

# MILIANA

investments



This document describes some of the key commercial and taxation factors that are relevant on setting up a business in Cyprus.

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# **1. Background**

## **1.1 Why Cyprus?**

Cyprus is a thriving business hub, strategically located between Europe, Middle East, Africa and Asia at the crossroads of global economy.

As a member of the European Union with a modern telecommunications network and tested infrastructure, Cyprus is a gateway to the world of international business.

The last two decades have witnessed Cyprus' gradual transformation into a reputable international business and financial centre.

Its attractiveness as a business and investment location is based on the following additional reasons:

- Democratic country with stable business environment, based on the free market philosophy
- Macroeconomic stability, as indicated by stable prices and currency
- Favourable tax policy, including a wide network of agreements for avoidance of double taxation
- Highly skilled, educated and flexible workforce well acquainted with the use of modern technology. Competitive level of wages and other costs
- Compliance with the European Union Code of Conduct for Business Taxation and with the commitment to the elimination of harmful tax practices according to OECD regulations
- Uncomplicated administrative procedures
- Well developed commercial infrastructure
- Easy access to international markets
- Lowest crime rates in Europe
- Well developed market of professional service
- Competitive banking system

## **1.2 Country overview**

Cyprus is an island located in the north-eastern corner of the Mediterranean Sea covering an area of 9,250 sq Km.

The capital of Cyprus is Nicosia.

Its population is approximately 839 thousand (Dec. 2011) of which 78.6% are Greek Cypriots and the official languages are Greek and Turkish. However English is almost universally used as a second language and is also widely used in business.

Cyprus is an independent and sovereign republic with a presidential system of government. The president serves a five year term and is both the Chief of State and Head of government.

The legislative power lies with the House of Representatives. Its members also serve five year terms.

Its legal system is based on common law, with civil law modifications. The most principles are the same which are applicable in the United Kingdom.

### **1.3 Economic overview**

The global economic crisis had minimum effect in Cyprus where its economy demonstrates a GDP per inhabitant and GDP reduction of -0.5% with inflation rate at 3.9% and a relatively low fiscal deficit.

Cost of living and quality of life compares favourably with other European Countries.

Following Cyprus' accession to the EU, on 1<sup>st</sup> May 2004, the government of the Republic of Cyprus undertook the obligation to join the Economic and Monetary Union and to adopt the euro as soon as the necessary requirements were fulfilled.

Cyprus joined the European Exchange Rate Mechanism II (ERM2) in May 2005. On 1<sup>st</sup> January 2008 Cyprus adopted the Euro which is now the official currency of the country.

The Cyprus workforce is around 400 thousand and the level of unemployment is expected to be at 7.6% (July –Sept. 2011) for the year 2010. The core inflation rate on consumer prices is approximately 2.4% which is lower than the EU average.

The Cyprus taxation system went through a reform to conform to EU entry regulations, and the low rates of corporation tax that applied from 1 January 2003, which are 10% for all companies, have made Cyprus an attractive financial business centre.

### **1.4 Transport infrastructure**

Cyprus is an important shipping centre with two ports in Limassol and Larnaca which are used for both storage of containers and break bulk cargo.

It is also connected with air routes to Europe, America, Asia and Africa.

The island demonstrates excellent telecommunication services giving the opportunity of reaching almost any country in the world with an automatic system.

## **2. Choice of Legal Form**

### **2.1 Limited Liability Company**

The Law in Cyprus governing limited liability companies is the Companies Law, CAP 113, which is based on the companies ACT 1948 of the United Kingdom.

The majority of companies incorporated in Cyprus are limited liability where the liability of the shareholders is limited to the amount unpaid on their shares. Companies must have at least one director and a company secretary. Directors are considered employees of the company and are paid salaries. In some cases directors may be shareholders as well and thus can choose to some extent to be remunerated by salary or by a way of dividend. The constitution of a registered limited company consists of two documents, the Memorandum of Association and the Articles of Association.

In order to establish a company in Cyprus the shareholders must file with the Registrar of Companies the documents listed in Appendix II.

Limited Liability Companies which are public or which prepare consolidated financial statements must file their accounts with the registrar of companies within 12 months of their year end. Also, all Limited Liability Companies have to file the special form "IR4"

which includes information on the financials and tax computations to the Inland Revenue within 12 months from their year end.

Limited Liability Companies will prepare accounts usually for 12 months with a year end at 31 December.

Limited Liability Companies which are public also have to conform to Stock Exchange regulations.

## **2.2 General Partnership**

The definition of a partnership is the relationship between two or more persons carrying on a business in common with a view to profit.

The members of the partnership are jointly and severally liable for all debts and obligations, without limitation.

Partnership profits are shared by the partners as income, and taxation is paid on this income in exactly the same way as a sole proprietor.

## **2.3 Limited Liability Partnership**

A limited partnership consists of one or more partners called general partners who shall be liable for all debts and obligations of the partnership and one or more persons called limited partners, who are not liable for the debts or obligations of the partnership beyond their fixed contribution.

## **2.4 Branch/Representative Office**

The registration formalities of registering a branch are the same as the company registration. Overseas companies may also establish a branch in Cyprus provided that they file with the registrar of companies the documents listed in Appendix II.

## **2.5 Sole Proprietorship**

The owner has unlimited liability for all debts. Cypriots are allowed to carry on business in their name or under a trade name which must be registered as a business name.

All business profits are treated as income of the sole proprietor who then pays income tax according to the applicable rates in force.

Foreign investors are also allowed to carry on the same business if they comply with the relevant exchange control regulations and the immigration law and regulations.

## **2.6 Offshore legal entities**

The Offshore legal entities in Cyprus ceased to exist on 1<sup>st</sup> January 2003. International Business Companies (IBCs) in Cyprus are essentially Cyprus registered entities owned by non-Cypriots and operating outside Cyprus. They are taxed at the same rates as local companies as indicated in Section 4 'Taxation' at the rate of 10% corporation tax.

Establishment of an IBC is made in the same way as a local limited liability company.

## 2.7 **Joint Venture**

Joint ventures can be set up in Cyprus and registered with the registrar of Companies. Their operation and treatment is similar to partnerships.

## 2.8 **Public Limited Company**

Public Limited Companies are limited companies which are listed in the Cyprus Stock Exchange.

In addition to the legislation applicable to limited liability companies, they have to conform to the provisions of the Cyprus Stock Exchange and Cyprus Securities and Exchange Commission regulations.

## 2.9 **Trust/Foundation**

### **The concept of Trust**

The Trust is one of the most important and flexible institutions of English law and finds no parallel in any legal system not influenced by English law. The Cyprus legal system is modelled on the English legal system and the concept of Trust in Cyprus is rooted in the English law.

The legal framework in Cyprus allows also the establishment and operation of International Trusts which are created by non-residents for the benefit of non-residents.

### **The nature of a Trust**

A Trust, or a Settlement as it is often called, is established by an individual "the Settlor" and is a means whereby property "the Trust Property" is held by one or more persons "the Trustees" for the benefit of another or others "the Beneficiaries" or for specified purposes. The Settlor can be a Trustee and the Settlor and the Trustees or any of them can be Beneficiaries. A Settlor cannot be a Trustee and a Beneficiary at the same time.

In law the Trustees are the owners of the Trust Property, although, they may not deal with it as absolute owners, but rather in accordance with the provisions of the law relating to Trusts and the rights of the Beneficiaries as set out in the Trust document. In other words, the Trustees are under a binding obligation to deal with the Trust document. The beneficial owners of the Trust Property are the Beneficiaries.

The Trust Property can include all kinds of assets situated anywhere in the world provided the Trustees have legal control and ownership of the assets according to the law governing the particular Trust.

Trusts can be established:

- by lifetime gift
- on a death pursuant to Will
- by operation of law
- by accident

### **Creation of Trusts**

A Trust may be created by the owner of property during his lifetime by Deed or upon his death by Will. Trusts created by operation of law and by accident are outside the scope of this publication.



No one should enter into a Trust arrangement without first having obtained expert professional advice and ensuring that he understands what he is doing. He should also see that the Trust instrument provides exactly the degree of flexibility or otherwise what he requires.

### **Reasons for making a Trust**

There are many reasons for which the Settlor may wish to create a Trust but some of the principal reasons are:

- to avoid or mitigate taxation liabilities. Trusts have traditionally been a very important tax planning device and even today a very high proportion of tax saving schemes involve Trusts.
- to preserve property in the family, by ensuring that an individual is well provided for, without giving that individual the opportunity of exhausting the family assets because of mismanagement of unsuitable marriage.
- to benefit disabled or mentally handicapped persons by making them Beneficiaries without passing control of the property to them.
- to keep control as Trustee over the enjoyment and ultimate destination, despite giving the assets away.
- to provide flexibility over the identity of the donees and the extent of the interest taken by them in order to take account of future developments.
- to make gifts for charitable and religious purpose to be held by Trustees for such purposes.

## **3. Audit Requirement**

### **3.1 Requirement and Thresholds**

All Limited Liability companies either public or private are required to have a statutory annual audit by a resident approved auditor as the annual Company Income declaration to the Director of Inland Revenue needs to be based on audited accounts in order to be accepted.

As from 1<sup>st</sup> January 2006 a self-employed person whose turnover exceeds the threshold of €70,000 must submit audited financial statements to the Director of Inland Revenue.

### **3.2 Requirement for consolidation**

Recent amendments to the Law have introduced the small size group criteria limiting the requirement of holding companies in Cyprus to prepare consolidated financial statements. The criteria apply for non-public companies only.

### **Amendments**

- 1) Financial statements should now be prepared in accordance with IFRSs as adopted by the European Union and as these are adopted by the European Union in accordance with the provisions of Regulation (EC) No.1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, as this is amended or replaced from time to time.

- 2) Small sized groups shall be exempt from the obligation to prepare consolidated financial statements.

The term “small sized group” shall mean a group of companies, of which the companies that are being consolidated:

- (i) Are non-public companies;
  - (ii) The preparation of their consolidated financial statements is not subject to other legislation; and
  - (iii) Together fulfill two out of the following three criteria at the date of closure of the balance sheet of the holding company:
    - (a) The total assets presented on the balance sheet (without deducting liabilities) does not exceed the amount of EUR 17,500,000;
    - (b) The net turnover does not exceed the amount of EUR 35,000,000;
    - (c) The average number of employees during the financial year does not exceed 250.
- 3) A company need not prepare consolidated financial statements, even if does not qualify as a small group, if it is itself a wholly owned subsidiary, or a subsidiary of a company which prepares consolidated financial statements under IFRS or other Generally Accepted Accounting Principles (GAAPs).

## 4. Taxation

Cyprus tax residents are subject to tax in Cyprus on their worldwide income, whilst non – residents are subject to tax only on their income derived in Cyprus. Non-Resident companies are subject to Cyprus tax only on income derived in Cyprus through a Permanent Establishment.

A resident of Cyprus is the individual who stays in Cyprus for a period or periods exceeding in aggregate 183 days in any one calendar year. A company is resident of Cyprus if is managed and controlled in Cyprus.

A Permanent Establishment is a fixed place of business through which the business of an enterprise is wholly or partly carried on.

The term “Permanent Establishment” includes especially:

- a place of management
- a branch
- an office
- a factory
- a workshop
- a mine, an oil or gas well or any other place of extraction of natural resources.

A building site or construction or installation project or supervisory activities constitute a Permanent Establishment only if they last more than three months. Different provisions may apply according to the Double Tax Treaty signed with the specific country.

### 4.1 **Corporation Tax**

- The taxable profits of all Cypriot companies, including International Business Companies (IBCs)s, will be taxed at the rate of 10%.
- The amount of loss that cannot be **wholly** set off against income from other sources for that year of assessment is carry forward without any time limitation but it must be set off against the first available profits of the following years. No carry back of losses is allowed.

A loss cannot be carry forward if within any three year period there is a change in the ownership of the shares of a company **and** a substantial change in the nature of the business of the company.

- Profits earned from a permanent establishment abroad are fully exempt from corporation tax except if:
  - More than 50% of the paying company's activities result in investment income; and
  - The foreign tax is significantly lower than the tax rate paid in Cyprus.
- Dividend income from Cyprus or from abroad is wholly tax-exempt from Cyprus corporation tax.
- Interest earned from trading activities or closely related with trading activities of the company, constitutes business income subject to 10% corporation tax and not interest.  
Interest on deposit is 100% exempt from corporation tax and is subject to 15% Special Contribution for Defence.
- Profit from the disposal of titles (shares) is wholly tax-exempt from Cyprus corporation tax.
- For the years 2011 and 2012 only, a fixed annual levy of €350 per year is imposed on each company incorporated in Cyprus (not applicable in the year of incorporation) which is paid to the Company House, capped at €20,000 for companies of the same group.

The levy for 2012 is payable by 30 June 2012.

Non payment will result to penalties and deregistration of the company from the Company House whilst dormant companies are exempt from payment of this levy.

#### **4.2 Small Companies Rate**

There is no small companies' rate in Cyprus since as explained above all companies are subject to corporation tax at the rate of 10%

#### **4.3 Dividend payments**

Dividends paid by Cyprus Companies are subject to withholding tax at 17% (the rate is increased to 20% for the period 2012 – 2013) for residents of Cyprus only. This applies for individuals. If the shareholder is a company then no withholding tax is levied. No withholding tax is paid on dividends which are paid to non-residents.

#### **4.4 Income tax on branches**

Branches are taxed under the provisions of the Income tax Law as Permanent Establishment.

#### 4.5 Personal income tax

##### Residents of Cyprus

The resident individuals in Cyprus are taxed by progressive tax rates, which are as follows:

	2012
Income (Euro)	Tax rate
0 – 19,500	0%
19,500 – 28,000	20%
28,000 – 36,300	25%
36,300 – 60,000	30%
Above 60,000	35%

##### Tax incentives to attract highly – paid employees

Employees who take up residency in Cyprus and whose annual remuneration is in excess of €100,000, will enjoy an exception from income tax of 50% of their employment income for a period of 5 years. The exception applies from the year of commencement of the employment and the employment must commence on or after 1 January 2012.

Standard progressive personal tax rates as per table above will apply on the income in excess of the tax free amount.

##### Taxation of retired persons

Pensions, received from abroad are taxed at 5% on income exceeding €3,420 per annum.

#### 4.6 Capital Gains Tax

Capital gains tax is levied at the rate of 20% on gains arising from the disposal of immovable property or the disposal of shares of companies, other than public, which own immovable property situated in Cyprus. In the case of disposal of company shares, the gain is calculated exclusively on the basis of the gain from the immovable property. The value of the immovable property will be its marked value at the time the shares were sold.

There is no taxation on the profits from the disposal of listed securities for all companies and individuals.

#### 4.7 Immovable Property Tax

Immovable property tax is levied on the market value of the property as at 1 January 1980.

The following rates will apply from 1 January 2012:

Value of property as at 1 January 1980 €	Rate ‰
0 – 120,000	0
120,001 – 170,000	4
170,001 – 300,000	5
300,001 – 500,000	6
500,001 – 800,000	7
800,001 and over	8

#### **4.8 Value Added Tax**

VAT is a tax on general consumption. In line with the practise in EU countries it coexists with certain taxes imposed on the consumption of specific products such as petroleum, tobacco, alcoholic beverages etc. The VAT standard rate is currently 17% (15% until 29 February 2012).

From 10 January 2011, changes to VAT rate are applicable for foodstuff, pharmaceutical products, vacancies and supplies in the course of catering.

VAT at the rate of 5% imposed on supplies of foodstuff, medicaments used for health care.

8% VAT is imposed on supplies of alcoholic beverages, beer and wine.

All supplies which take place in Cyprus are subject to VAT at the standard rate but there are also supplies which can be included under one of the following categories:

- subject to VAT at the rate of 8%
- subject to VAT at the rate of 5%
- subject to VAT at the rate of 0%
- exempt

All businesses with an annual turnover of €15,600 must register for VAT.

VAT registered businesses must complete and submit a quarterly VAT return. The return is used to calculate the difference between VAT input and VAT output. The difference is either a credit or a payment to be made. Should a payment be required this must accompany the VAT return.

Failure to submit returns or pay VAT due will result to penalties and interest will be charged on the payable amount.

Provisions also exist in the law for when a company receives certain services from abroad and these services are considered to be provided by the company itself and output tax must be accounted for (reverse charge).

Group VAT registration is available in Cyprus for companies which form a group by having a 50% direct or indirect holding relationship.

#### **4.9 Sales tax**

There is no sales tax imposed under Cyprus legislation.

#### **4.10 Local taxes**

##### **Defence contribution (a specific tax levied on tax residents)**

- As from 1 January 2003 onwards companies, which do not distribute 70% of their profits after tax, as defined by the relevant tax law, within two years after the end of the relevant tax year, will be deemed to have distributed as dividends 70% of these profits. Special contribution for defence at 17% (the rate is increased to 20% for the period 2012 – 2013) will be payable on such deemed dividends to the extent that the shareholders (companies and individuals) are Cyprus tax residents. The amount of deemed distribution is reduced by any actual dividends paid out of the profits of the relevant year during the following two years. This special contribution for defence is payable on behalf of the shareholders.

Companies where their shares are kept by Nominee Company and the beneficial shareholders are non-residents should sign and submit a special letter confirming that.

- Under certain conditions interest income may be subject to defence contribution at the rate of 15%.
- Dividends received from an overseas company:
  - are subject to Special Defence Contribution at 17% (the rate is increased to 20% for the period 2012 – 2013) if the company paying the dividend engages directly or indirectly more than 50% in investing activities **AND** the foreign tax burden is lower than 5%.

#### **4.11 Tax treaties**

The Cyprus Government signed an extensive number of Double Tax Treaties with other countries.

Refer to Appendix I for a table which shows the double taxation agreements between Cyprus and other countries in relation to withholding tax.

#### **4.12 Taxation of Trusts**

An International Trust will enjoy the benefit of total exemption from income, capital gains and estate taxation. The only tax burden that will be imposed on International Trusts is a fixed stamp duty rate of €550 which will be payable on the creation of the Trust.

## **5 Allowances**

### **5.1 Depreciation**

Depreciation is provided on all fixed assets except land in order to write off the value of the asset over its useful economic life.

Depreciation is not an allowable expense for tax computation purposes. However capital allowances are provided using the rates defined by legislation for each category of asset and are tax deductible.

### **5.2 Investment allowance**

Investment allowance has been abolished in Cyprus from 1 January 2003.

### **5.2 Tax credits**

No tax credits are available according to Cyprus tax law.

## **6 Employment**

### **6.1 Social Security/Unemployment taxes**

Contributions to the Social Security are compulsory for both employees and employers as well as for self employed individuals ordinarily residing in Cyprus. The rates of contributions for employees and employers is 6.8% for each party with maximum insurable amount of €53,300 per annum. The rate for self employed persons is 12.6%. Expatriate employees of IBC's are exempt from contributing to this fund.

The employer must make the following contributions based on employee's emoluments:

	%
Social Cohesion Fund	2.0
Redundancy fund	1.2
Industrial training fund	0.5
Holiday fund (if not exempt)	8.0

### **6.2 Employment of foreign personnel**

Short/Long term employment of non-EU personnel by a Cyprus Company or IBC or foreign branch or an individual is possible provided that the proper permit is obtained by the Cyprus Immigration Authorities and the Labour office.

### **6.3 Medical**

There is no defined medical scheme for employees

## **7. Withholding taxes**

### **7.1 Interest**

See Appendix I for withholding tax deducted at source in terms of interest with countries that have tax treaties with Cyprus.

### **7.2 Royalties**

See Appendix I for withholding tax deducted at source in terms of royalties with countries that have tax treaties with Cyprus.

### **7.3 Dividends**

Dividends paid by Cyprus Companies are subject to withholding tax at 17% (the rate is increased to 20% for the period 2012 – 2013) for individual residents of Cyprus only. No withholding tax is paid on dividends which are paid to non-residents.

## APPENDIX I

### Table of withholding tax

In cases where the Cyprus Tax Law is more beneficial such as dividends paid to Non-Residents, it overcomes the Double Tax Agreement.

Received in Cyprus				Paid from Cyprus			
	Dividends	Interest	Royalties		Dividends	Interest	Royalties
Countries with agreement:	%	%	%	Countries with agreement:	%	%	%
Armenia	0	0	0	Armenia	0	0	0
Austria	10	0	0	Austria	10	0	0
Belarus	5/15	5	5	Belarus	5/10/15	5	5
Belgium	10/15	0/10	0	Belgium	10/15	0/10	0
Bulgaria	5/10	0/7	10	Bulgaria	5/10/15	0/7	10
Canada	15	0/15	0/10	Canada	15	0/15	0/10
China	10	10	10	China	10	10	10
Czech Republic	10	0/10	5	Czech Republic	10	0/10	5
Denmark	10/15	0/10	0	Denmark	10/15	0/10	0
Egypt	15	15	10	Egypt	15	15	10
France	10/15	0/10	0	France	10/15	0/10	0/5
Germany	10/15	0/10	0	Germany	10/15	0/10	0/5
Greece	25	10	0/5	Greece	25	10	0/5
Hungary	5/15	0/10	0	Hungary	0	0/10	0
India	10/15	0/10	10/15	India	10/15	0/10	10/15
Ireland	0	0	0/5	Ireland	0	0	0/5
Italy	15	10	0	Italy	0	10	0
Kuwait	10	0/10	0/5	Kuwait	10	0/10	0/5
Kyrgyzstan	0	0	0	Kyrgyzstan	0	0	0
Lebanon	5	5	0	Lebanon	5	5	0
Malta	0	10	10	Malta	15	10	10
Mauritius	0	0	0	Mauritius	0	0	0
Moldova	5/10	5	5	Moldova	5/10	5	5
Norway	0/5	0	0	Norway	0	0	0
Poland	10	0/10	5	Poland	10	0/10	5
Qatar	0	0	5	Qatar	0	0	5
Romania	10	0/10	0/5	Romania	10	0/10	0/5
Russia	5/10	0	0	Russia	5/10	0	0
San Marino	0	0	0	San Marino	0	0	0
Singapore	0	7/10	10	Singapore	0	0/7/10	10
Slovakia	10	0/10	5	Slovakia	10	0/10	0/5
Slovenia	10	10	10	Slovenia	10	10	10
Seychelles	0	0	5	Seychelles	0	0	5
Serbia-Montenegro	0	0	0	Serbia-Montenegro	0	0	0
South Africa	0	0	0	South Africa	0	0	0
Sweden	5/15	0/10	0	Sweden	5/15	0/10	0
Syria	0/15	0/10	10	Syria	0/15	10	10
Tajikistan	0	0	0	Tajikistan	0	0	0
Thailand	10	10/15	5/10/15	Thailand	10	10/15	5/10
Ukraine	0	0	0	Ukraine	0	0	0
United Arab Emirates From 01/01/2012	0	0	0	United Arab Emirates	0	0	0
United Kingdom	15	10	0/5	United Kingdom	0	10	0/5
USA	5/15	0/10	0	USA	0	0/10	0
Uzbekistan	0	0	0	Uzbekistan	0	0	0
Yugoslavia	10	10	10	Yugoslavia	10	10	10



## APPENDIX II

### Information required for incorporation

Documents to be filed with the application to the Registrar of Companies in order to establish a company/branch in Cyprus.

1. Company name (3 choices)
2. Full names of shareholders  
Address  
Profession
3. Bank references
4. Share Capital
5. Nominee shareholders
6. Name of Directors
7. Nominee directors
8. Secretary
9. Register office
10. Objects of new company
11. Bank signatories
12. Letter heading
13. Shareholding

#### Note 1

After application described above is accepted, the following documents must be filed with the Registrar of Companies:

- (i) copies of the memorandum and articles of association (in Greek and English).
- (ii) statutory declaration of compliance with the Companies Law signed by a registered practicing advocate.
- (iii) the names of the first directors and secretary.
- (iv) the intended address of the registered office of the company (which must be in Cyprus).

Once the registration is completed and the relevant statutory fees are paid the Registrar will issue - in English if you so prefer - certificates of incorporation, directors, secretary and registered office. Registration renders the company a separate legal entity distinct from its members. The whole procedure may be completed in a matter of days after all the necessary documents and information is received.



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