THE CYPRUS HOLDING COMPANY

2017
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A. INTRODUCTION

Holding companies are set up as the vehicle to hold investments in subsidiaries or associate companies. Their primary income derived from their holding activities is dividend income and profits from the disposal of their investments, mainly shares.

For a country to be an attractive location in which to set up a holding company, various tax criteria are taken into consideration.

With the introduction of the Cyprus new tax legislation on 1.1.2003 and the relevant tax provisions enacted, Cyprus has become a major player in the field of holding companies.

With this brochure we examine the main features of the Cyprus tax regime in order to highlight the importance of the Cyprus holding company in the field of holding structures judged from the international investor’s point of view.

B. MAIN CRITERIA FOR THE SELECTION OF A PRIME LOCATION FOR A HOLDING COMPANY

The following issues related to the holding activities are considered to be the main criteria for the selection of the prime location to set up a holding company in conjunction with the particular circumstances of the investor.

(I) Incoming Dividends – Withholding Tax on Foreign Jurisdiction

Incoming dividends remitted by the subsidiary to the holding must either be exempt from, or subject to, low withholding tax rates relying on any applicable foreign legislation or any applicable double tax treaty.

(II) Dividend Income Received – Local Tax

Dividend income received by the holding company must either be exempt from or subject to low corporate income tax rates in the holding company’s jurisdiction.

(III) Outgoing Dividends

Outgoing dividends paid by the holding company to its ultimate shareholders must either be exempt from or subject to low withholding tax rates in the holding company’s jurisdiction.

(IV) Capital Gains Tax on the Sale of Titles

Profits realized by the holding company on the sale of titles in the subsidiary must either be exempt from or subject to a low rate of capital gains tax in the holding company’s jurisdiction.
(V) Additional Tax Considerations

Additional tax considerations, which may identify whether a particular location is suitable for a holding company to be established may include:

- The existence or not of flexible re-organisation rules;
- Whether group relief is granted;
- Possibility of losses to be carried forward;
- The existence or not of Controlled Foreign Company (CFC) rules;
- The existence or not of thin capitalisation provisions and the ability to obtain interest deduction as an expense in full;
- Possibility of re-domiciliation to other jurisdictions;
- Favourable or not provisions as to the taxation of interest income and royalties;
- Percentage of withholding taxes on interest and royalties;
- Obligation or not to get registered with VAT;
- Favourable or not liquidation provisions and taxation of assets distributed to the shareholders; and
- The level of corporate and local tax rates in respect of other income;

Jurisdictions which provide some or all of the above criteria with flexible and favourable rules at low tax rates are considered as prime locations for holding companies. The location that is more suitable in each specific case ultimately depends on the particular circumstances in question and on individual tax and non-tax objectives.

C. THE CYPRUS TAX REGIME FOR HOLDING COMPANIES

In this section we examine the above-mentioned 5 criteria and analyse their application within the context of the Cyprus holding company.

(I) Incoming Dividends – Withholding Tax on Foreign Jurisdiction

The first criterion that a holding company will need to satisfy is the ability to extract dividends from its subsidiaries at a zero or low tax rates.

The Cyprus holding company achieves this criterion with:

- The extensive network of Double Tax Treaties that Cyprus has signed. Double Tax Treaties apply both to countries outside European Union or within European Union, in which countries the European Commission Parent Subsidiary Directive does not apply once its conditions for implementation are not met;
- The European Union Parent Subsidiary Directive within European Union Member States; and
- The application of the unilateral tax credit relief.
Double Tax Treaties

Cyprus has signed an extensive number of Double Tax Treaties. With these Treaties, double taxation is avoided on the same profits in respect of the same person or entity.

Double Tax Treaties give tax relief only to legal persons or individuals who are tax residents in one or in both contracting states. According to the Cyprus Income Tax Law, legal persons are considered as tax residents of Cyprus if their management and control is exercised in Cyprus.

The tax residency issue must in addition, always be examined from the angle of the applicable laws of the other contracting state or according to the applicable laws of the place where the company has operations.

Double Tax Treaties usually provide that in case of dispute as to the residency of a legal person between contracting states or in case of dual residency where the legal person is considered as resident in both contracting states, the residency of the legal person is determined to be there where the effective management of the legal person is exercised.

Careful tax planning must be made related to the residency issue as the implementation of such provisions as to the effective management in Double Tax Treaties might impose serious tax liabilities on the companies.

Relief under the European Commission Parent Subsidiary Directive

The Parent Subsidiary Directive provides for the abolition of withholding taxes on dividends paid by a subsidiary to its parent company being resident of any Member State.

The main conditions that need to be met for the Directive to apply are:

- the parent company must be tax resident of a Member State and
- must hold at least 25% of the share capital of the subsidiary.

Some Member States require that the holding of the 25% capital in the subsidiary maintained for a minimum number of years in order for the provisions of the Directive to be applicable. Also a number of Member States have introduced additional anti-avoidance provisions in order to avoid abuse and fraudulent use of the benefits of the Directive.

Cyprus has implemented the Parent Subsidiary Directive by virtue of the Special Contribution for the Defence Law. According to this law, there is no minimum qualifying holding period of years and no minimum shareholding percentage is required.

Unilateral Tax Credit Relief

Even if the Double Tax Treaty or the Parent Subsidiary Directive relief are not providing sufficient protection or if their criteria for their implementation are not met, Cyprus applies unilateral tax credit relief in the form of tax credit by operation of its local tax laws.

Tax credit is granted in Cyprus for any withholding tax or other tax paid on the particular income abroad. This credit applies also to Cyprus Income Tax and Special Contribution for the Defence Tax due on this income.
In effect, any tax paid abroad will be credited against any tax that might be payable for the particular income in Cyprus under any category of taxation.

Tax credit is also given by operation of particular provisions in some of the Double Tax Treaties, such as those of Russia, UK, Greece, Bulgaria, Austria and others, in relation to the underlying tax paid by the subsidiary—local trade tax—and not only as to the withholding tax upon the transfer of the dividends to the Cyprus holding company.

(II) Dividend Income Received in Cyprus – Local Tax

The second important criterion that a holding company has to meet is the zero or low taxation rates on the dividends that it will receive from its subsidiaries.

According to Cyprus Tax legislation foreign dividend income received in Cyprus by a Cyprus tax resident company will not be taxed under the Income Tax Law but under the Special Contribution for the Defence Law.

In effect the taxation on dividends is as follows:

Income Tax

Dividends received from Cyprus companies (either resident or non-resident) or dividends received from overseas companies do not bear any corporation tax. There is full exemption.

Special Contribution for the Defence Tax

Dividends received from another Cyprus resident company

There is no Special Contribution for the Defence tax in case dividends are paid from a Cyprus tax resident company to another Cyprus tax resident company.

In the cases where the ultimate beneficial shareholders of the Cyprus tax resident company are tax residents in Cyprus and have their domicile in Cyprus, there are certain provisions in the law relating to a deemed distribution of dividends every two years and to indirect payment of dividends every four years. These provisions do not apply to companies whose beneficial shareholders either directly or indirectly through nominees or trusts, are not tax residents of Cyprus.

Dividends received from a non-resident company

Such dividend is exempt from Special Contribution for the Defence tax. However, this exception is not granted if,

(a) The company paying the dividend is engaged directly or indirectly by more than 50% in activities which result in investment income

AND

(b) The rate of the foreign taxation on the income of the company paying the dividend is substantially lower than the 12.5% payable by the recipient Cyprus resident company.
If the exception does not apply, the dividend income received from the non-resident company is taxed at the rate of 17%. If on any dividend income any foreign tax was paid, then unilateral tax credit is granted in Cyprus as explained in the preceding paragraph.

(III) Outgoing Dividends

Non-Resident Shareholders

Dividends payable by a Cypriot resident company to its non-resident shareholders (whether a company or individual) are not subject to any withholding tax in Cyprus.

The non-resident shareholder of a Cyprus company receives the dividends from Cyprus free of any withholding tax. In effect, Cyprus provides full exception on the payment of dividends to its non-resident shareholders and has a real advantage over the other traditional holding jurisdictions.

Resident Shareholders

If the physical person receiving the dividend is tax resident in Cyprus and of Cypriot domicile then there is withholding tax on the dividends payable at the rate of 17%. There is no withholding tax on actual dividends payable from one Cyprus tax resident company to another Cyprus tax resident company.

The law provides for a deemed distribution of dividends every two years and also there are special provisions in case of indirect payment of dividends every four years. These provisions are applicable only in the case that the ultimate beneficial owners are tax residents of Cyprus and of Cypriot domicile. In effect, these provisions do not affect companies whose beneficial owners are either, directly or indirectly, non-tax residents of Cyprus.

(IV) Capital Gains Tax on the Sale of Titles

The word “titles” according to the law means, “shares, bonds, debentures, founders’ shares and other titles of companies or other legal persons incorporated in Cyprus or abroad and rights thereon”.

Income Tax

There is full exemption from corporation tax on profits from the sale of titles.

Capital Gains Tax

There is also full exemption from any capital gains tax from profits realized from the disposal of titles.

If the company whose titles (shares) are sold is the owner of immovable property situated in Cyprus, then there is Capital Gains tax at the rate of 20% calculated according to the specific provisions of the relevant law.

In effect, any profits from the disposal of titles as defined above are free from any taxation in Cyprus unless the company, whose titles are sold, is the owner of immovable property in Cyprus. It is crucial to mention at this stage that promissory notes are NOT titles according to Cyprus tax law and any profit from the sale of promissory notes increases the taxable income of the company and on any resulting net profit of the company there will be 12.5% corporation tax.
Also, trading in currencies does not fall within the definition of trading with titles. It is a normal trading activity and is subject to 12.5% corporation tax on net profits if any.

(V) Additional Tax Considerations

Flexible Re-organisation Rules for Companies

The tax legislation extensively provides for flexible re-organisation rules. It implements the European Commission Merger Directive. The Cyprus legislation implemented the Directive in a very liberal approach and the Cyprus re-organisation rules are far more flexible than the EC Directive.

The re-organisations according to Cyprus Tax Law,

- apply not only to companies but also to any legal body of persons;
- can be made not only between Cypriot or European Union entities but equally apply to entities from non-member states; and
- any profits or gains made by reason of re-organisations, the transfer of property, and the transfer of shares in exchange for shares in another company, are exempt from income tax.

On the contrary, re-organisations according to companies’ law are allowed only between Cypriot and European Union entities and not with entities registered in non-member states. There is though a pending bill to change this law which is expected to pass very soon and bring the two laws that deal with the subject in line.

Re-organisations include merger, de-merger, transfer of assets and exchange of shares between Cyprus resident companies and / or non-resident Cyprus companies.

Losses Carried Forward

Losses can be carried forward for 5 years and set off against future profits.

Group Relief Granted

Up to 31 December 2014 Group relief (set off of the loss of one company with the profit of another) was allowed provided both companies of the group are tax residents of Cyprus for the whole financial year. On 1 January 2015 in order to align the Cypriot tax laws with the European Court of Justice’s decision in the Marks & Spencer case, the law was amended so that a subsidiary company which is tax resident in another EU member state can surrender its taxable losses to another group member company tax resident in Cyprus, provided the subsidiary has exhausted all the means of surrendering or carrying forward the losses in the member state of residence of the subsidiary or to any intermediary holding company. The losses surrendered must be calculated on the basis of the Cypriot tax laws.

The law has also been amended to allow, for the purposes of considering whether two companies are members of the same group, the interposition of holding companies established in (a) another EU member state, (b) in a state with which Cyprus has concluded a double tax treaty or (c) in a state which has signed the OECD multilateral convention for exchange of information.

Two companies are deemed to be members of the same group if:
• one company is the 75% subsidiary of the other or,
• both are 75% subsidiary of a third company.

A 75% subsidiary means a company holding either directly or indirectly at least 75% of its voting shares and beneficially entitled to at least 75% of the income and 75% of the assets in case of winding up. A company incorporated by its holding company any time during a tax year is considered as part of the group from the beginning of the year for group relief purposes.

Losses incurred in one year can be set off only against profits of the same year. A partnership transferring business into a company can carry forward tax losses into the company for future utilisation.

**Absence of Controlled Foreign Company (CFC) Legislation**

Cyprus does not have Controlled Foreign Company (CFC) Legislation. In effect, no income is imputed to a Cyprus parent even if the income arises in a tax heaven country or in respect of passive activities.

A recent judgment of the European Court of Justice (ECJ) (between Cadbury Schweppes and the UK Commissioners of Income Tax) reconfirmed the tax competition within Members States and in effect established that CFC rules cannot be enforced once the subsidiary registered in a Member State is engaged in genuine economic activities.

This judgment of the ECJ gives tremendous possibilities to investors and businessmen to proceed to a careful tax planning and use for their business activities, subsidiaries situated in low tax rate countries like Cyprus the tax system of which even if it provides for low tax rates has been strengthen with this decision.

**Absence of Thin Capitalization Rules**

Cyprus tax legislation does not contain Thin Capitalization Rules, namely, no provisions in the law exist requiring the companies to maintain a debt to equity particular ratio.

In this respect, a Cyprus holding company may be capitalised with loans without any risk that interest paid at arms’ length to the parent company will not be deductible, given that the funds are used for the production of taxable income.

**Possible Re-domiciliation**

Cyprus has enacted a new law allowing re-domiciliation of foreign companies in Cyprus and Cyprus companies to be re-domiciled abroad.

This possibility gives tremendous flexibility to foreign holding companies which currently are using particular not suitable holding jurisdictions, to move their holding companies in Cyprus without disturbing their overall structure.

**Taxation of Interest Income**

The law distinguishes in an indirect way between trading interest income and passive interest income. The following questions and their respective answers identify the nature of the interest income:

• Is the particular interest income acquired from the ordinary activities of the company?
• Is the particular interest income acquired from activities **closely connected** with the ordinary activities of the company?
If the answer to either of the above two questions is positive, then the interest income is treated as **trading interest income** and if not, as **passive interest income**.

The trading interest income is taxed as income according to the Income Tax Law. On such trading interest income there will be 12.5% taxation on **net profits**, if any.

If the answer to the above two questions is negative, then the interest is treated as **passive interest income** and is taxed only under the Special Contribution for the Defence Law at the rate of 30% on the interest income received or credited.

**Holding Company financing its group of companies**

A holding company acting as the financing vehicle of its group of companies is considered that the interest income it receives from the group financing is closely related to its ordinary activities and this interest income will be taxed only according to the provisions of Income Tax Law and not to Special Contribution for the Defence Tax Law.

**Purely Holding Company outside the scope of VAT**

Holding activities fall outside the scope of the VAT in Cyprus and the Cyprus holding company engaged exclusively to holding activities is not entitled or obliged to register for VAT purposes.

**No Withholding Taxes on Interest and Royalties**

There are no withholding taxes on payments of interest to non-residents. Any interest due to non-residents is paid free of withholding taxes from Cyprus.

There are also no withholding taxes on royalties arising from sources outside Cyprus.

**Liquidation - Distribution of Assets without taxation to Non-Residents**

If a Cyprus Holding Company is liquidated and its assets are distributed to its shareholders, if the shareholders are non-residents of Cyprus then the distribution is done without any taxation on the non-resident shareholders.

**Low Tax Rate for Trading Income**

Trading income is taxed at the rate of only 12.5% on net profits.

**D. CONCLUSION**

The tax legislation of Cyprus has created a unique environment for holding companies. It has introduced numerous advantages making Cyprus a prime holding location in the international field of holding regimes.

In effect,

- the ability to receive dividends on low or zero withholding tax rate;
- the non-taxation of dividends received under the circumstances mentioned above;
- the non-taxation of profits from the sale of shares;
- the tax free distribution of dividends to its non-resident shareholders; and
• the flexible re-organization rules along with all the other tax considerations and incentives make the Cyprus holding company the key player in the world regime of holding companies and also a valuable vehicle to the international investor for investments within the European Union or outside European Union.