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**SUBJECTS** TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

**SECTORS** MANUFACTURING RETAIL/WHOLESALE INSURANCE BANKS/FINANCIAL INSTITUTIONS RESTAURANTS/FOOD SERVICE CONSTRUCTION AEROSPACE ENERGY AUTOMOTIVE MINING AND MINERALS ENTERTAINMENT AND MEDIA OIL AND GAS

**COUNTRIES AND REGIONS** EUROPE AUSTRIA BELGIUM BULGARIA CYPRUS CZECH REPUBLIC DENMARK ESTONIA FINLAND FRANCE GERMANY GREECE HUNGARY IRELAND ITALY LATVIA LITHUANIA LUXEMBOURG MALTA NETHERLANDS POLAND PORTUGAL ROMANIA SLOVAKIA SLOVENIA SPAIN SWEDEN SWITZERLAND UNITED KINGDOM EMERGING MARKETS ARGENTINA BRAZIL CHILE CHINA INDIA ISRAEL MEXICO RUSSIA SOUTH AFRICA SOUTH KOREA TAIWAN VIETNAM CENTRAL AND EASTERN EUROPE ARMENIA AZERBAIJAN BOSNIA CROATIA FAROE ISLANDS GEORGIA KAZAKHSTAN MONTENEGRO NORWAY SERBIA TURKEY UKRAINE UZBEKISTAN ASIA-PAC AUSTRALIA BANGLADESH BRUNEI HONG KONG INDONESIA JAPAN MALAYSIA NEW ZEALAND PAKISTAN PHILIPPINES SINGAPORE THAILAND AMERICAS BOLIVIA CANADA COLOMBIA COSTA RICA ECUADOR EL SALVADOR GUATEMALA PANAMA PERU PUERTO RICO URUGUAY UNITED STATES VENEZUELA MIDDLE EAST ALGERIA BAHRAIN BOTSWANA DUBAI EGYPT ETHIOPIA EQUATORIAL GUINEA IRAQ KUWAIT MOROCCO NIGERIA OMAN QATAR SAUDI ARABIA TUNISIA LOW-TAX JURISDICTIONS ANDORRA ARUBA BAHAMAS BARBADOS BELIZE BERMUDA BRITISH VIRGIN ISLANDS CAYMAN ISLANDS COOK ISLANDS CURACAO GIBRALTAR GUERNSEY ISLE OF MAN JERSEY LABUAN LIECHTENSTEIN MAURITIUS MONACO TURKS AND CAICOS ISLANDS VANUATU

## Cyprus Tax Roundup 2016

by Philippos Aristotelous,  
Andreas Neocleous & Co LLC

Contact: aristotelous@neocleous.com,  
Tel. +357 25 110000



### Introduction

Although the changes have been fewer than in 2015, tax professionals in Cyprus have had plenty of new developments to keep them busy during 2016, including several new or substantially modified double tax agreements and a reformed intellectual property box regime. The main changes are summarized in the following paragraphs.

### Double Taxation Agreements (DTAs)

#### *Deferral of the provisions of the 2010 Protocol regarding shares in companies holding immovable property in Russia*

As 2016 drew to an end, the Cyprus Ministry of Finance announced that the Russian government had agreed to defer the introduction of new provisions allowing for source-based taxation of capital gains on shares in "property-rich" Russian companies, which were due to take effect on January 1, 2017.

Under the 1998 double taxation agreement between Cyprus and Russia, gains on disposals of shares are taxable only in the country of residence of the person disposing of the shares. Since Cyprus does not impose any capital gains tax on disposals of shares in companies unless they own immovable property in Cyprus, this makes Cyprus a very advantageous location for holding shares in Russian companies.

The Protocol to the 1998 double taxation agreement, which was signed in 2010, provided that gains on the disposal of shares in companies which derive their value principally from immovable property in Russia (so-called "property-rich" companies) would be subject to tax in Russia after a transitional period, which was due to expire at the end of 2016. Shares in other companies were not affected.

However, the application of this provision of the Protocol has now been deferred until similar provisions are introduced into Russia's double taxation agreements with other European countries, and disposals of shares in property-rich companies will continue to be taxable only in the country of residence of the person disposing of the shares, in the same way as other shares. According to the official announcement, an additional Protocol is being prepared in order to formalize the deferral.

#### ***Entry into effect of new DTAs with Guernsey and Switzerland***

On January 1, 2016, the new DTAs with Guernsey and Switzerland, both of which were signed in 2014 and entered into force in 2015, took effect. Further details of the DTAs can be found in previous issues of *Global Tax Weekly*.<sup>1</sup>

#### ***Entry into force of DTAs with Bahrain, Georgia and Latvia***

Ratification of the DTAs with Bahrain and Georgia, which were signed in 2015, and with Latvia, which was signed in May 2016, was completed during 2016 and the DTAs entered into force on April 26, January 4, and October 27, 2016, respectively. These are the first DTAs between Cyprus and the countries concerned, as neither Georgia nor Latvia adopted the 1982 Cyprus–USSR agreement when they became independent. The DTAs will take effect from the beginning of 2017. They closely follow the 2010 OECD Model Tax Convention; further details of the individual agreements can be found in previous issues of *Global Tax Weekly*.<sup>2</sup>

### **Signature Of New DTAs And Protocols**

During 2016, in addition to signing the DTA with Latvia referred to above, Cyprus signed new DTAs with Jersey and India. The DTA with Jersey is the first between the two countries: while Jersey is not large in economic terms, it is an important financial center and the DTA will be a valuable addition to Cyprus's extensive treaty network. The new agreement with India, which was signed in November, was ratified very expeditiously and will replace the existing 1994 DTA with almost immediate effect.

#### ***Jersey***

The DTA will come into force once it has been ratified in accordance with both parties' domestic legal procedures and will have effect from the beginning of the following year.<sup>3</sup> The 2004 agreement on taxation of savings income between Cyprus and Jersey will continue in force, but the DTA will be more beneficial to taxpayers once it takes effect.

The new agreement closely follows the 2010 OECD Model Convention, with only minor modifications, and the Protocol to the agreement clarifies the information exchange provisions. Dividends, interest and royalties are taxable only in the state of residence of the recipient. Capital gains derived from the alienation of immovable property may be taxed in the state in which the property is situated; all other gains, including gains on disposal of shares in "property-rich" companies, are taxable only in the state in which the disponor is resident.

The exchange of information article reproduces Article 26 of the OECD Model Convention verbatim. However, unusually, the exchange of information provisions will take effect eight taxable years prior to the entry into force of the agreement. A protocol to the DTA provides robust safeguards against abuse of the information exchange provisions by requiring the contracting party that requests information to fulfill specified procedures to demonstrate the foreseeable relevance of the information to the request. No request is to be submitted unless the party making the request has reciprocal procedures and means of obtaining similar information, and every request must be accompanied by the comprehensive details prescribed in the protocol.

### ***India***

There had been pressure from India to renegotiate the 1994 agreement between the two countries since the early 2000s, as the Indian authorities believed that the provisions on taxation of capital gains were vulnerable to abuse in the form of "round-tripping," a method of tax evasion where money leaving India was recycled back into India in the form of foreign direct investment via a third country.

Apparent deadlock in the negotiations seems to have been a factor in the Indian authorities designating Cyprus as a notified jurisdictional area under Section 94A of the Indian Income-tax Act 1961 in 2013, leading to increased administrative burdens for Cyprus companies operating in India. Following the Indian tax authorities' success in renegotiating the DTAs with Mauritius and Singapore, which contained similar provisions, it was inevitable that the Cyprus DTA would soon follow, and a new DTA was signed on November 18, 2016.<sup>4</sup>

As was widely expected following similar changes to India's agreements with Mauritius and Singapore, the new DTA provides for source-based taxation of gains from the alienation of shares. However, investments undertaken before April 1, 2017 are grandfathered, with taxation rights over gains on the disposal of such shares at any future date remaining solely with the state of residence of the disponor.

Ratification procedures were completed within a month of signature, and the new DTA entered into force on December 14, 2016. This means that the agreement will have effect in Cyprus in respect of tax withheld at source for amounts paid on or after January 1, 2017, and in respect of other taxes for years of assessment beginning on or after January 1, 2017.

In India, where the tax year begins on April 1, the agreement will have effect in respect of tax withheld at source for amounts paid on or after April 1, 2017, and in respect of other taxes for years of assessment beginning on or after that date.

Simultaneously with the agreement entering into force, on December 14, 2016, the Indian tax authorities issued Notification No. 114/2016, rescinding the designation of Cyprus under section 94A of the Income-tax Act 1961 as a notified jurisdictional area. The rescission has retrospective effect from November 1, 2013.

## **Reform Of The Intellectual Property Box Regime**

In October 2016, the Cyprus Parliament passed Law 118(I) of 2016, which amends the Income Tax Law to bring its provisions on taxation of income from the use or sale of intangible assets into line with the "modified nexus" approach. This approach allows taxpayers to benefit from an intellectual property taxation regime, commonly known as an intellectual property (IP) box, only to the extent that they can show material relevant activity, including a clear connection between the rights which create the IP income and the activity which contributes to that income. Regulations issued under the law, which will have retrospective effect from July 1, 2016, provide detailed guidance on the calculations and application of the new IP regime.

### ***Transitional arrangements for IP assets developed prior to June 30, 2016***

The existing IP box regime, which was introduced in 2012, provides for 80 percent tax exemption of income from the use of a wide range of intangible assets. Coupled with Cyprus's low corporate income tax of 12.5 per cent, it gives an effective tax rate on such income of 2.5 per cent or less.

Taxpayers already benefiting from the existing scheme may continue to claim the same benefits on all assets within the scheme at June 30, 2016 until June 30, 2021, subject to certain conditions regarding assets acquired from related parties between January 2, 2016 and June 30, 2016. Assets acquired in this period from a related party will qualify for benefits only until the end of the 2016 tax year, unless at the time of their acquisition they were benefiting under the Cyprus IP box regime or under a similar scheme for intangible assets in another state.

### ***New arrangements for IP assets developed from July 1, 2016***

The arrangements for assets developed after July 1, 2016, follow the modified nexus approach. Qualifying assets are restricted to patents, software and other IP assets which are legally protected. IP rights used to market products and services, such as business names, brands, trademarks and image rights, do not fall within the definition of qualifying assets.

Relief is geared to the cost incurred by the taxpayer in developing the IP through its research and development (R&D) activities. Costs of purchase of intangible assets, interest, costs relating to the acquisition or construction of immovable property, and amounts paid or payable directly or indirectly to a related person are excluded from the definition of qualifying expenditure.

As was the case under the existing scheme, 80 percent of the overall profit derived from the qualifying intangible asset is treated as deductible expense, preserving the effective tax rate of less than 2.5 percent on such income.

### **Other Amendments**

Other amendments made by the new law include the introduction of capital allowances for all intangible assets other than goodwill and assets qualifying for the existing IP regime. The capital cost of the assets will be tax deductible, spread over the useful life of the asset in accordance with generally acceptable accounting principles, with a maximum useful life of 20 years, and a balancing allowance or a balancing charge on disposal of the asset.

In addition, relief under Articles 35 and 36 of the Income Tax Law in relation to relief from double taxation will not be allowed if the taxpayer has chosen to claim losses in accordance with Article 13(9).

### **Conclusion**

The year 2016 has seen Cyprus's DTA network continue to grow, and by the beginning of 2017 DTAs with 58 countries will be in effect. The signature of the new agreement with India, one of the world's largest and fastest-growing economies, and the restoration of normal tax relations are particularly important. While the revised DTA no longer provides exemption from capital gains tax on investments made after April 1, 2017, it places Cyprus on no less advantageous a footing than Mauritius and Singapore in this regard. Furthermore, by bringing to an end the notified jurisdictional area designation, it will eliminate the bureaucratic burdens this imposed.

The amendments to the IP box regime secure the existing generous benefits for IP developed before June 30, 2016 until June 30, 2021. While the range of assets and the categories of expenditure qualifying for relief after July 1, 2016, are more restricted than under the previous rules, Cyprus's IP box regime still represents a very attractive option for taxpayers, with an effective tax rate of less than 2.5 percent on qualifying income.

## **ENDNOTES**

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<sup>1</sup> Guernsey: *Global Tax Weekly*, No. 95, September 04, 2016; Switzerland: *Id*, No. 94, August 28, 2014.

<sup>2</sup> Bahrain: *Global Tax Weekly*, No. 127, April 16, 2015; Georgia: *Id*, No. 142, July 30, 2015; Latvia: *Id*, No. 189, June 23, 2016.

<sup>3</sup> A full analysis of the new DTA with Jersey can be found in *Global Tax Weekly*, No. 198, August 25, 2016.

<sup>4</sup> A full analysis of the new DTA with India can be found in *Global Tax Weekly*, No. 213, December 8, 2016.