

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

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Overview of the Ukrainian tax system



Overview of the Ukrainian tax system

- Corporate Tax – 25%
- VAT – 20%, but not EU compliant
- Withholding Tax: (no treaty)
 - Dividends – 15%
 - Interest – 15%
 - Royalties – 15%
 - Services – up to 15%
- Advance Corporate Tax – 25% on dividends distribution

Overview of the Ukrainian tax system

- Capital Gains Residents 25%
 Non-Residents 15% withholding tax

- Blacklist 85% limit on deductibility of payments

Ukrainian Double Tax Treaties



Ukrainian Double Tax Treaties

General withholding tax rates

	interests	dividends	royalties	capital gains**
Non-Treaty	15	15	15	15
Netherlands*	2/10	0/5/15	0/10	nil
Germany*	2/5	5/10	0/5	nil
Sweden*	10	0/5/10	0/10	nil
United Kingdom*	0	5/10	0	nil
United States*	0	5/15	10	nil
Cyprus	0	0	0	nil

* Conditions apply

** Ukraine trading company not owning real estate

Ukrainian Double Tax Treaties

Specific rules for sale of Ukrainian real estate companies:

Taxable in Ukraine:

Netherlands

Germany

United Kingdom

United States

Sweden

Non-Treaty

Not taxable in Ukraine:

Slovakia

Cyprus

Overview of Cyprus tax system



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 avoid)
- 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

- New legislation effective from 1 January 2003
- EU & OECD compliant
 - Recent Progress Report issued by the OECD following G20 request at their meeting in London (April 2009), Cyprus was included in the '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 holding requirement
 - No minimum shareholding
 - ✓ Foreign dividends are exempt from taxation in Cyprus
 - At least 1% holding in a direct or indirect trading group
 - ✓ Foreign PE trading 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.

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

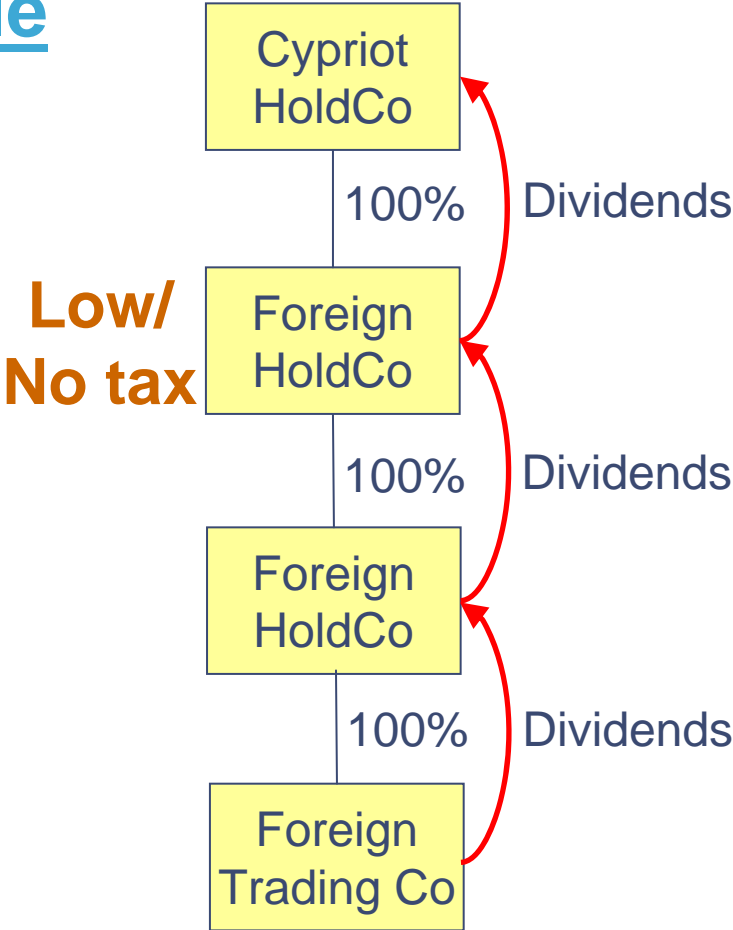
Participation exemption

- Foreign dividends exempt from Cyprus tax when holding at least 1%
- Exemption not available ONLY if:
 - dividend emanates directly or indirectly from investment / 'passive' Income; **AND**
 - the foreign paying company was subject to tax at a rate lower than 5% on that income.
- 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

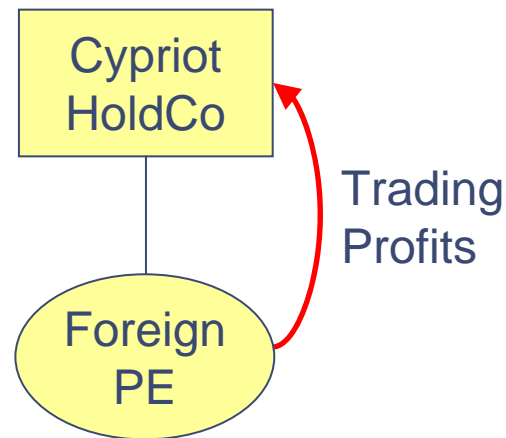
Example



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

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 “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.
- 15% approximate effective tax rate on “passive” interest
 - 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 recently 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)

Other non-tax considerations



Other non – tax considerations

- No stamp duty on contracts relating to matters outside Cyprus.
 - €17.086 ceiling on stampable contracts
- 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
 - Common Law system
 - Principles of Common law and Equity apply

Other non – tax considerations

- Cyprus Companies' Law based on English Companies' law of 1948 – updated and modernised in 2005
- English case law as precedents – until 1960 English cases had binding effect. Since 1960 cases have persuasive effect especially in areas of law where there have not been any cases decided in the Cyprus courts
- Many lawyers in Cyprus are UK qualified
- European Court of Justice decisions binding
- Capital markets legislation harmonised with EU directives

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.
- Mutual Funds bill now going to Parliament

Cyprus' companies on AIM

Company Name	Date of joining	Money Raised (£m)	Countries of main operations	Industry
AISI realty public ltd	8/1/2007	16.2	Ukraine	Real Estate Holding & Development
Mirland development corp plc	12/18/2006	143.4	Russia	Real Estate Holding & Development
Helesi plc	11/23/2006	11.6	Greece, U.K.	Industrial Suppliers
IFR capital plc	11/15/2006	89.2	Germany, Austria, Switzerland, Slovenia, Czech Republic	Restaurants & Bars
ASBISc Enterprises plc	10/25/2006	Introduction	Former Soviet Union, Central and Eastern Europe, Middle East, North Africa	Computer Hardware
Teleset networks plc	10/12/2006	Introduction	Russia	Fixed Line Telecommunications
XXI century investments	12/16/2005	67.976	Ukraine	Real Estate Holding & Development
Charalambides dairies	11/29/2005	Introduction	Cyprus	Food Processors
Urals energy public co	8/9/2005	64	Russia	Oil & Gas - Exploration & Production
Eastern mediterranean resources	5/9/2005	2.0	Eastern Europe, Caucasus, Cyprus	Gold Mining

Advance rulings

Cypriot tax authorities willing to issue rulings on tax treatment of specific transactions

PwC Cyprus has been very successful in obtaining rulings like:

- Dividends arising from rental income of foreign companies may be from active income hence participation exemption
- Other securities may be qualifying 'titles', therefore gains on disposal is exempt from corporate income tax
- Excess over initial capital received during liquidation of subsidiary may be tax exempt
- Interest income from bank deposit accounts under circumstances is active income therefore taxed only under income tax at 10%
- Disposal of immovable property abroad may be profit from foreign PE therefore tax exempt

No arm's length rulings issued, but developments expected

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 unilaterally on foreign tax suffered on same income.

Income of a Non – Cyprus Tax Resident Individual

Certain Cyprus sourced income only

- Profits of Cyprus Permanent Establishment
- Cyprus Employment income
- Cyprus pension income
- Cyprus rental income
- Sports / entertainment performance in Cyprus

All at rates up to 30%

Withholding tax rates

	Cyprus
Dividend	Nil
Interest	Nil
Royalty	Nil ¹
CGT	Unconditional Exemption

1 10% only when intangible used in Cyprus (subject to DTTs/EU tax directives)

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 2010
 - No change on WHT's
 - Dividends 5% / 10%
 - Interest 0%
 - Royalties 0%
 - Up to 31 December 2013, only Cyprus has taxing rights on share disposals.
 - 2014 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 black list" will take place simultaneously with the coming into effect of the protocol

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

Cyprus Double Tax Treaties in Force

Austria

Greece

Poland

Thailand

Belarus

Hungary

Qatar

United Kingdom

Belgium

India

Romania

United States

Bulgaria

Ireland

Russia

Yugoslavia**

Canada

Italy

San Marino

China, P.R.

Kuwait

Seychelles

Czech Republic

Lebanon

Singapore

Denmark

Malta

Slovakia

Egypt

Mauritius

South Africa

France

Moldova

Soviet Union*

Germany

Norway

Sweden

Syria

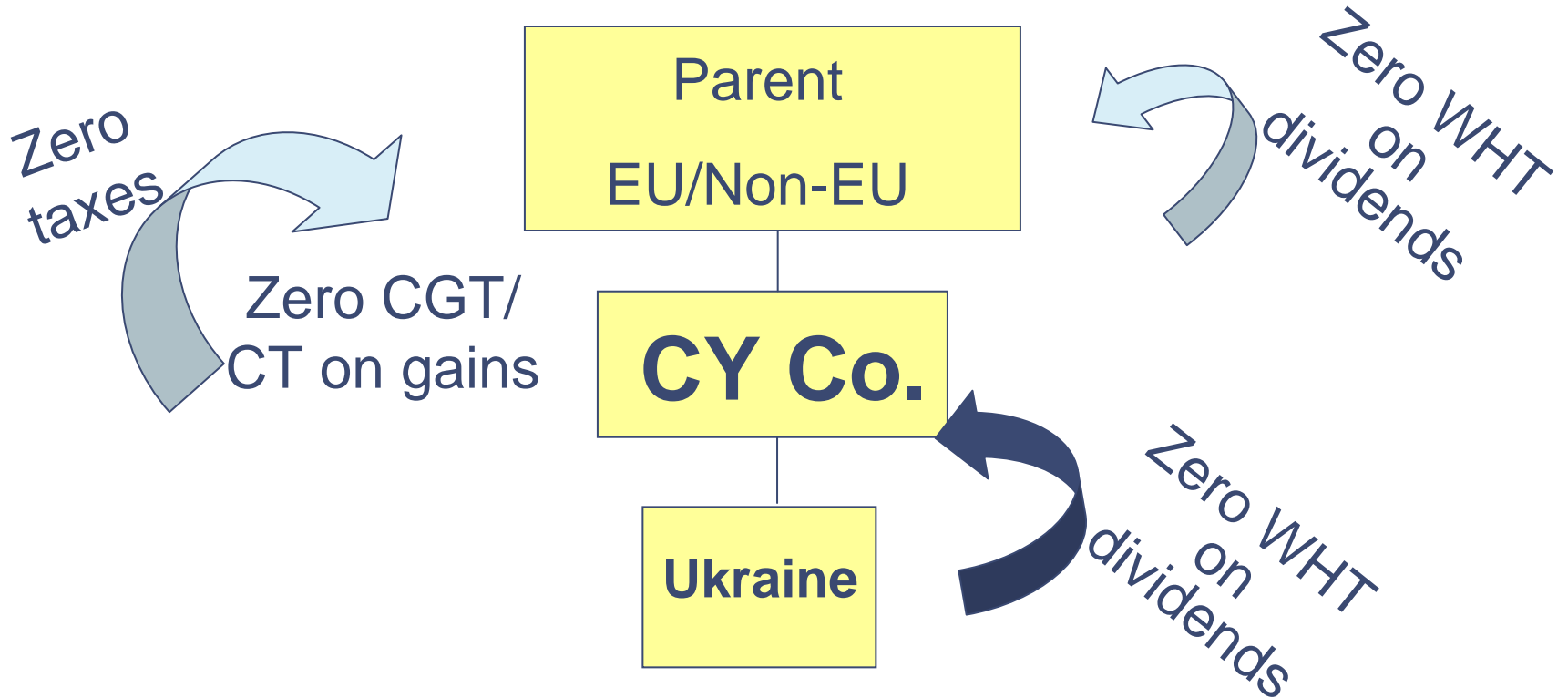
*Honoured by Armenia, Kyrgyzstan, Tadjikistan and Ukraine

** Honoured by Montenegro, Serbia and Slovenia

Tax planning ideas involving Ukraine and Cyprus



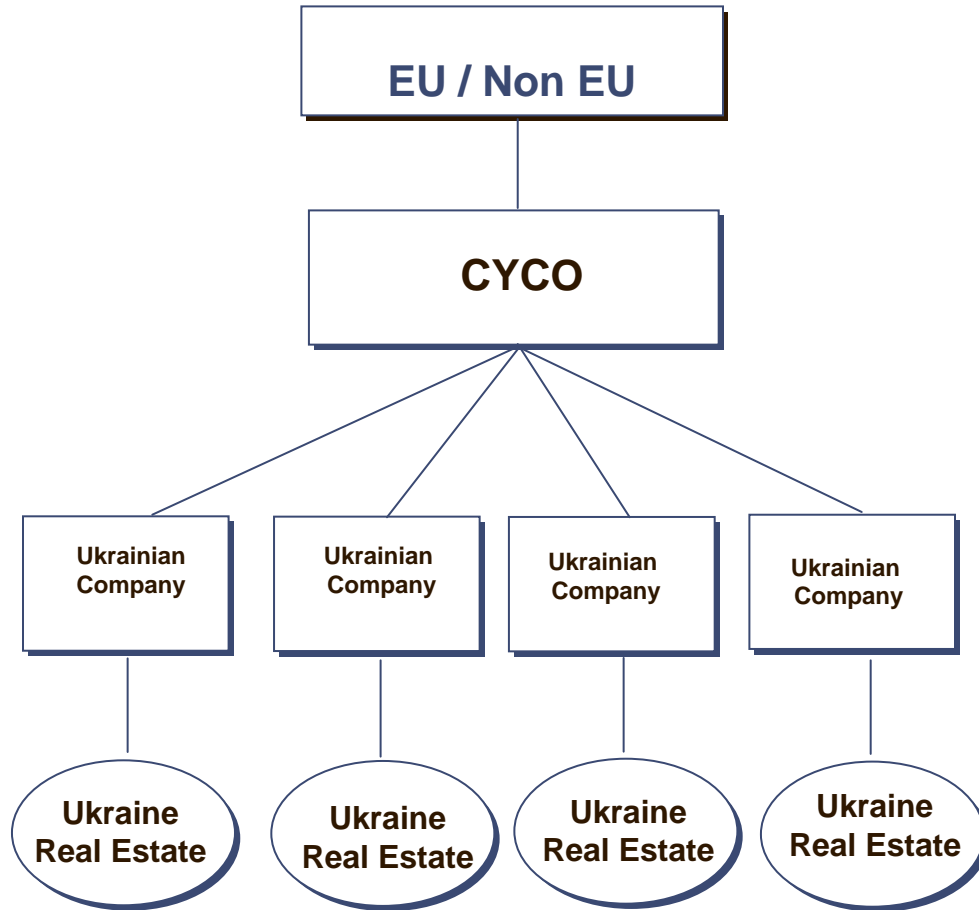
Holding Company Structure



Tax free exit

No Holding period required for dividend or capital gain exemption

Real Estate Structures



Plan

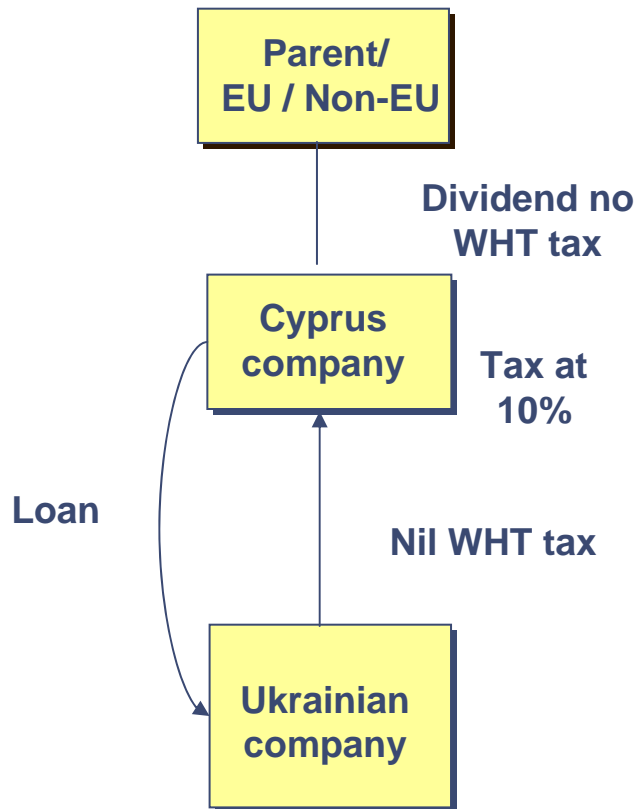
- Establish one Ukrainian company for each Real Estate unit held in Ukraine
- Establish one Cyprus holding company

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

Cyprus Finance company

Basic Structure



Plan

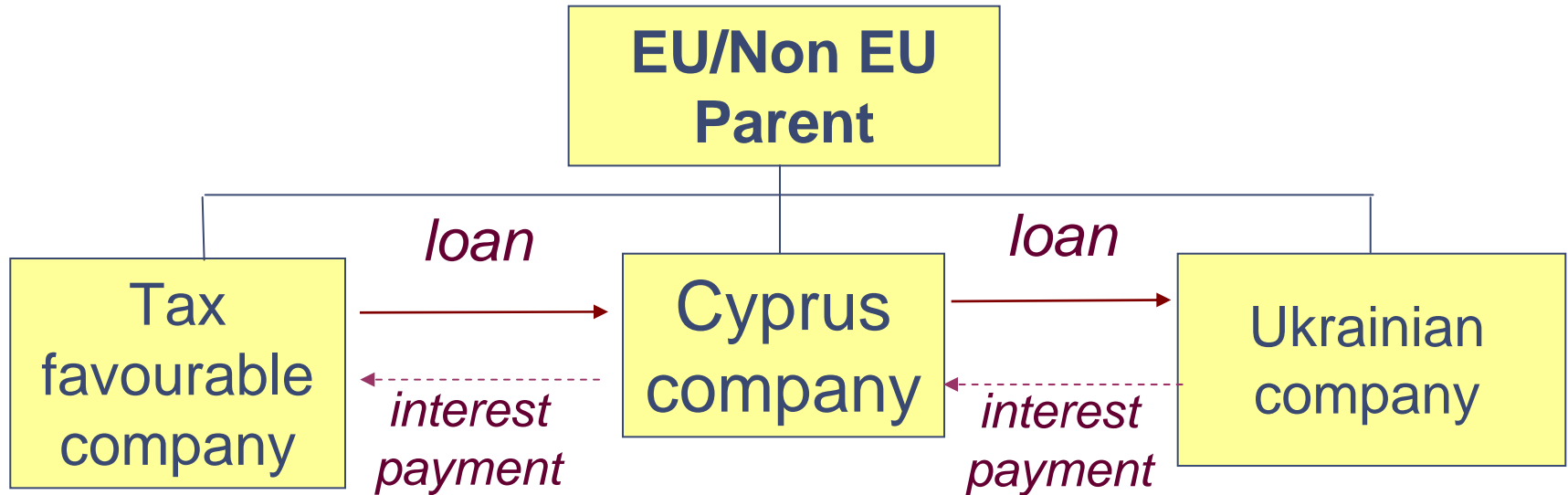
- EU or Non-EU parent establishes Cyprus company to be the group finance company of Ukrainian operations.
- Capitalization with equity

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%

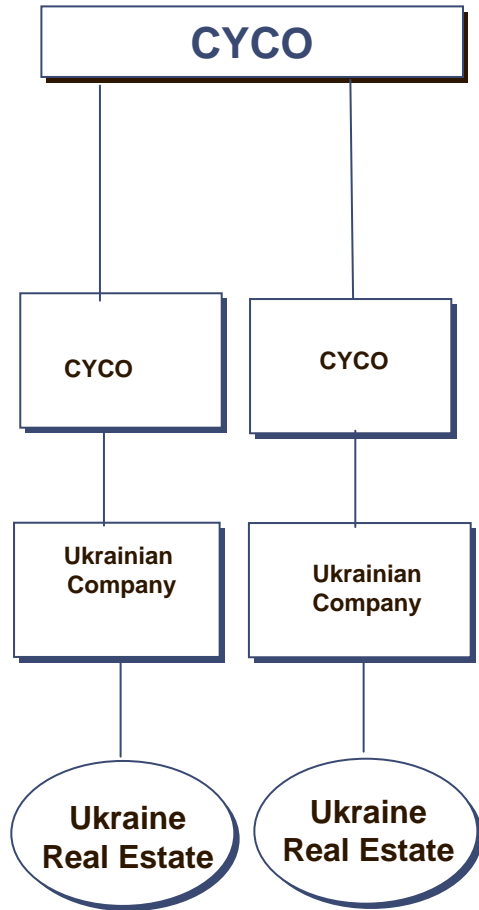
Cyprus – Ukraine Double Tax Treaty



New treaty?

- Renunciation of the current DTT has failed in the Ukrainian Parliament
 - 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.

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 and PwC Cyprus



Cyprus – Facts and Figures

Economic Summary

	2006	2007	2008	2009
Real GDP Growth (annual % change)		4.4	3.4	0.3
GDP per Head (\$)		27.171	28.381	29.335
Inflation (annual % change)		2.2	4.6	1.08
Unemployment (%)		4.4	3.6	3.9
Population	800.000			

Source: Economist Intelligence Unit, IMF; Tomson Datastream: Cyprus Statistical Service

Published in Financial Times October 29, 2008

- Member of the European Union since 1 May 2004
- Euro Currency was introduced in Cyprus on 1 January 2008

The firm today

Numbers by Town

	Partners	Directors	Staff	Total
Nicosia	32	9	696	737
Limassol	10	1	180	191
Larnaca	3	1	61	65
Paphos	2	1	54	57
	47	12	991	1,050

The firm today

Numbers by Service Line

	Partners & Staff	
Assurance	434	
Advisory	56	
TLS		
- GCS	222	
- Tax	136	
- CSS (incl. 14 Landwell employees)	<u>32</u>	390
IFS	170	
Total	1,050	



Summary



Summary

Ukrainian State Statistics Committee – 1st half 2009 Data

- EU direct investment in Ukraine – USD30 billion
(representing 79% of total direct investment in Ukraine)

• From:	Cyprus	USD8,1 billion	26,9%
	Germany	USD6,5 billion	21,8%
	Netherlands	USD3,7 billion	12,4%
	Austria	USD2,5 billion	8,3%
	UK	USD2,3 billion	7,8%

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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