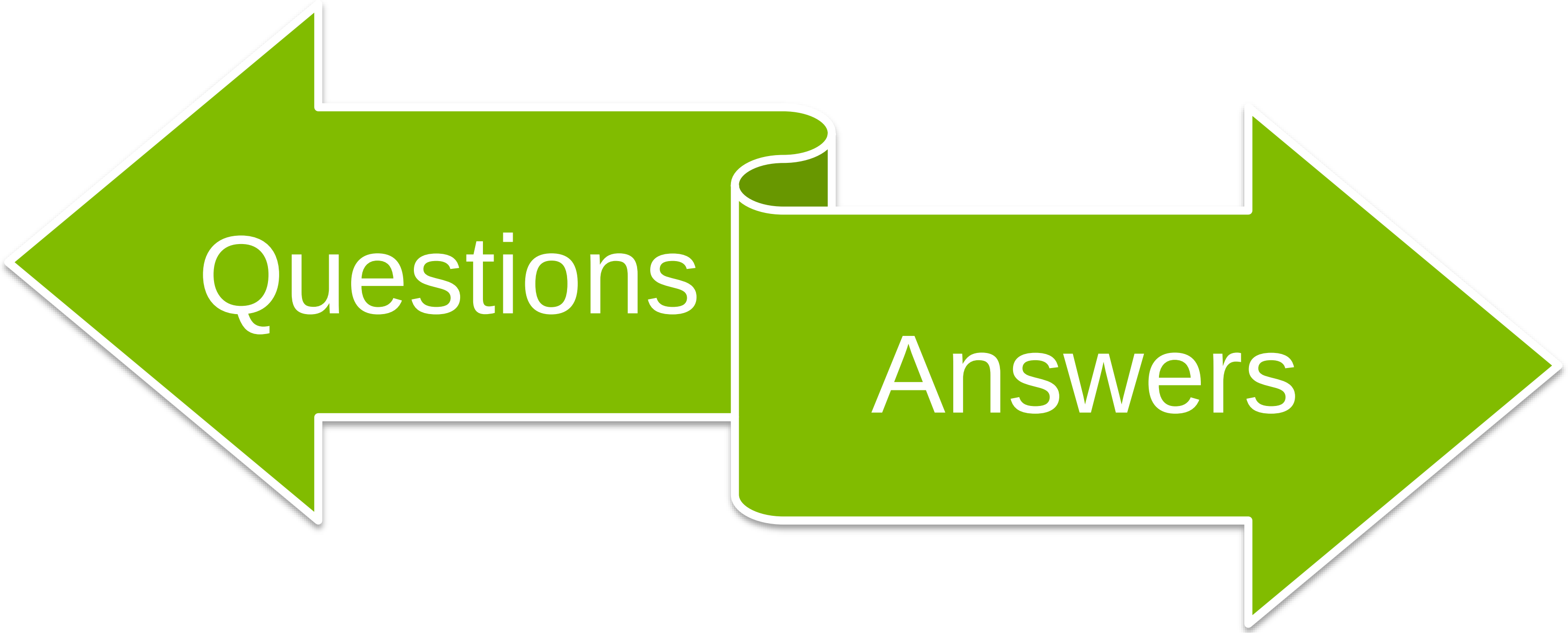
- **Amendments to PE definition in the Tax Code:**
  - server (fixed PE);
  - negotiation of substantial conditions of contracts (agency PE).

- **Beneficial ownership status**
  - Letter of the State Fiscal Service of Ukraine N 9033/7/99-99-10-02-02-17 dated 31 October 2014 recommends to consider the economic substance of the transaction in addition to the legal right for income;
  - The approach is supported by court practice.

Other legislative developments & trends

Various matters (cont'd)

- **Exchange of information in tax matters**
  - Ukraine is part to the Convention on Mutual Administrative Assistance in Tax Matters (effective for Ukraine starting 01/07/2009) and signed the Protocol thereto (effective since 01/09/2013). Amended Convention provides for all possible forms of administrative co-operation between states in the assessment and collection of taxes, in particular with a view to combating tax avoidance and evasion. Instrument – effective DTTs of Ukraine with 73 countries.
  - Automatic exchange information on financial and tax matters:
    - ✓ amend Ukrainian laws, to become part to new multilateral agreement on automatic exchange (CRS Multilateral Competent Authority Agreement);
    - ✓ implement the CRS into domestic laws;
    - ✓ complete reviews of Global Forum on Transparency and Exchange of Information on Tax Purposes;
    - ✓ amend appropriate DTTs clauses on exchange of information, where necessary;
    - ✓ amend technical regulations in local laws, etc.


Questions
Answers

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