



CHRYSSES DEMETRIADES & CO. LLC

Advocates and Legal Consultants

Head Office

Fortuna Court, 284 Makarios III Avenue, 3105 Limassol

Postal Address: P.O. Box 50132, 3601 Limassol, Cyprus

Telephone: +357 25 800 000

Facsimile: +357 2558 7191 or +357 2558 7309

E-mail Address: commercial@demetriades.com

Website: <http://www.demetriades.com>

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Cyprus Holding Company

The term 'Cyprus holding company' has been in use in tax consultancy circles worldwide since the introduction of Cyprus's current tax regime in 2002, ahead of its accession to the European Union (EU) when the country aligned its laws with those of the *Acquis Communautaire*.

Usually, the term 'holding company' when used in legal documents denotes a company that controls either through the holding of the majority of voting rights, or the right to nominate the majority of the board of directors, of another company.

However, in Cyprus tax legislation, when referring to the tax treatment of the dividends received by a Cyprus company, the term holding company has a wider meaning. Subject to certain conditions, it is extended to cover not only dividends received by a Cyprus holding company from a subsidiary, but from any shareholding in a foreign company which represents more than 1% of the issued share capital of that foreign company. However, this is subject to the criteria mentioned below.

Effectively, if a Cyprus company, or a foreign company which is managed and controlled in Cyprus and thus a tax resident of Cyprus, receives any dividends from another company, such dividend is free from income tax and it is also free from any withholding tax on dividends, which in Cyprus is known as special defence contribution. If that other company is a foreign company it may also be free from Cyprus income tax and special defence contribution, under certain conditions.

In this short article we shall not analyse the tax treatment of dividends payable by a Cyprus tax resident company to another Cyprus tax resident company or to their ultimate shareholders who are Cyprus tax residents, but focus on the tax treatment of royalties received by a Cyprus company (the holding company) from foreign companies or corporations, and also the tax treatment of any dividends which such a Cyprus holding company pays over to its non-resident shareholders, individuals or corporations.

If a Cyprus holding company holds at least 1% of the share capital of a foreign company and receives any dividend from it, this dividend will not be subject to any income tax or special defence contribution in Cyprus provided that either:

- no more than 50% of the profits of the foreign company that pays the dividend emanate, directly or indirectly, from passive investment income; or
- the foreign company's profits are subject to tax in the foreign country at rates in excess of 5%.

Of importance is the reference to direct or indirect income from passive investment. This means that the important criterion is not the character of the income received by the foreign company, which may in most cases be a dividend, but the original source of the income from subsidiaries or participations down the line, which in almost all cases, with minor exceptions, is active income.

By application of the above provision the dividends which do not qualify for the exemption are effectively dividends from minor participation or from substantial participation in huge listed companies abroad where the holding is under 1%.

Even in such cases, however, by application of the relevant treaties, exemptions may be applicable ending again in no tax or special defence contribution in Cyprus.

The Cyprus tax authorities are now considering the possibility of abolishing the 1% holding requirement as well as the other criteria in order to further promote Cyprus as a centre for the structuring and administration of mutual funds.

It is also very important to note that the application of double tax treaties may lead to low or even no withholding tax on dividends in the foreign country despite the fact that there will be also no tax in Cyprus on such dividends as explained above.

When a Cyprus holding company owned by shareholders who are not tax residents of Cyprus declares a dividend, such dividend can be paid to these non-resident shareholders without any withholding or other tax or special defence contribution in Cyprus. When investors who are not tax residents of Cyprus (whether or not they are companies/corporations in countries which are European Economic Union members) acquire shares in a Cyprus company, which in turn acquires shares in foreign companies or corporations, they may ultimately receive dividends via the Cyprus holding company and obtain the benefits of the Cyprus double tax treaties. The Cyprus double tax treaty network is quite extensive covering over 40 countries in various parts of the world.

It is also important to point out that a Cyprus holding company is not a special corporate entity from either a

corporate law or tax law perspective, but is just an ordinary company and could engage in other activities as well, including trading and generally whatever a company can do. The tax treatment of dividends as explained above is not related to the company itself but to the nature of the particular income.

Other income of such a holding company not falling within the definition of dividend from the worldwide operations of a company which is a tax resident of Cyprus, is subject to corporation tax at the rate of 10%, which is the lowest corporation tax in the EU.

Double tax treaties also apply with respect to such other income. In addition, unilateral relief is granted on any tax that would be payable in Cyprus on such income for any tax paid abroad on the same income, whether there is a treaty or not.

The dividends which the Cyprus company may pay to its non-resident shareholders from any such other income are also tax exempt in Cyprus in the same manner as any dividends emanating from dividend income.

From the above it is not surprising that the Cyprus holding company and Cyprus companies in general are regarded as the best vehicles for investment and operations in various countries. Cyprus is considered a gateway for investments by EU investors in other EU or non-EU countries, as well as for investment by non-EU investors into EU countries.

The favourable tax regime coupled with the well-established legal system of Cyprus which is based on common law, as well as the high standards of professional services have led to the success of Cyprus as an international financial centre. Recently Cyprus companies have been listed in international stock exchanges, such as the London Stock Exchange, the Alternative Investment Market, the Frankfurt Stock Exchange, and Oslo.

For further information, please contact:

Christos Mavrellis
Managing Partner
christos@demetriades.com

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