



Commodum Limited
Domopol 40, 1 Georgiou Anastasiou
2nd Floor, Flat 201, 2008, Strovolos
Nicosia, Cyprus

D: +357 22 252747
F: +357 22 252772
info@commodumaudit.com
www.commodumaudit.com

Introduction

During the past thirty years Cyprus has developed into a formidable financial centre, renowned for its high quality services.

The local tax system is a key reason for this development. Cyprus is well known for its simplified tax system that provides numerous advantages to international investors.

Below you may find a detailed analysis of the three most popular types of international Businesses, operating through Cyprus, financing, holding and trading companies.

Financing companies

Back to back loans

Please note that the Institute of Certified Public Accountants of Cyprus (ICPAC) has agreed with the Commissioner of Income Tax that the below spreads would apply in the case of back to back loans.

Loan amount	Spread to be earned
Up to €50m	0,35%
Between €50m- €200m	0,25%
Above €200m	0,125%

It should be noted that the above spreads relate only to back to back loans when the Cyprus Company acts as an intermediary which obtains loan(s) from a related company and provides loan(s) to another related company.

Such loans should not be subject to any risks in order to justify the low spreads.

Subsequently, the Cyprus Company would not be able to claim as tax deductible any amounts which cannot be collected.

The time period between obtaining and granting the loan should not be more than 6 months.

The above spreads should result after taking into account any expenses. Any foreign exchange differences arising from such back to back loan arrangements will not be taxable/tax deductible.

In order for the above to apply, the Cyprus Financing Company should be in a position to prove that the funds granted as a loan to its related party were obtained as a loan from another related party. This could be done for example through the movement in the company's bank statements and the relevant loan agreements.

Other loans

In relation to provision of financing facilities to any party, related or non-related, other than back to back loan(s) arrangement, a "market interest rate" should be charged on the loan facilities.

There are no provisions in the tax legislation or any tax guidance or circular by reference to what constitutes a "market interest rate". It could be said that currently in practice the Tax Authorities generally consider as an arm's length interest rate the rate of 5- 6%, although different factors should also be taken into consideration in order to determine the arm's length rate (e.g. currency, economic risks of the jurisdiction of the borrower).



Holding companies

As per the Cypriot tax legislation any gain/ (loss) arising from the disposal of "titles" is exempt / (not allowable) for income tax purposes. Taking this opportunity please find attached a list of "titles" as per a circular issued by the CTAs.

- Ordinary shares
- Founder's shares
- Preference shares
- Options on titles
- Debentures
- Bonds
- Short positions on titles
- Futures/forwards on titles
- Swaps on titles
- Depository receipts on titles (ADRs and GDRs)
- Rights of claims on bonds and debentures (interest)
- Income is excluded and taxed under normal rate)
- Index participations only if they represent titles
- Repurchase agreements or Repos on titles
- Participations in companies
- Units in open-end or closed-end collective investment schemes

Any profit from the disposal of the abovementioned products is not taxable (it is deducted from the company's income) when determining the tax charge of a Cyprus resident Company. On the other hand, any loss deriving from the trade of the such instruments is also not tax allowable (it is added back to income, thus eliminating the effect of such loss).

Dividend income from participations in companies

Dividends received from abroad are tax exempt unless both of the following conditions are not satisfied.

- The company paying the dividend must not engage directly or indirectly more than 50% in investing activities, and
- The foreign tax burden on the income of the company paying the dividend is not substantially lower than the tax burden in Cyprus (the lowest acceptable rate is considered to be 5%, even though CTA has not provided this in writing in the form of circular or guidance).

If both conditions fail then the company is taxed under Special Contribution for Defence (SCD) at 20% for the years 2012 and 2013 and 17% from 2014 and onwards.

Trading companies

Cyprus Tax Authorities(CTAs) are expecting that a Cyprus tax resident company will be selling goods and/or services at a reasonable gross profit margin resulting to reasonable net taxable margin after accounting for administration expenses.

Trading companies are taxed under the normal rate of 12.5%. All expenses that are wholly and exclusive for the generation of taxable income are allowable for tax purposes. All other expenses (which relate to non-business assets or activities are not allowable and are restricted during the computation of the taxable income(please see "disallowable expenses " section below).

There are no "safe harbor" regulations regarding net profit margin to be generated for trading companies. In practice though the CTAs accept a reasonable margin between 5% to 10% for companies with trading activities, of the gross annual income after the administrative expenses are deducted there from. The actual percentage margin should also be a function of the absolute amount of the annual income. The higher the amount of annual income the lower the acceptable net profit margin could be in percentage terms. Furthermore the net profit margin should be a function of the actual financial and operating risks undertaken by the company.



In addition to the above the arm's length provision of the Cyprus tax legislation should be considered which requires transactions between related parties to be conducted at an arm's length basis.

Arm's length transactions

According to the Cyprus tax legislation, article 33 of the Income Tax Law, transactions between related parties must be carried out on an arm's length basis. This means that they should be carried out at no different terms to those applied in transactions between unrelated parties.

In case the Cyprus Tax Authorities (CTAs) consider that transactions between related parties are carried out on a non-arm's length basis, they could adjust the tax base of the company accordingly.

Restriction of disallowable expenses

As discussed above expenses that are not wholly and exclusively for the purpose of trade are not allowable when determining the Cyprus chargeable income.

Example: The servicing cost of a loan used for the purchase of any asset following under "titles", in which case the restriction of interest should be calculated using the weighted average cost of borrowings and the cost of "non-business assets" or in case where it can be proved that the investment has been financed out from a specific loan, the interest rate of that specific loan could be accepted.

According to the Cyprus tax legislation and to the circular 2010/8 issued by the Cyprus Tax Authorities, interest expense relating or deemed to relate to the cost of acquisition of "non-business assets" (assets that do not generate taxable income) should not be allowed as tax deductible for income tax purposes.

In addition the circular 2008/14 states that expenses which relate directly or indirectly to exempt income and portion of the overheads expenses should not be treated as tax deductible expenses for income tax purposes.

The same circular further clarifies that overhead expenses can be apportioned to taxable and exempt income according to the proportion of cost of the assets used for the production of taxable and exempt income.

Therefore, administration expenses apportioned to assets or activities that result to the production of income which is exempt from Cyprus income tax (i.e. dividend income, profits from the disposal of titles etc) are not treated as tax deductible expenses for income tax purposes.

Foreign exchange differences

Foreign exchange (FX) differences recorded through the profit and loss should be as follows:

- (i) realised and unrealised FX gains/(losses) of a capital nature are treated as exempt/(non deductible)
- (ii) realised FX gains/(losses) of a revenue nature are treated as taxable/(tax deductible)
- (iii) in the case of unrealised FX gains/(losses) of a revenue nature, a company can opt either:
 - (a) to treat such FX gains/(losses) as taxable/(tax deductible) as they accrue, or
 - (b) to treat such FX gains/(losses) as exempt/(non deductible) as they accrue until realization (i.e. upon settlement)

Once a company opts for one of the two methods (a) or (b) mentioned above, it should be followed consistently in all years.

Non-resident companies with local presence

Companies that are non-residents in Cyprus are only taxed for their profits generated in the Republic.



Commodum Limited
Domopol 40, 1 Georgiou Anastasiou
2nd Floor, Flat 201, 2008, Strovolos
Nicosia, Cyprus

D: +357 22 252747
F: +357 22 252772
info@commodumaudit.com
www.commodumaudit.com

Losses

According to the circular 2013/08 taxable losses are carried forward for five years. Any unitized losses of more than five years, are lost.

Disclaimer

The purpose of this memo is to provide a general understanding as for the tax treatment of each type of IBC. The information stated in the memo should not be used for making business decisions without prior consultation of a Cyprus tax advisor. Such an advisor could provide you with a proper tax planning and can inform you as for the remote, possible and probable tax risks of each venture, something that relates to the specific characteristics of each company.

In case you need more information or clarifications please contact us at info@commodumaudit.com or at + 357 22 252747.