

THE CYPRUS HOLDING COMPANY
A serious contender to holding company jurisdictions



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The tax law of Cyprus, as reformed, is probably the most modern, effective and simple tax system in the EU and in addition, it conforms to the EU and OECD regulations.

Opportunities to reduce the burden of income tax are numerous, for individuals as well as for domestic and international businesses. The full acceptance by Cyprus of the European Union Code of Conduct and the Campaign against Harmful Tax Competition has added a lot to the reputation of Cyprus, as having a very competitive but internationally respected tax legislation.

Cyprus is a long established and reputable international financial centre. It has gained this enviable position through its attractive tax system, transparent legal system, worldclass professional and banking services and superior global telecommunications capabilities. Cyprus's accession to the EU on 1 May 2004 has come to add to the country's impressive advantages. Cyprus has also adopted the Euro as its official currency as from 1st of January 2008.

This has created excellent opportunities for tax professionals to establish Cyprus as a major financial centre within the European Union, developing Cyprus from an alleged tax haven country into a Country that has a modern and competitive tax environment.



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Tax considerations may not be the decisive factor in choosing to set up a holding company in a particular jurisdiction. There are instances where the non-tax considerations may outweigh the tax considerations of an international group in choosing the location of its holding company.

Some non-tax considerations may include among others:

- Company law requirements
- Political stability and stable economic infrastructure
- Availability of human resources
- Telecommunication capabilities
- Set-up and other administration costs
- Spoken language and time zone

This publication aims to discuss only the major tax considerations that an international group should take into account in choosing the location of its holding company.



The major tax considerations that a multinational group should take into account in choosing a suitable holding company jurisdiction should include the following:

- Tax treatment of capital gains
- Tax treatment of outward dividends
- Tax treatment of inward dividends
- Double taxation treaties
- Tax on liquidation
- Other significant provisions
 - Controlled Foreign Companies
 - Thin capitalisation
 - Group loss relief
 - Capital duty
 - Stamp duty
 - Parent Subsidiary Directive
 - Reorganisation rules
 - Pre-transaction rulings

In the following sections, we will consider each of the above tax considerations in detail, relative to locating a holding company in Cyprus.



Cypriot tax rules provide full exemption from local taxation on the realisation of capital gains from the disposal of 'securities', irrespective of whether the gain is considered to be of a capital or of a revenue nature.

There is no requirement for any minimum holding period or minimum % holding.

Securities, as defined in the law, include shares, debentures, government bonds, founder's shares or other securities of companies or other legal persons which have been incorporated in Cyprus or abroad and options thereon.

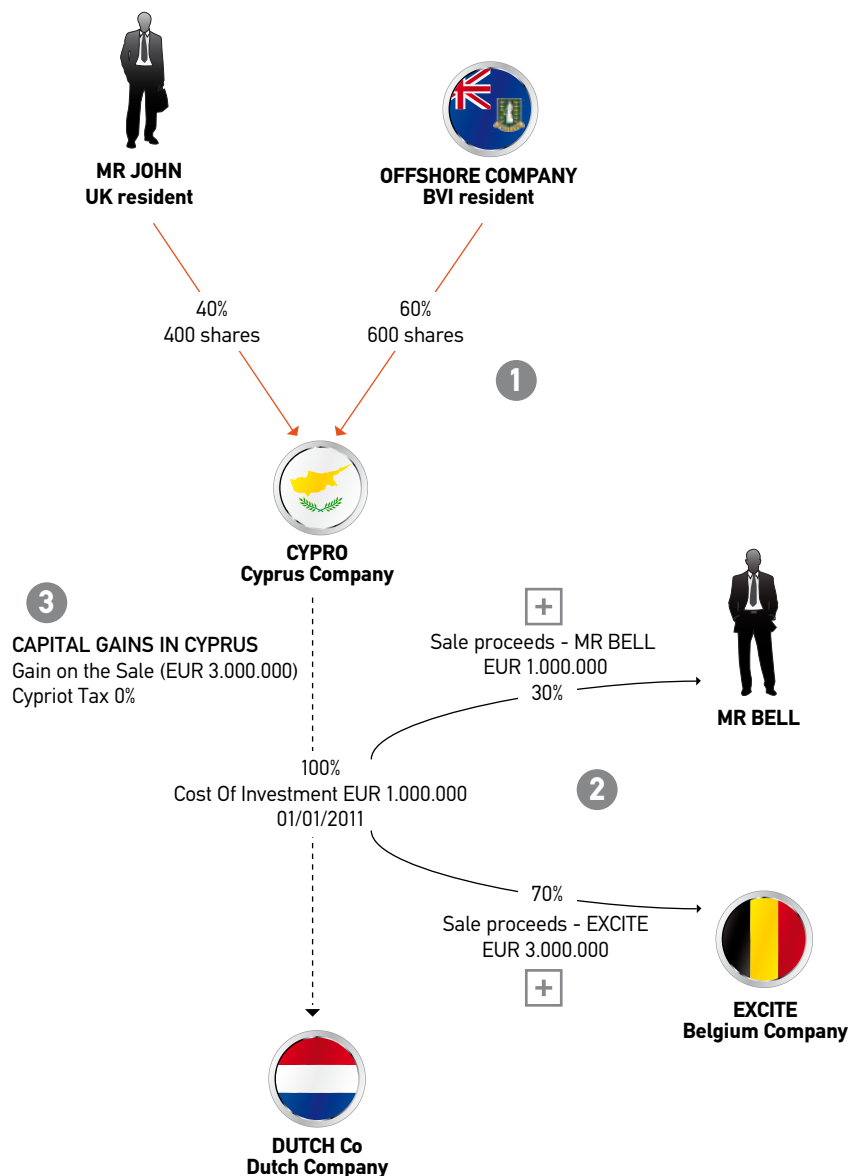
A circular has been issued by the Cypriot tax authorities in 2008 further clarifying what is included in the term Securities. According to the circular the term includes, among others, options/short positions/futures/forwards on Securities, swaps on Securities, depositary receipts on Securities (ADRs, GDRs), rights of claim on bonds and debentures (rights on interest of these instruments are not included), index participations only if they relate to Securities, repurchase agreements or Repos on Securities, units in open-end or closed-end collective investment schemes).

The circular also clarifies specific types of participation in foreign entities which are considered as Securities. In cases where it is not certain whether a specific financial instrument falls under any of the categories included in the circular, a request for a ruling may be submitted to the Commissioner of Income Tax.

Flowchart 1, gives a diagrammatical example showing the tax treatment on the realisation of capital gains from the disposal of a subsidiary.

FLOWCHART 1:

SALE OF A SUBSIDIARY COMPANY



- A Cypriot holding company is an ordinary company that besides holding shares in other companies may be engaged in other activities such as trading, manufacturing, financing etc.
 - There are no legal requirements as to the minimum or maximum share capital of the Company. Furthermore the currency of the share capital can be in all major known currencies. Lastly, not all of the authorized share capital needs to be subscribed for, but at least one share as a minimum should be issued.
 - The legislation allows the payment of shares to be made in monetary means and in kind, including transferring shares of other companies.
- 1 The Cyprus Company purchased 100% of the Share capital of a Dutch Company for Euro1.000.000 on 1/1/2011.
 - 2 On 31/12/2011 the Cyprus Company sold 30% of the shares in the Dutch company to Mr. Bell, a Swedish resident individual, for Euro1.000.000 and 70% of the shares in the Dutch company to Excite Ltd, a Belgium resident company, for Euro3.000.000.
 - 3 Cypriot tax rules provide full exemption from local taxation on the realisation of capital gains from the sale of shares in subsidiaries. There is no requirement for any minimum holding period or minimum investment %. The exemption applies irrespective of the jurisdiction of incorporation of the subsidiary company.

- Outward dividends paid by the Cypriot holding company to its ultimate parent company do not suffer any withholding tax in Cyprus.
- The exemption applies to dividend payments made to both resident and non-resident companies, irrespective of the country of residency of the parent company, whether it is resident in a EU country or not.
- Outward dividends paid by the Cypriot holding company to individuals non-resident in Cyprus do not suffer any withholding tax in Cyprus.
- Outward dividends paid by the Cypriot holding company to individuals resident in Cyprus, do suffer a 20% special defence tax at source.

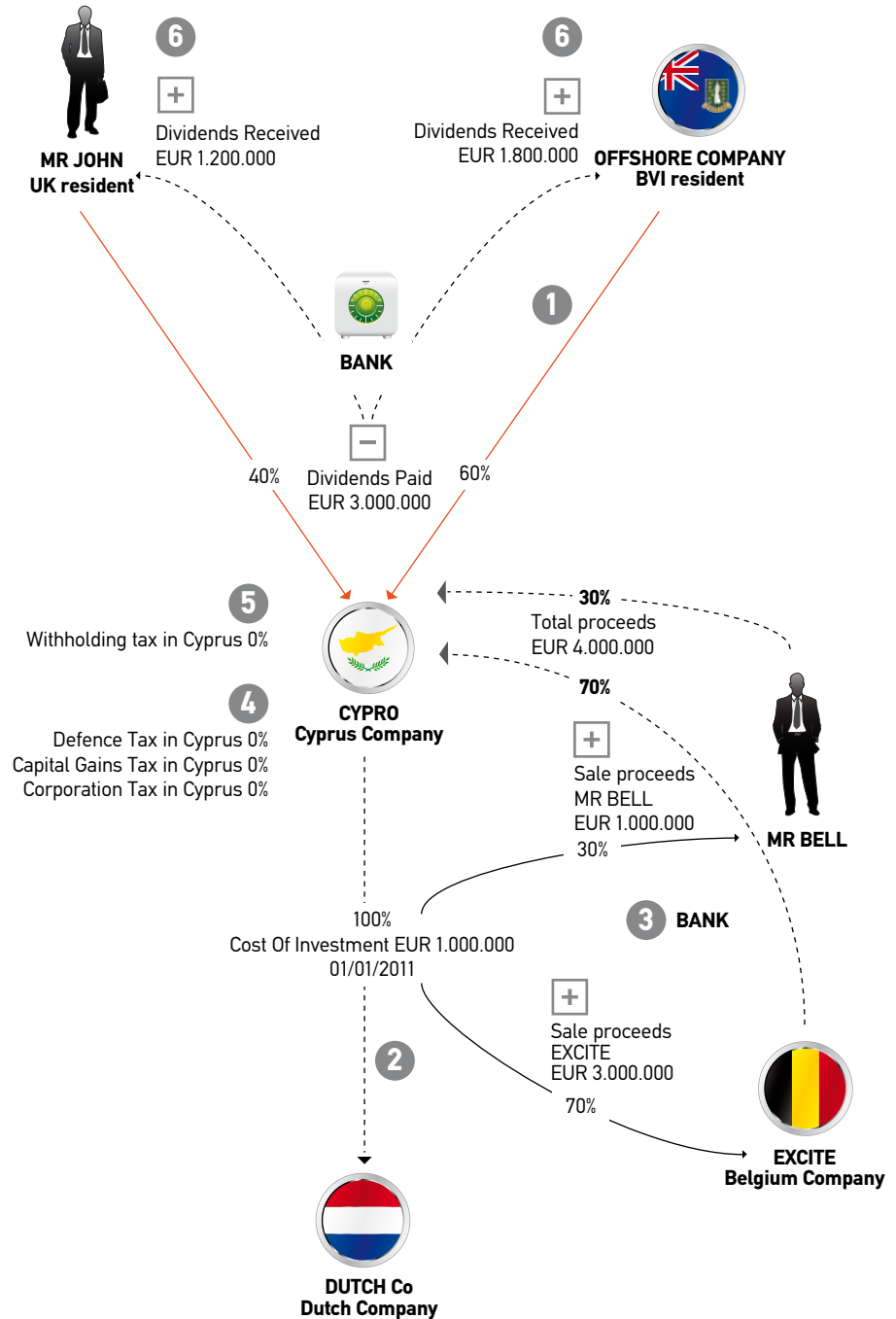
Flowchart 2, gives a diagrammatical example showing the tax treatment of outward dividends.



FLOWCHART 2:

WITHHOLDING TAX ON OUTGOING DIVIDENDS

- 1 On 1/1/2011 the Cyprus company issued 400 shares to Mr John for EUR400.000 and 600 shares to Offshore Company for EUR600.000.
- 2 On the same date Cypro purchased 100% of the share capital of DutchCo for EUR1.000.000.
- 3 On 31/12/2011 the Cyprus company sold 30% of the shares in DutchCo to Mr Bell, a Swedish resident individual, for EUR1.000.000 and 70% of the shares in the DutchCo to Excite Ltd, a Belgium resident company, for EUR3.000.000.
- 4 Cypriot tax rules provide full exemption from local taxation on the realisation of capital gains from the sale of shares in subsidiaries. There is no requirement for any minimum holding period or minimum investment.
- 5 The Cyprus company distributes in the form of dividends, the whole profit of Euro3.000.000 from the realisation of the investment in DutchCo.
- 6 Mr John will receive EUR1.200.000 and the Offshore Company will receive EUR1.800.000, both receipts without any deduction of withholding tax in the Cyprus company.



Cyprus provides full exemption from local taxation in respect of dividends received by a Cyprus holding company from its local subsidiaries. This exemption is given regardless of the holding period of the shareholding and without any minimum % holding requirements.

Cyprus provides full exemption (subject to certain conditions) from local taxation in respect of dividends received by a Cyprus holding company from its non-resident subsidiaries.

This exemption is given regardless of the holding period of the shareholding and without any minimum % holding requirements.

The exemption will not be granted only if **both** of the conditions below are satisfied:

- If the company paying the dividend engages directly or indirectly more than fifty per cent (50%) in activities which lead to investment income*; AND
- The foreign tax burden** on the income of the company paying the dividend is substantially lower than the tax burden in Cyprus.

* Investment income means any income which is not derived or arising from any business, employment, pensions or annuities which are paid by reason or in connection with a past employment. Dividends and interest can be considered as investment income.

** Foreign tax burden substantially lower. Generally accepted by the tax authorities in Cyprus that substantially lower means lower than 5%.

When dividend income is not exempt there is a 20% defence tax contribution. However, Cyprus Income Tax Law provides relief from double taxation in relation to tax imposed by the laws of another country.

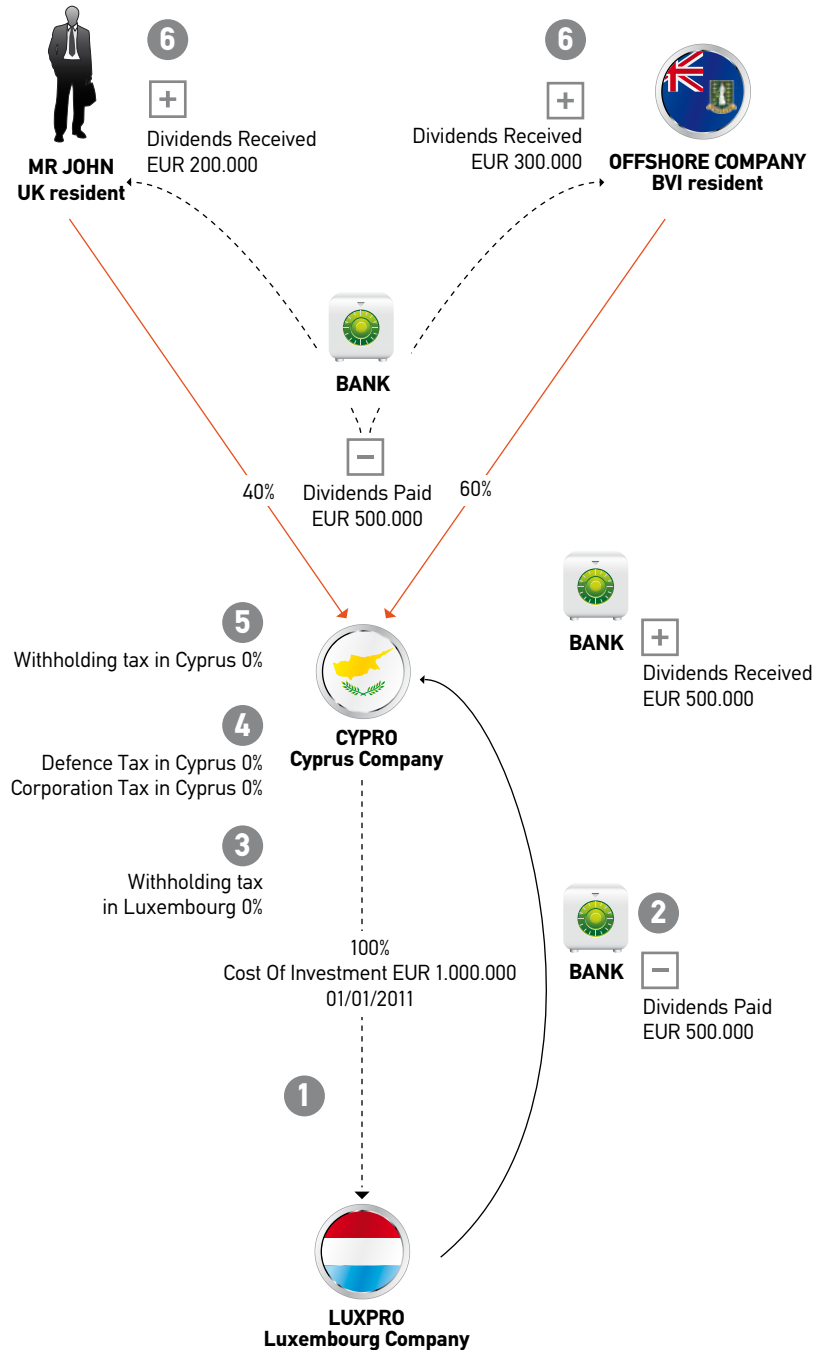
Flowcharts 3&4. give two diagrammatical examples showing the tax treatment of inward and outward dividends when the subsidiary is located in Europe and when the subsidiary is located outside Europe .

FLOWCHART 3:

TAX TREATMENT OF IN-BOUND DIVIDENDS FROM A EU RESIDENT SUBSIDIARY

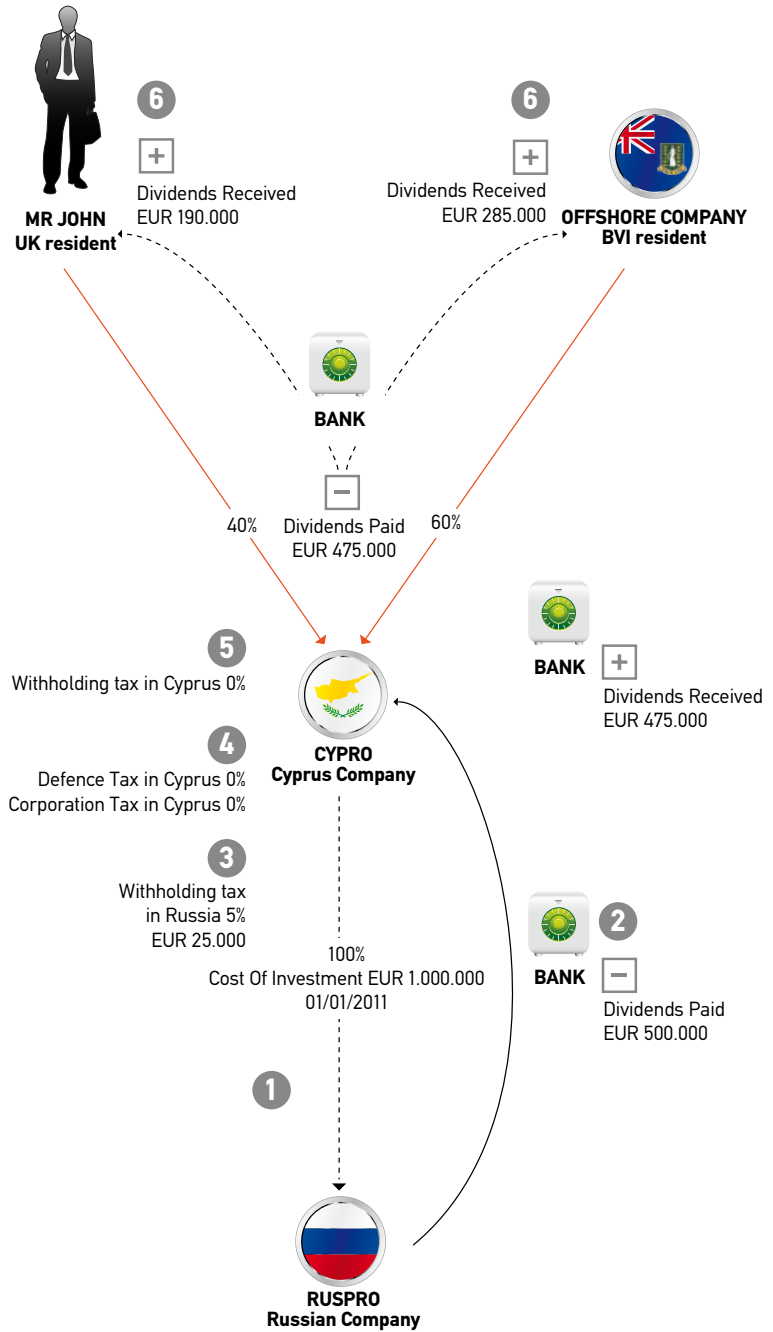
- 1 The Cyprus company purchased 100% of the Share capital of a Luxembourg Company for EUR1.000.000 on 1/1/2011.
- 2 On 1/1/2012 Luxpro declared a dividend payment of EUR500.000
- 3 The dividends are not subject to withholding tax in Luxembourg if the following conditions are fulfilled:
 - Direct and continuous shareholding of at least 10% in the Capital of Luxpro or with an acquisition price of at least EUR1.2m, for a period of at least 12 months.
 - The recipient of the dividends is a company listed in Article 2 of the EU Parent Subsidiary Directive.
 - Luxpro is a fully taxable company which is a resident of Luxembourg.

It is clear that all the above conditions are met and as a result there is no withholding tax on dividends paid to Cypro in Luxembourg. Dividends received in Cyprus EUR500.000.
- 4 Cypriot tax rules provide full exemption from local taxation in respect of dividends received from its foreign subsidiaries.
- 5 The Cyprus company distributes in the form of dividends, the whole proceeds. No withholding tax as recipients are non Cyprus tax residents.
- 6 Mr John will receive EUR200.000 and Offshore Company will receive EUR300.000, both receipts without any deduction of withholding tax in the Cyprus company.





FLOWCHART 4:
**TAX TREATMENT OF IN-BOUND DIVIDENDS
 FROM A NON-EU RESIDENT SUBSIDIARY**



Cyprus has an extensive double tax treaty network. In most of the cases, incoming dividends received by a Cyprus holding company from its foreign subsidiary are either exempt from, or subject to reduced withholding taxes in the subsidiary's jurisdiction.

Flowchart 5, shows the list of double tax treaties that Cyprus has enacted with third countries, as well as the corresponding rates of withholding tax. The main purpose of these treaties is the avoidance of double taxation of income earned in any of these countries. Under these agreements, a credit is usually allowed against the tax levied by the country in which the tax payer resides, for taxes levied in the other treaty country, and as a result the tax payer pays no more than the higher of the two rates.

CYPRUS DOUBLE TAX TREATIES - PAID FROM CYPRUS

Dividends

Outward dividends paid by a Cypriot Company to non-tax residents of Cyprus, do not suffer any withholding tax in Cyprus.

Interest

Interest payments by a Cypriot Company to non-tax residents of Cyprus, are made gross, without any tax deducted.

Royalties

No withholding tax is levied on royalties as long as the right is used outside Cyprus.

RECEIVED IN CYPRUS	DIVIDENDS	INTEREST	ROYALTIES
NON-TREATY COUNTRIES	0	0	0

TREATY COUNTRIES

RECEIVED IN CYPRUS	DIVIDENDS	INTEREST	ROYALTIES
Mauritius	0	0	0
Moldova	5 ⁽¹⁹⁾	5	5
Montenegro ⁽²⁸⁾	10	10	10
Norway	5 ⁽³⁾	0	0
Poland	10	10 ⁽⁸⁾	5
Qatar	0	0	5
Romania	10	10 ⁽⁸⁾	5 ⁽¹⁴⁾
Russia	5 ⁽⁶⁾	0	0
San Marino	0	0	0
Serbia ⁽²⁸⁾	10	10	10
Seychelles	0	0	5
Singapore	0	10 ⁽²³⁾	10
Slovakia ⁽²⁹⁾	10	10 ⁽⁸⁾	5 ⁽¹⁴⁾
Slovenia	5	5 ⁽³³⁾	5
South Africa	0	0	0
Sweden	5 ⁽¹⁾	10 ⁽⁸⁾	0
Syria	0 ⁽¹⁾	10 ⁽⁸⁾	15 ⁽¹³⁾
Tajikistan ⁽²⁷⁾	0	0	0
Thailand	10	15 ⁽¹⁷⁾	5 ⁽¹⁸⁾
Ukraine ⁽²⁷⁾	0	0	0
United Arab Emirates ⁽³⁵⁾	0	0	0
United Kingdom	0 ⁽²⁴⁾	10	0 ⁽²⁶⁾
United States	15 ⁽⁵⁾	10 ⁽¹⁰⁾	0
Uzbekistan ⁽²⁷⁾	0	0	0

Armenia	0 ⁽³²⁾	5 ⁽³³⁾	5
Austria	10	0	0
Belarus	5 ⁽⁴⁾	5	5
Belgium	10 ⁽¹⁾	10 ⁽¹⁶⁾	0
Bulgaria	5 ⁽¹⁹⁾	7 ⁽²⁵⁾	10 ⁽²⁰⁾
Canada	15	15 ⁽⁷⁾	10 ⁽¹¹⁾
China	10	10	10
Czech Republic ⁽²⁶⁾	0 ⁽³⁰⁾	0	10
Denmark	0 ⁽³⁴⁾	0	0
Egypt	15	15	10
France	10 ⁽²⁾	10 ⁽⁹⁾	0 ⁽²⁶⁾
Germany ⁽³¹⁾	10 ⁽¹⁾	10 ⁽⁸⁾	0 ⁽²⁶⁾
Greece	25 ⁽²¹⁾	10	0 ⁽¹²⁾
Hungary	5 ⁽¹⁾	10 ⁽⁸⁾	0
India	10 ⁽²⁾	10 ⁽⁸⁾	15 ⁽¹⁵⁾
Ireland	0	0	0 ⁽¹²⁾
Italy	15	10	0
Kuwait ⁽³¹⁾	10	10 ⁽⁸⁾	5 ⁽¹⁴⁾
Kyrgyzstan ⁽²⁷⁾	0	0	0
Lebanon	5	5 ⁽¹⁶⁾	0
Malta	0 ⁽²²⁾	10 ⁽⁸⁾	10

NOTES:

1. 15% if received by a company controlling less than 25% of the voting power.
2. 15% if received by a company controlling less than 10% of the voting power.
3. NIL if paid to a company controlling at least 50% of the voting power.
4. This rate applies if the amount invested by the beneficial owner is over €200,000 irrespective of the % of voting power acquired. 10% is imposed if received by a holder of at least 25% of the share capital of the paying company. Otherwise the rate is 15%.
5. 5% if received by a company controlling at least 10% of the voting power.
6. 10% if received by company, which has invested less than \$100,000. (A Protocol to the existing treaty was signed on 7 October 2010. Formal ratification, happened beginning of 2012 and thus the Protocol will become effective in 2013. The Protocol provides for a change in the amount invested from \$100,000 to €100,000).
7. NIL if paid to the Government or for export guarantee.
8. NIL if paid to the Government of the other State or to a financial institution.
9. NIL if paid to the Government of the other State or in connection with the sale on credit of any industrial, commercial or scientific equipment or any merchandise by one enterprise to another or in relation to any form of loan granted by a bank or is guaranteed from government or other governmental organisation.
10. NIL if paid to the Government of the other State, to a bank or a financial institution or in respect to debt obligations arising in connection with sale of property or the provision of services.
11. NIL on literary, dramatic, musical or artistic work with the exception of films used for television programs.
12. 5% on film royalties (except films shown on TV).
13. 10% on literary, dramatic, musical, artistic work, films and TV royalties.
14. NIL on literary, artistic or scientific work including films.
15. 10% on payment of technical fees, management fees and consultancy fees.
16. NIL if paid to the Government of the other State, a political subdivision or a local authority, the National Bank or any institution the capital of which is wholly owned by the State or a political subdivision or a local authority or in the form of interest income from bank deposits.
17. 10% on interest received by financial institutions, on interest paid in connection with industrial, commercial, scientific equipment or the sale of merchandise between two companies.
18. 10% on right to use industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience and 15% for patents, trademarks, designs, models, plans, secret formulas or processes.
19. This rate is applicable if received by a company owning directly at least 25% of the capital. In all other cases the withholding tax is 10%.
20. This rate does not apply, where 25% or more of the capital of the Cypriot resident is owned directly or indirectly by the Bulgarian resident paying the royalties and the Cyprus company pays less than the normal rate of tax.
21. The treaty provides for 25%, but the domestic rate of NIL applies since it is lower than the treaty rate.
22. The treaty provides that the tax on the gross amount of the dividends shall not exceed that chargeable on the profits out of which the dividends are paid.
23. 7% if paid to a bank or similar financial institution. NIL if paid to the government.
24. The treaty provides for 15% withholding tax but the local taxation provides for 0% withholding tax.
25. NIL if paid to or is guaranteed by the Government, statutory body, the Central Bank.
26. 5% on film royalties, including films used for television programs.
27. The treaty between the Republic of Cyprus and the United Soviet Socialist Republic still applies.
28. The treaty between the Republic of Cyprus and the Socialist Federal Republic of Yugoslavia still applies.
29. The treaty between the Republic of Cyprus and the Czechoslovak Socialist Republic still applies.
30. Nil if the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends where such holding is being possessed for an uninterrupted period of no less than one year. 5% in all other cases.
31. The new treaty which provides for changes in the above rates has been published in the Government Gazette but has not come into force until the time of publication of this booklet.
32. 5% if the beneficial owner has invested in the capital of the company less than the equivalent of €150,000 at the time of the investment.
33. Nil if paid to the Government or to the local authority, or to the Central Bank.
34. Nil if the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends, where such holding is being possessed for an uninterrupted period of no less than 12 months. Nil if the beneficial owner is the other Contracting State or the Central Bank of that other State, or any national agency or any other agency (including a financial institution) owned or controlled by the Government of that other State. Nil if the beneficial owner is a pension fund or other similar institution providing pension schemes in which individuals may participate in order to secure retirement benefits, where such pension fund or other similar institution is established, recognized for tax purposes and controlled in accordance with the laws of that other State. 15% in all other cases.
35. The treaty has been published in the Government Gazette but has not come into force until the time of publication of this booklet.

NON-RESIDENT SHAREHOLDERS

In case of the liquidation of a Cyprus resident company, irrespective of the method of liquidation, there are no taxes to be paid on the distribution of assets to non-resident shareholders, whether this is in the form of dividends, proceeds from liquidation etc. There is one exemption to the above rule. If the Cyprus holding company owns immovable property situated in Cyprus then the disposal of the Cyprus situated property can result in Capital Gains Tax.

RESIDENT SHAREHOLDERS

If a Cyprus holding company is liquidated, the total of the profits of the last five years before the liquidation which have not been distributed, or have not been deemed to have been distributed, shall be deemed on liquidation to be distributed and the shareholders shall be deemed to receive such dividends. This deemed distribution is subject to 20% special defence contribution. This provision does not apply in the case of liquidation of a company for the purposes of reorganisation.



CONTROLLED FOREIGN COMPANIES (CFC) RULES

- Countries such as Germany, UK, France, Denmark have CFC legislation. Under their CFC rules, income and sometimes capital gains of a subsidiary or sub-subsidiary company may be appropriated to the parent company.
- Cyprus does not have in its legislation CFC rules as strict as those in the above countries. As a result, no income is appropriated to the parent company even if the income arises in a tax haven company.

THIN CAPITALISATION

- Most of the European countries, with some exceptions (such as Austria and Ireland), have thin capitalisation rules, such as rules imposing minimum debt to equity ratio requirements. Under these rules, if a company is thinly capitalised, part of the interest deduction may be disallowed and treated as a dividend distribution.
- Cyprus tax legislation does not contain thin capitalisation provisions.
- There is however an indirect debt to equity restriction. Under normal circumstances, if a Cyprus company pays interest in order to finance its trading activities, such interest is a tax deductible expense. However, if a Cyprus holding company borrows money from a bank at an interest rate of 10%, but advances the money to its subsidiary free of any interest, then this interest payable will not be a tax deductible expense, as it was not incurred for the purpose of the production of income.

LOSS RELIEF

When a loss is not wholly set-off against income from other sources in the same year, it can be carried forward and set-off against future profits of the company. The loss is automatically set-off against the first available profits of the company. There is no time limit for claiming loss relief. Losses can only be carried forward. No carry-back of losses is allowed.



This provision is applicable for all losses incurred from the 1997 tax year and onwards. In case there is any change in the ownership of the shares of a company and a substantial change in the nature of the business of the company, within any three-year period from the year of the loss, then the loss cannot be carried forward to the following years.

Group Loss Relief

Two companies shall be deemed to be members of a group for loss relief purposes if:

- a) One is by 75% a subsidiary of the other, OR
- b) Each one separately is a 75% subsidiary of a third company

The 75% refers to 75% of the

- Voting ordinary shares
- Profits available for distribution
- Assets that would have been available to members on a winding up

Any company member of the group may surrender its current year loss to any other member company of the group. The loss is set off against the total chargeable income of the claimant company for its corresponding year of assessment. Both the company surrendering the loss, as well as the company claiming the loss, should be members of the same group for the whole year of assessment. There is no requirement on the company surrendering the loss to relieve its loss against its own profits first. Group relief applies between Cyprus resident companies and not with nonresident members of the group.

CAPITAL DUTY

According to the Cyprus Companies Act Law, every Cyprus incorporated company must pay capital duty on incorporation equal to CYP60 plus 0,6% on the authorised share capital, or on any subsequent increase in the authorised share capital. As there is no capital duty payable on share premium, a company can arrange its capital structure in such a way as to have small authorised capital and issue the shares above their nominal value, at a premium.

STAMP DUTY

Stamp duty in Cyprus is dealt with by the Stamp Duty Law 1963 as amended. Section 4 of the law, states that every document listed in the first schedule to the law needs to be stamped, if it concerns property that is situated in the Republic, or if it concerns matters or things that are going to be executed or will be carried out in the Republic, irrespective of the place where these have been drafted or prepared. It is important to be stated that any contracts relating to assets situated outside Cyprus or business affairs that take place

outside Cyprus are exempt from stamp duty. For 2012 the maximum stamp duty on contracts is Euro17.086.

Exemption:

Transactions which fall within the scope of reorganizations are exempt from stamp duty.

PARENT SUBSIDIARY DIRECTIVE

Cyprus has transposed into Cypriot Law the EU Parent Subsidiary Directive. Though Cyprus tax rules are more liberal than the requirements of the Directive.

- While the directive provides for a minimum holding by a parent company of 10% of the capital of a company in another member state, Cyprus imposes no minimum holding requirements.
- Furthermore, while the directive allows a member state not to apply the directive to companies of that member state that do not maintain for an uninterrupted period of at least two years a holding, qualifying them as parent companies, Cyprus has no such minimum requirement either for Cyprus or non-Cyprus subsidiaries.

REORGANISATION RULES

Cyprus has adopted and has included in its legislation with sections 26-30 of the Income Tax Law, the EU Merger Directive on the common system of taxation applicable to different types of mergers. Therefore, where a transaction falls into the definition of a "reorganisation", it is exempt from corporation tax, capital gains tax and transfer fees. Transfers of assets and liabilities between companies can be effected without any adverse tax consequences within the framework of a reorganisation.

Reorganisations include:

- mergers
- demergers
- partial divisions
- transfer of assets
- exchange of shares
- transfer of registered office

PRE-TRANSACTION RULINGS

A pre-transaction ruling in respect of a particular type of transaction serves to remove taxation uncertainties. Cyprus has introduced an advance ruling practice in accordance with OECD recommendations. The commissioner of Income Tax does provide advance interpretations of the law, when requested, concerning the tax consequences of proposed transactions.

CONCLUSION

The tax law of Cyprus, as reformed, is probably the most modern, effective and simple tax system in the EU and in addition, it conforms to the EU and OECD regulations.

The country's attractiveness as a holding company location, in our opinion, lies in the fact that all the tax benefits that the Cyprus holding company has are not only available to EU residents but are also available, to non-EU residents.

The Cyprus holding company is of particular interest in the following circumstances:

- a. To hold subsidiary companies that have scope for significant capital appreciation. The realisation of capital gains on the disposal of these subsidiaries are exempted from local tax.
- b. To hold subsidiary companies that will have dividend income streams. Such in-bound dividends from local or foreign subsidiaries are exempted from local tax.
- c. To utilise the extensive double tax treaties network of Cyprus.
- d. To utilise the non-existent thin capitalisation rules of Cyprus and the very narrow in scope CFC conditions.
- e. To utilise the exit strategy benefits that exist on the liquidation of a Cyprus holding company, owned by non-residents. There are no taxes to be paid on the distribution of the assets to the non-resident shareholders.
- f. To utilise the low set-up and annual maintenance and administrative costs.
- g. To be used as a vehicle for funds or similar investment schemes, since all gains from the trading of securities are exempt from tax, even if this is the main trading activity of the company.



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