The Cyprus

Group Loan Financing Company

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Preface

Throughout the world the barriers to capital movements are fast disappearing. Tax differences have become a very significant factor in commercial decisions, and therefore investment structures which have the least tax leakage are preferred by investors. During the last decade various European Countries have introduced finance company regimes and nowadays it is very difficult for a multinational group to select the right jurisdiction in which to establish their finance company.

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.

The Cyprus finance company is becoming increasingly popular as a group financing company. The acceptance by the Cyprus tax authorities of very low interest margins and their willingness to issue pre-tax rulings confirming the acceptance of pre-approved interest margins has created excellent opportunities for tax professionals to prefer Cyprus as the primary location to establish their group finance company within the European Union.

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Managing Director

Introduction

Tax considerations may not be the decisive factor in choosing to set up a finance 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 group financing 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 group financing company.

Tax Considerations

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

- Tax regime with regards to withholding taxes on outward interest payments
- Tax regime with regards to the tax deduction of interest payments
- Tax regime with regards to the tax treatment of interest receivable
- Tax regime with regards to the net interest margin required by the tax authorities and the availability of pre-transaction rulings
- Other significant tax considerations
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Tax regime with regards to withholding taxes on outward interest payments

If a Cyprus finance company is financed in the form of loans by its non-resident parent company, or by its non-resident individual shareholder, it will make the interest payments to the non-resident individual or company gross, without any tax deducted.

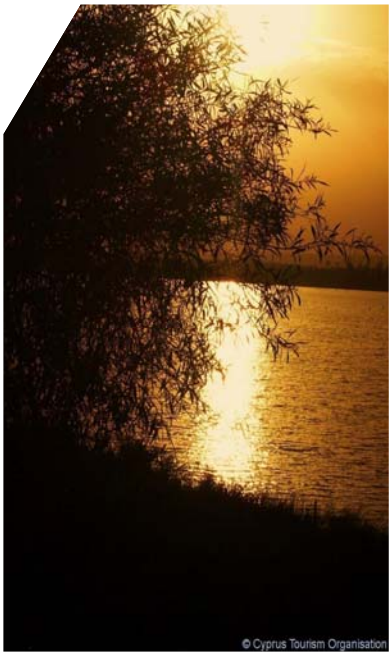
The 0% withholding tax rate applies irrespective of the existence or not of any double tax treaties, or on whether the parent company is located in an offshore jurisdiction or not.

Tax regime with regards to the tax deduction of interest payments

In general, interest payments by a Cypriot company on borrowings are fully tax deductible.

However, any interest payable by the Cyprus finance company that was not incurred for the purpose of the production of income will not be tax deductible.

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 finance 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.



Tax regime with regards to the tax treatment of interest receivable

Interest Receivable – Main Trading Activity

Interest income "derived in the ordinary course of business", or interest income closely connected with the carrying on of a business, is subject to tax normally, at the standard rate of 12,5%.

The 12,5% is not on the total amount of interest received but on the net profit (less interest paid, other expenses etc).

Interest income derived from the ordinary course of business.

Interest falling into this category can be classified as the interest that is earned by banks, finance companies, hire purchase companies etc.

Interest closely connected with the normal carrying on of a business.

Interest falling into this category can be classified as the interest that is earned by:

I. A company acting as a vehicle to finance other group companies.
II. A company that is having trading debtors and is charging interest for late payment.
III. A property developer receiving interest in the course of his business by extending the credit period given to his customers.
IV. An investment company that is earning interest on deposits until good investment opportunities arise.

Interest Receivable—Not Main Trading Activity

If interest income is neither considered to arise in the ordinary course of business nor is closely connected to the ordinary course of business, the gross amount of interest is subject to defence tax at 30%.

Tax regime with regards to the net interest margin required by the tax authorities and the availability of pre-transaction rulings

A pre-transaction ruling in respect of a particular type of transaction serves to remove taxation uncertainties.

Cyprus has for some years now 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.

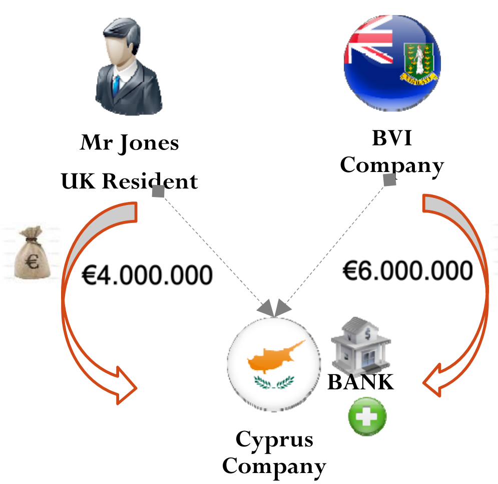
The issuance of pre-tax rulings confirming the acceptance of pre-approved interest margins (as shown on the table below) can remove the taxation uncertainty significantly.

LOAN AMOUNT	NET INTEREST MARGIN
Up to Euro50 million	0,35%
Between Euro 50 million—Euro 200 million	0,25%
In excess of Euro 200 million	0,125%

Flowchart 1, gives a diagrammatical example showing the tax treatment of interest.

Loan Financing – Cyprus Company

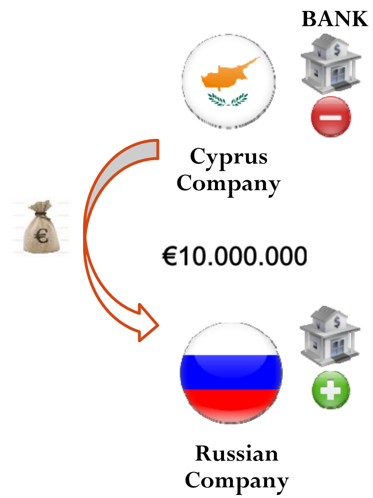
1



- On 1/1/2013 the two shareholders of the Cyprus company gave a loan to the Cyprus company equal to €10.000.000. Mr Jones gave €4.000.000 and BVI Co gave € 6.000.000.
- The interest rate on both loans was 8%.
- According to the terms of the loan agreement, repayment of the loan amount as well as the interest should be made at the end of 2013.

Loan Financing – Russian Company

2



- On 1/1/2013, the Cyprus company financed a Russian company, with €10.000.000, under a loan agreement bearing an interest rate of 8.35%.
- According to the terms of the loan agreement, repayment of the loan amount as well as the interest should be made at the end of 2013.

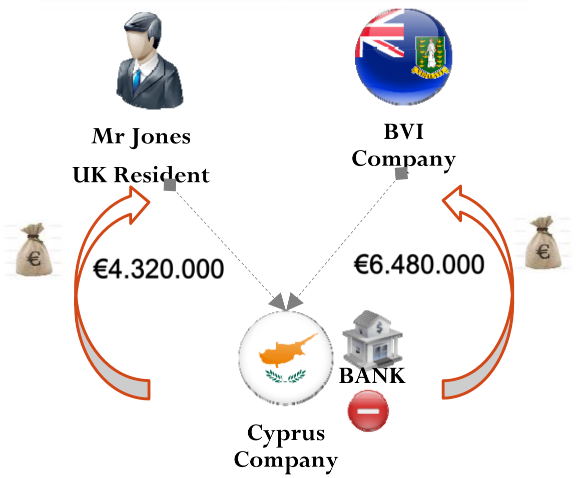
Loan Repayment – Russian Company

3

- The double tax treaty between Russia and Cyprus, imposes a withholding tax rate on interest payments from Russia to Cyprus of 0%.
- On 31/12/2013 the Russian Company pays €10.835.000 to the Cyprus company, being the loan amount together with the outstanding interest.

Loan Repayment – Cyprus Company

4



- Cypriot tax rules provide no withholding tax on interest payments made to non-residents of Cyprus. On 31/12/13, Mr Jones will receive €4.320.000 and BVI Co will receive €6.480.000, both receipts without any tax deduction in the Cyprus company.

Tax Payable – Cyprus Company

5

	€
Interest Receivable	10.835.000
Interest Payable	10.800.000
Net Profit	35.000
Tax @ 12,5%	4,375

Flowchart 1
Taxation of Interest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Other Significant Tax Considerations

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.

Inheritance or Estate Taxes

Cyprus does not have in its legislation any inheritance or estate taxes.

Wealth Taxes

Cyprus does not have in its legislation any taxes that are imposed on wealth.

Tax Losses

When a loss is not wholly set-off against income from other sources in the same year, it can be carried forward for the next five years (from the end of the tax year in which they were incurred) and set-off against future taxable income of the company. Loss is automatically set-off against the first available taxable income of the company. Losses can only be carried forward. No carry-back of losses is allowed.

Tax Credit for foreign tax paid

Any tax suffered abroad on income subject to income tax will be credited against any income tax payable on such income irrespective of the existence of a double tax treaty.

Stamp Duty

In accordance with the Stamp Duty Law of 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 2014 the maximum stamp duty on contracts is Euro20.000.

Capital Duty

According to the Cyprus Companies Act Law, every Cyprus incorporated company must pay capital duty on incorporation equal to Euro103 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.

Re-Domiciliation of Companies

Re-domiciliation of companies in and out of Cyprus is permissible, however the other jurisdiction's legislation must also recognize such a possibility.

EU Interest and Royalties Directive

Cyprus has transposed into Cypriot Law the EU Interest and Royalties Directive (Council Directive 2003/49/ EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments between associated companies of different Member States).

Though Cyprus tax rules are more liberal than the requirements of the Directive.

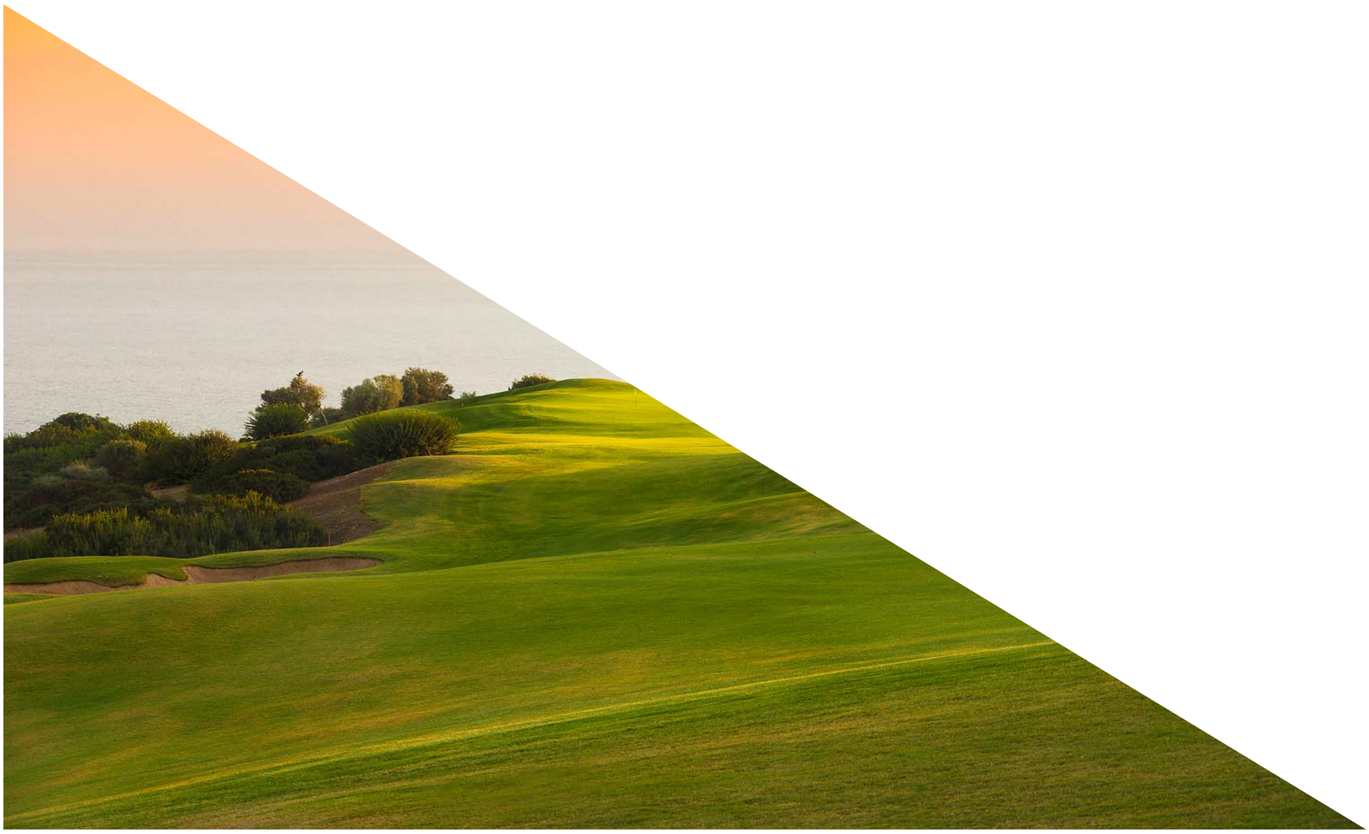
- There is no withholding tax on interest payments made to companies or individuals non-resident in Cyprus.
- There is also no withholding tax on royalty payments, where the rights have been granted for use outside Cyprus, irrespective of the form of the recipient of the income.

Tax Treatment of Liquidation Proceeds

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 company owns immovable property situated in Cyprus then the disposal of the Cyprus situated property can result in Capital Gains Tax.



Appendix 1 - Double Tax Treaties

	RECEIVED IN CYPRUS	Dividends	Interest	Royalties
	Treaty countries:			
1	**Armenia**	0(32)	5(33)	5
2	**Austria(31)**	10	0	0
3	**Belarus**	5(4)	5	5
4	**Belgium**	10(1)	10(16)	0
5	**Bulgaria**	5(19)	7(25)	10(20)
6	**Canada**	15	15(7)	10(11)
7	**China**	10	10	10
8	**Czech Republic**	0(30)	0	10
9	**Denmark**	0(34)	0	0
10	**Egypt**	15	15	10
11	**Estonia(35)**	0	0	0
12	**France**	10(2)	10(9)	0(26)
13	**Finland***	5(37)	0	0
14	**Germany**	5(2)	0	0
15	**Greece**	25	10	0(12)
16	**Hungary**	5(1)	10(8)	0
17	**India**	10(2)	10(8)	15(15)
18	**Ireland**	0	0	0(12)
19	**Italy**	15	10	0
20	**Kuwait(31)**	10	10(8)	5(14)
21	**Kyrgyzstan(27)**	0	0	0
22	**Lebanon**	5	5(16)	0
23	**Malta**	0(22)	10(8)	10
24	**Mauritius**	0	0	0
25	**Moldova**	5(19)	5	5
26	**Montenegro(28)**	10	10	10

	RECEIVED IN CYPRUS	Dividends	Interest	Royalties
27	Norway	5[3]	0	0
28	Poland	0[36]	5[8]	5
29	Portugal*	10	10	10
30	Qatar	0	0	5
31	Romania	10	10[8]	5[14]
32	Russia	5[6]	0	0
33	San Marino	0	0	0
34	Serbia[28]	10	10	10
35	Seychelles	0	0	5
36	Singapore	0	10[23]	10
37	Slovakia([29]	10	10[8]	5[14]
38	Slovenia	5	5[33]	5
39	South Africa	0	0	0
40	Spain*	5[38]	0	0
41	Sweden	5[1]	10[8]	0
42	Syria	0[1]	10[8]	15[13]
43	Tajikistan[27]	0	0	0
44	Thailand	10	15[17]	5[18]
45	Ukraine	5[39]	2	5
46	United Arab Emirates[35]	0	0	0
47	United Kingdom	0[24]	10	0[26]
47	United States	0[5]	10[10]	0
48	Uzbekistan[27]	0	0	0

NOTES:

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. 10% in the case of royalties granted for use within the Republic. 5% on film and TV rights.

(1) 15% if received by a company controlling less than 25% of the voting power.

(2) This rate if received by a company controlling more than or equal to 10% of the voting power. 15% in all other cases.

(3) NIL if paid to a company controlling at least 50% of the voting power.

(4) This rate 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.

(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, musical, artistic work, films and TV royalties.

(14) NIL on literary, artistic or scientific work including films.

(15) Treaty rate restricted to Cyprus legislation rate of 10%. 10% also applies to 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 or 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) A new treaty has been signed as of 8 November 2012 that has not come into effect yet.

(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 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 a 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.

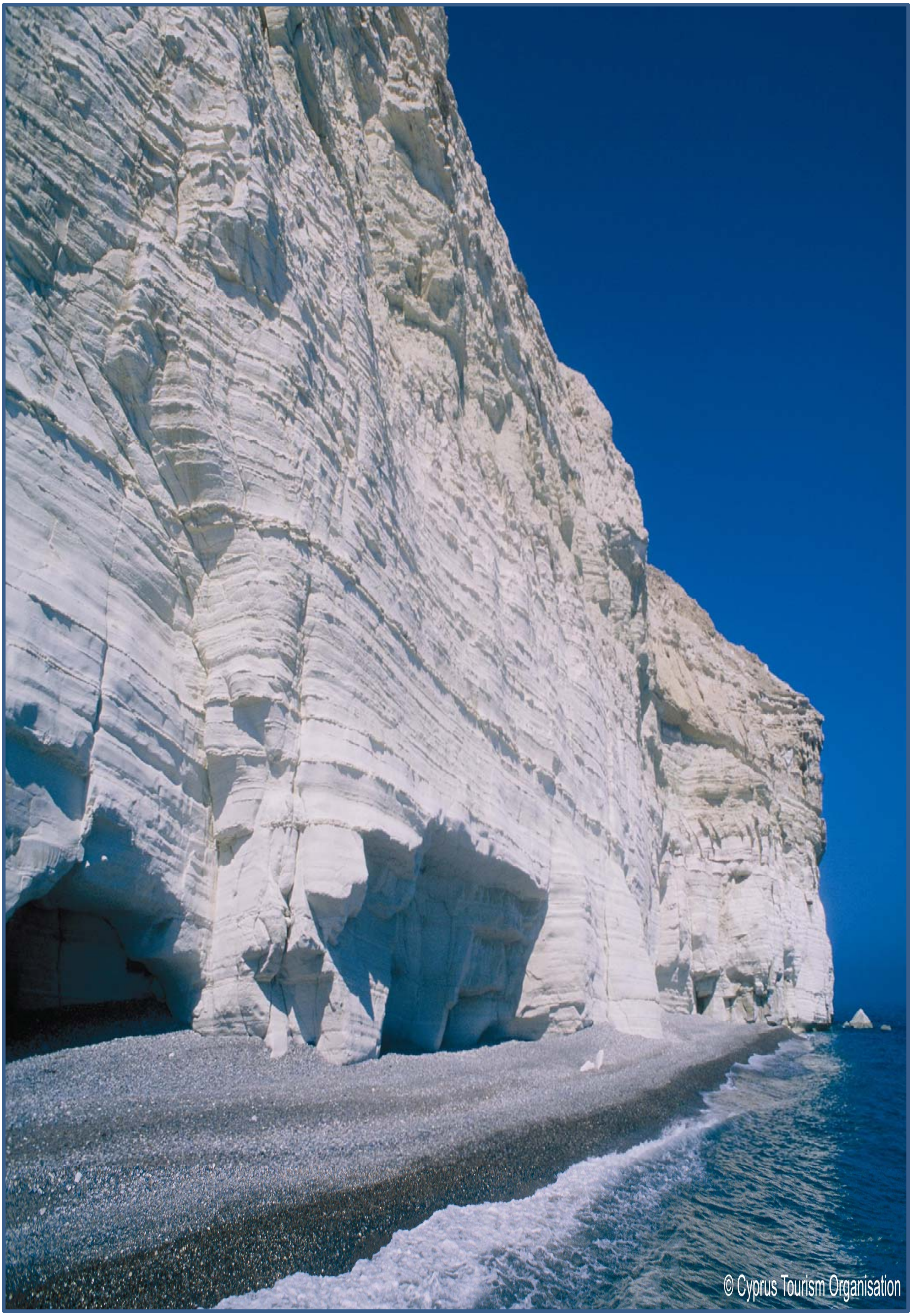
(35) The treaty has been published in the Government Gazette but has not come into force until the time of publication of this booklet.

(36) 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 24 months. 5% in all other cases.

(37) 5% 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. 15% in all other cases.

(38) NIL if paid to a company controlling at least 10% of the voting power.

(39) 5% if the beneficial owner holds at least 20% of the capital of the company paying the dividends or has invested in the acquisition of the shares or other rights of the company equivalent of at least Euro100.000. 15% in all other cases.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