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a closer look

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Cyprus Oil And Gas Taxation

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The Republic of Cyprus is a relative newcomer to the upstream oil and gas industry. For some years there had been indications of likely substantial gas deposits in the Levant Basin, in the South-Eastern Mediterranean area, which were confirmed by the discovery of the Tamar gas field in Israel's exclusive economic zone in the early 2000s. Interest soon spread to the waters off Cyprus, and the government took steps to delineate its Exclusive Economic Zone (EEZ) and initiate a first licensing round for prospecting and exploration. The first license, for Block 12 in the Aphrodite field, was issued in 2008, and in 2012 the licensee announced discovery of a natural gas field with an estimated resource range of between 5 and 8 trillion cubic feet (TCF). The estimate has since been revised to 3.6 to 6 TCF following further exploratory drilling, but even these lower figures will make Cyprus an important energy source.

A second licensing round in 2012 has resulted in the issuing of five further licenses to consortia including the world's largest energy companies. Exploratory drilling in these new blocks is scheduled to begin shortly.

The Government's objective is to make Cyprus not only a hydrocarbons producer, but a gas export hub for the region, taking advantage of its location and



its geopolitical stability in a volatile region, and negotiations are under way for the development of an LNG compression and export facility costing several billion euro.

As a member of the EU, Cyprus has aligned its energy policy with the *acquis communautaire* and transposed all relevant EU Directives into national law. Hydrocarbon exploration and exploitation activities in Cyprus and its EEZ are governed by the Hydrocarbon (Prospection, Exploration and Production) Law (4(I)/2007), which transposed into national law Directive 94/22/EC on the conditions for using authorizations for the prospection, exploration and production of hydrocarbons. The Hydrocarbon Law and the Hydrocarbon (Prospection, Exploration and Production) Regulations (51/2007 and 113/2009) together set out the licensing framework for prospecting, exploration and extraction activities. Successful applicants for a license are required to enter into an Exploration and Production Sharing Contract (EPSC), in the form published by the Ministry of Energy, Commerce, Industry and Tourism, which is the regulatory authority.

The model EPSC includes a tax clause requiring the contractor to comply with the applicable tax laws and regulations of Cyprus and the EU but, given that Cyprus's gas reserves were discovered only recently, it is no surprise that there is not yet an established taxation regime in relation to oil and gas companies operating in Cyprus.

The Current Tax Law

Currently, Cyprus resident companies are subject to corporate income tax at a rate of 12.5 percent on worldwide income, after deduction of expenses wholly incurred for the production of income and capital allowances for assets used in the company's trade. There is no withholding tax on interest or dividends paid to non-residents and taxation of capital gains, except to the extent that the gain is derived from immovable property in Cyprus. Non-resident companies are subject to corporate income tax at 12.5 percent on Cyprus-source income or the profits of a permanent establishment in Cyprus.

Current Cyprus tax legislation defines a permanent establishment in the same way as the 2010 OECD Model Convention, as a fixed place of business through which the business of an enterprise is wholly or partly carried on. A permanent establishment includes a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

Double Tax Agreements

Most of Cyprus's double taxation agreements, which number more than 50, define the Republic

of Cyprus as including its EEZ and so implicitly bring offshore activities within their scope, but they do not deal specifically with offshore activities. However, the three most recent agreements, with the United Arab Emirates (in force), Latvia (under negotiation) and Norway (under negotiation), include articles regulating this matter.

The Cyprus–UAE agreement merely provides that the contracting states' freedom to apply their domestic laws and regulations related to the taxation of income and profits derived from hydrocarbons and associated activities is not affected by the agreement. However, the draft agreements with Latvia and Norway contain detailed provisions. They both provide that a resident of one contracting state undertaking activities offshore (either on its own account or with associated enterprises) in the other contracting state for more than 30 days in any 12 month period in connection with the exploration or exploitation of the seabed or subsoil or their natural resources is deemed to be carrying on business in that other contracting state through a permanent establishment.

Profits from offshore supply and transport operations in connection with the exploration or exploitation of the seabed or subsoil or their natural resources of a contracting state are taxable only in the contracting state in which the enterprise providing the services is resident.

Salaries, wages and the like earned by a resident of one contracting state from employment in the offshore zone of the other contracting state are taxable

in the contracting state in which the activities are carried out. However, if the employer is not resident in the contracting state in which the activities take place, and the employment is for less than 30 days in any 12 month period, the remuneration is taxable only in the contracting state in which the individual is resident.

Salaries, wages and similar remuneration derived from employment aboard ships or aircraft engaged in offshore supply and similar activities may be taxed in the contracting state in which the enterprise providing the services is resident.

Gains derived by a resident of one contracting state from:

- the alienation of exploration or exploitation rights (the term is defined in the article); or
- property situated in the other contracting state and used in connection with the exploration or exploitation of the seabed or subsoil or their natural resources situated in the second contracting state; or
- shares deriving their value or the greater part of their value directly or indirectly from such rights or such property,

may be taxed in the second contracting state.

Possible Amendments To The Income Tax Law

In order to bring offshore activities within the scope of taxation, the government is considering amending the Income Tax Law (Law 118(I)/2002)

by adding the following text to the definition of the Republic of Cyprus: "*and, when used in a geographical sense, includes the national territory, the territorial waters of the Republic of Cyprus, as well as any area outside the territorial waters, including the border zone, the EEZ and continental shelf, which in accordance with international law and the laws of the Republic of Cyprus, is determined as an area in which the Republic of Cyprus exercises sovereign rights or jurisdiction*".

It has also been suggested that the definition of the term "permanent establishment" should be amended to include "*offshore activities with respect to mining, exploration, or exploitation of the shelf, subsoil, or natural resources located within the EEZ and continental shelf, or the provision of services related to such mining, exploration or exploitation*". As a matter of interpretation and considering the relevant commentaries of the 2010 OECD Model Convention, such an amendment may not be strictly necessary as a permanent establishment may be deemed to exist without it, but it could serve to eliminate ambiguity.

In summary, Cyprus has in place the legislation needed to deal with current hydrocarbon exploration and exploitation activities in line with the cumulative body of EU laws. However, as hydrocarbon-related activities increase in scope and in volume, fuller and more specific provisions for taxation of oil and gas companies within either the model EPSC or relevant legislation might be necessary in due course.