CYPRUS –THE ULTIMATE HOLDING COMPANY JURISDICTION

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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.

This is mainly due to:

- only 12.5% corporation tax on trading profits;
- exemption from tax on the majority of cases on dividend income received from abroad and profit from a foreign permanent establishment ("PE");
- no withholding tax on dividend distribution, interest and royalties to non-tax resident shareholders;
- absence of Controlled Foreign Company (CFC's) and Thin capitalisation rules;
- extensive network of double tax treaties; and
- access to all EU directives.

Dividend Income

Dividends received by Cypriot companies from foreign subsidiaries are wholly exempt from tax in Cyprus provided:

- Less than 50% of the paying company's income is the result of investment activities; or
- The foreign tax burden is not significantly lower than the tax burden in Cyprus (6.25% and less is considered as significantly lower).

Profits from a permanent establishment

Profit of a PE of a Cyprus company is wholly exempt from tax in Cyprus and its losses can be set off against Cyprus income provided:

- Less than 50% of the PE's income is the result of investment activities; or
- The foreign tax burden is not significantly lower than the tax burden in Cyprus (6.25% and less is considered as significantly lower).

Outgoing dividends

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.

Profits from disposal of securities

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.

Absence of Controlled Foreign Company ("CFCs") and thin capitalisation rules

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.

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.

Cyprus Double Tax Treaty Network

Cyprus has signed an extensive number of Double Tax Treaties with more than 50 countries with these Treaties; double taxation is avoided on the same profits in respect of the same person or entity.

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.

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.

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.

Our Firm

CCP Professional Services is a dynamic, fast growing firm of chartered accountants dedicated to providing a wide range of services, such as auditing, accounting, international tax planning, tax and VAT compliance and financial advisory.

Our team of UK and EU-qualified accountants, auditors and tax consultants provides efficient and high quality services and is capable of meeting the current demanding challenges of the local and international business environment.

If you would like to receive further information or to contact us on any relevant matter, please do not hesitate to get in touch with us.

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