The Private Wealth & Private Client Review

Editor
John Riches

Law Business Research

THE PRIVATE WEALTH & PRIVATE CLIENT REVIEW

This article was first published in The Private Wealth & Private Client Review (published in November 2012 – editor John Riches).

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Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

ISBN 978–1-907606–42–7

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: +44 870 897 3239

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

ALARCÓN ESPINOSA ABOGADOS

ALON KAPLAN INTERNATIONAL LAWFIRM

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EDITOR'S PREFACE

There are three dominant themes that have emerged in the last year as ones of critical importance for advisers to wealthy families. These themes are the morality of tax planning, the changing relationship between taxpayers and Revenue authorities and expectations for transparency in disclosure of asset holding structures. It is no surprise that these themes are intimately linked.

With regard to the subject of the morality of tax planning, there is clearly a concerted effort being made by governments in OECD jurisdictions to create an ethical climate not only in which tax evasion is reviled as criminal activity (as it rightly should be) but also in which 'aggressive' tax planning is regarded with disdain and stigmatised. It is apparent that politicians and policymakers alike are responding to what is clearly a perceived swing in public opinion that is not unlike that which occurred in the early 1930s. The arguments advanced in favour of encouraging taxpayers to see it as their moral duty (as well as legal obligation) to pay taxes and to refrain from indulging in aggressive avoidance are based on the proposition that the wealthiest members of society should make a proportionate contribution to public services and support those less fortunate than themselves. As a basic proposition this is clearly correct. The debate becomes rather more problematic when complex arguments are reduced to simplistic sound bites especially in the context of a perception of what is regarded as aggressive tax planning – it is notable in the UK in the aftermath of the Spring Budget of 2012, when the government had proposed capping the amount of relief available to taxpayers to a maximum of 25 per cent of an individual's annual income, serious commentators were suggesting that the individuals who made significant contributions to charity and claimed tax relief were in some way engaging in aggressive tax avoidance. This is just a small example of the way in which the rhetoric of debate over tax policy becomes swirled in confusion – frequently, there is a tendency to characterise certain aspects of tax systems that are deliberate reliefs or exemptions as loopholes.

There is also some irony in the fact that this proposal was withdrawn in response to a concerted campaign from the voluntary sector – an argument that could have been advanced in defence of the proposal was that allowing unlimited tax deductions for charitable donations might be seen as a form of hypothecation in which individuals with sufficient funds could substitute donations to their favoured charities for contributions to the basic services which other taxpayers effectively support. This reasonable defence of the proposal was somewhat lost in the furore and never effectively advanced.

One especially concerning aspect of the debate about the morality of tax planning is the absence of any parallel emphasis upon the duty of tax authorities to produce clear

and fair rules of taxation that could be easily understood and applied – if one sees the relationship between taxpayer and tax authority as akin to a 'social contract' then there has been rather too little emphasis upon the duties of tax authorities to refrain from ill-thought out changes to tax statutes or from producing sweeping anti-avoidance rules that create huge uncertainty for both individuals and businesses.

Regardless of this, it would seem that in the years ahead, those of us acting as advisers to wealthy families will need to ensure that in delivering our advice on what is an appropriate tax strategy to our clients, we bear in mind the possibility that, in future, the actions of our clients (and indeed our own advice) are likely to be judged not just for their technical accuracy, as is legally appropriate, but also for their 'moral' content. In the prevailing climate, it will be important for us to highlight for clients whether the tax planning strategy being considered may risk being seen as unduly aggressive even if it is legally correct.

One positive development in the area of relationships between Revenue authorities and wealthy taxpayers is the introduction of high net worth ('HNW') units in many OECD countries. These units look to provide a greater degree of coordination in overseeing the usually more complex tax affairs of wealthy individuals and the ability for a taxpayer's professional adviser (in some cases) to foster an enhanced relationship of openness with the HNW unit – given that in many jurisdictions the principle of self-assessment places an onus upon taxpayers to highlight areas of uncertainty so that the Revenue authority can consider them. It could well be the case in future that those taxpayers will find their long-term interests are better served by erring on the side of transparency in their dealings with Revenue authorities. In many jurisdictions, the ability to seek advance rulings is one route to achieving greater certainty; in others, ensuring one's tax adviser has well-placed contacts with Revenue authorities is an alternative. The traditional climate of mutual suspicion that has historically been characteristic of dealings between taxpayers and tax authorities will not evaporate overnight. The evidence emerging in other sectors (notably that of large corporate taxpayers) is, however, that in many cases, a more transparent approach will serve the client's interests and also may reduce compliance costs. This is not to suggest that the role of the tax adviser should not be to defend and advance the client's interests robustly on specific tax issues but to suggest that advisers also consider how to achieve an optimal outcome bearing in mind that it is in the client's long-term best interests to remain in good standing with the tax authorities.

Moving to my final and third theme, the publication by the OECD in February 2012 of its updated guidance in respect of the FATF 40 recommendations and the expanded interpretive notes accompanying them[1] are the latest manifestation at the supranational level of policymakers seeking to force through a transparency agenda for international holding structures in their fight against tax evasion. I set out below some comments from interpretive guidance on Recommendation 24 commenting on bearer share arrangements.

1 See www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%20approved%20February%202012%20reprint%20March%202012.pdf – see in particular pp. 82–87 with interpretive notes on recommendations 23 and 24.

> *14. Countries should take measures to prevent the* ***misuse of bearer shares and bearer share warrants,***[2] *for example by applying one or more of the following mechanisms: (a) prohibiting them; (b) converting them into registered shares or share warrants (for example through dematerialisation); (c) immobilising them by requiring them to be held with a regulated financial institution or professional intermediary; or (d) requiring shareholders with a controlling interest to notify the company, and the company to record their identity.*
>
> *15. Countries should take measures to prevent the misuse of nominee shares and nominee directors, for example by applying one or more of the following mechanisms: (a) requiring nominee shareholders and directors to disclose the identity of their nominator to the company and to any relevant registry, and for this information to be included in the relevant register; or (b) requiring nominee shareholders and directors to be licensed, for their nominee status to be recorded in company registries, and for them to maintain information identifying their nominator, and make this information available to the competent authorities upon request.*

It will be seen from this that the underlying philosophy to the FATF guidance is that any arrangement that is based upon anonymity will be regarded by authorities as suspicious and a prima facie indication of an attempt to conceal the reality of beneficial ownership. In the vast majority of cases, families wish to maintain privacy in relation to their financial affairs not to evade taxes, but to maintain anonymity to protect their assets from predators such as kidnappers or individuals who may be motivated to exploit them in inappropriate ways. The fact that the FATF's mandate was renewed in April 2012 for a further eight years until at least 2020 is evidence of the desire of OECD countries to maintain a sharp focus on transparency in tandem with the actions of the parallel initiatives being undertaken by the Global Tax Forum.

It is quite clear that the boundary line as to what can legitimately be regarded as private and not requiring explanation or justification in the structuring of an individual's financial affairs has been radically redrawn in recent years. Any individual wishing to engage the services of a financial institution or professional adviser will be effectively obliged to provide full beneficial ownership information as an essential pre-condition. As advisers we will therefore need to carefully consider the way in which we can legitimately protect our law-abiding taxpaying clients from unwarranted and unwelcome scrutiny from those who are motivated by greed or improper motives. We also need to ensure that we maintain an effective and ongoing dialogue with policymakers that highlights the legitimate strategies that wealthy families pursue and the many non-tax reasons that underpin those strategies – in particular, where complex cross-border challenges of holding assets are addressed by using trusts or foundations that have a strong rationale in ensuring business continuity or legitimate asset protection.

To conclude, in the years ahead I believe it may well behove us, as advisers, to exercise proper judgement to assist our clients in making appropriate choices with regard to the moral probity as well as the legality of their tax planning arrangements. Equally, it will be necessary to consider very carefully how to properly protect our clients' privacy without giving the impression that their desire for privacy is a cloak for other

2 Emphasis added.

improper motives that will invite unwelcome suspicion or hostility from tax or regulatory authorities or indeed third-party service providers with whom they wish to engage in a business relationship. Failure to abide by the new prevailing norms of transparency could well be costly. The effectiveness of our own advice in the future is likely to be judged with the benefit of '20/20' hindsight. I commend this review to you and hope you find it a helpful resource in advising your clients.

John Riches
Withers LLP
London
July 2012

Chapter 10

CYPRUS

Elias Neocleous and Philippos Aristotelous[1]

I INTRODUCTION

Despite being among the smallest countries in terms of area and population, Cyprus has developed into one of the world's most important financial and business centres. It has numerous advantages, including a strategic location, membership of the EU and the eurozone, a mature and transparent legal system, world-class professional and financial services and a modern, business-friendly tax regime, which offers attractive planning opportunities.

During the years following *perestroika*, Cyprus developed into the portal of choice for investment from the west into the rapidly developing economies of Russia and central and eastern Europe.

Even the largest Russian and eastern European companies have a substantial degree of owner involvement, and high net worth individuals from the region found Cyprus an excellent location for their personal financial affairs. In 1992 Cyprus enacted the International Trusts Law, which gave investors from overseas formidable asset protection and tax mitigation opportunities and allowed individuals from jurisdictions with forced heirship regimes effectively to regain testamentary freedom.

The links between eastern Europe and Cyprus extend beyond finance. Both share a common Orthodox religious culture and Cyprus is home to tens of thousands of Russians and eastern Europeans.

Today, Cyprus is a low-tax jurisdiction with a modern tax regime and an extensive network of double taxation treaties, allowing effective tax planning. All forms of succession taxes were abolished in 2000. It has world-class professional and financial services and a robust legal infrastructure founded on common law. It enjoys an excellent climate and a high standard of living, and its strategic location at the crossroads of Europe, Asia and Africa gives it a cosmopolitan atmosphere. While Russia and central and eastern Europe remain the key markets for Cyprus, China, India and the Middle East are also

1 Elias Neocleous is the head of the corporate and commercial department at Andreas Neocleous & Co LLC and Philippos Aristotelous is a senior associate in the corporate and commercial department.

significant. The island is home to a large number of extremely wealthy individuals and the financial base for many thousands of non-residents.

II TAX

i Introduction

Cyprus offers a benign personal tax system, with generous allowances and a top rate of 35 per cent on taxable income in excess of €60,000. Interest and dividends are exempt from income tax. Special defence contribution ('SDC tax') is payable on interest, dividends and rents received by resident individuals at rates of 20 per cent, 15 per cent and 2.25 per cent respectively. Non-residents are not liable to SDC tax. There are no succession taxes and all capital gains apart from those deriving from the disposal of real estate located in Cyprus are exempt from taxation.

ii Personal income tax

The tax year is the calendar year and individuals are considered to be resident if they are present in Cyprus for more than 183 days in the relevant year.

Cyprus residents are taxed on the basis of worldwide income, irrespective of whether it is remitted to Cyprus. Husband and wife are taxed separately.

Persons who are not resident in Cyprus are subject to income tax on income accruing or arising from sources in Cyprus.

Personal income tax rates are as follows:

Income band	*Tax rate*	*Cumulative tax at top of band*
0–€19,500	0	0
€19,500–€28,000	20%	€1,700
€28,000–€36,300	25%	€3,775
€36,300–€60,000	30%	€10,885
€60,000–	35%	

Relief is given for donations to approved charities, professional and trade union subscriptions, life insurance premiums and contributions to pension, social insurance and welfare funds. Relief may also be available under a double taxation treaty.

Resident expatriate employees or secondees are subject to income tax on their worldwide income at the rates shown above. For the first three calendar years following the start of their employment, individuals taking up residence and employment in Cyprus will be entitled to an annual allowance of the lower of €8,543 or 20 per cent of their remuneration. With effect from the 2012 tax year, if income from employment exceeds €100,000 per annum, a 50 per cent deduction is allowed for the first five years of employment.

Exemptions and special cases

The following are exempt from income tax:

a interest and dividends receivable by individuals (these are subject to SDC tax – see below);

b lump sums received on retirement;

c profit from the sale of shares;

d capital sums from approved life assurance policies and provident or pension funds;

e income from employment services provided abroad to a non-resident employer or an overseas permanent establishment of a resident employer for a period exceeding 90 days in the tax year;

f certain pensions, such as widow's pension;

g salaries of officers and crew of ships owned by a Cyprus shipping company that sail under the Cyprus flag and operate in international waters;

h income from a qualifying scholarship, exhibition, bursary or similar educational endowment.

For income tax purposes a 20 per cent deduction is allowed from rental income received.

The first €3,420 per annum of any foreign pension is free of tax and the excess over that amount is taxed at 5 per cent.

Special defence contribution

SDC tax is payable by Cyprus-resident (determined in the same way as for income tax) individuals on interest, dividend and rentals received at the rates set out below. Relief or credit for tax paid abroad may be available either under the terms of a double tax treaty or by way of unilateral relief.

Type of income	*Rate*
Dividends	20%
Interest	15%
Rents	3% of 75% of the rent

Special contributions by private sector employees and pensioners and the self-employed

With effect from 1 January 2012 a special contribution has been imposed for two years on remuneration and pensions paid to private sector employees and the self-employed at the following rates:

Gross monthly amount	*Contribution*
Below €2,500	0
Between €2,500 and €3,500	2.5% (minimum €5)
Between €3,500 and €4,500	3%
Above €4,500	3.5%

In the case of an employee, special contribution is borne by the employer and the employee in equal shares.

iii Capital gains tax

There is no taxation of capital gains in Cyprus apart from gains made on the disposal of real estate located in Cyprus or on the shares of companies holding real estate in Cyprus, to the extent that the gains are attributable to the real estate holding.

iv Succession taxes

There are no succession taxes in Cyprus.

III SUCCESSION

Cyprus's succession law reflects the cosmopolitan nature of the island and gives an interesting insight into its history. The current succession law dates back to when Cyprus was a British colony and the wording of the law and many of its provisions are unmistakably English. However, Cyprus succession law also enshrines the concept of forced heirship, usually associated with civil law and Islamic countries, and recognises the rights of widows of polygamous marriages.

Cyprus succession law governs the devolution by death of all immoveable property in Cyprus, regardless of the domicile of the owner, and of the moveable property of individuals who have a Cyprus domicile at the time of their death. It is incorporated in a number of enactments, the most significant of which are the Wills and Succession Law, Cap 195 ('WSL') and the Administration of Estates Law, Cap 189 ('AEL'). The WSL deals with both wills and intestacy. The part dealing with wills is based on the English Wills Act of 1837, whereas the part dealing with intestacy is based on the Italian Civil Code and reflects Continental law. Cyprus succession law therefore can be said to represent a mixture of common and civil law, in roughly equal proportions.

If an individual dies leaving certain categories of relatives, part of his or her estate, known as the statutory portion, is reserved for them and distributed according to the rules of intestacy. The actual proportion of the net estate taken up by the statutory portion varies according to which relatives survive the deceased person and can be as much as three-quarters of the net estate. Section 42 WSL provides that there is no statutory portion for anyone who was born, or whose father was born, in the United Kingdom or most Commonwealth countries. Such individuals are entitled to dispose of all their property by will. Individuals who would otherwise be subject to the forced heirship provisions can easily regain the freedom to dispose of their property as they wish by using a domestic trust or a Cyprus International Trust.

IV WEALTH STRUCTURING AND REGULATION

i Introduction

As with succession law, Cyprus offers wealth holding structures typical of both common law jurisdictions (in the form of trusts) and civil law jurisdictions (in the form of

foundations). However, foundations are rarely used in practice because of the high degree of bureaucracy under the Associations and Foundations Law of 1972 and trusts overwhelmingly predominate.

Cyprus's first law on trusts, the Trustee Law of 1955, Cap 193, dates back to when the island was a British colony and is a near-replica of the English Trustee Act 1925. The English doctrines of equity were formally introduced into the post-independence legal order by Section 29 of the Courts of Justice Law, Law 14 of 1960, which requires the courts to follow English common law and equitable principles unless there are other provisions to the contrary under Cyprus law or such adherence would be inconsistent with the Constitution of Cyprus.

ii The Cyprus international trust

In 1992 Cyprus gave itself a state-of-the-art international trusts regime with the enactment of the International Trusts Law, Law 69 of 1992 ('the 1992 Law'), which provides a framework for the establishment of trusts in Cyprus by non-residents.

The 1992 Law introduced a new type of trust, known as the international trust, with tax planning advantages and robust asset protection features. Like similar laws in other jurisdictions, the 1992 Law was not a comprehensive codification and the Trustee Law 1955 applies to international trusts except where the 1992 Law provides otherwise.

Cyprus international trusts proved extremely popular with high net worth individuals and professionals and a number of other jurisdictions introduced similar regimes. Towards the end of the first decade of the current century it became apparent that the international trusts regime in Cyprus had fallen behind its competitors'. The world had changed considerably since the 1992 Law was enacted, not least by Cyprus joining the EU, and a number of restrictions and limitations contained in the original law were no longer necessary or appropriate. New opportunities and investment practices had emerged, which the original law did not take account of. As a result, while the basic structure provided by the International Trusts Law remained sound, it required updating to adapt it to current needs and likely future developments.

The International Trusts (Amendment) Law of 2012, which entered into force in March 2012, addressed the perceived deficiencies and brought Cyprus back to the forefront of leading trust jurisdictions. It clarified the eligibility provisions for Cyprus international trusts, strengthened their already formidable asset protection features, gave settlors far more flexibility than under the 1992 Law and widened trustees' investment powers. It also made several technical amendments and aligned the International Trusts Law with the EU acquis communautaire. The Amending Law of 2012 does not repeal and replace the 1992 Law but instead builds on it. Section 16 provides that it applies to trusts created before it came into effect.

The Cyprus international trust is the structure of choice for non-resident settlors and in the following paragraphs we describe its main features under the International Trusts Law as amended.

Definition of a Cyprus international trust

The 1992 Law restricted the availability of international trusts in order to prevent tax avoidance by Cyprus residents. It provided that neither the settlor nor any beneficiary could be permanent residents of Cyprus. This is inconsistent with the EU principle of free movement of persons. Under the International Trusts Law, as amended, the restrictions are relaxed and a Cyprus international trust is now defined as trust in respect of which:

a the settlor (whether a natural or legal person) is not a resident of Cyprus for the calendar year prior to the creation of the trust;

b at least one of the trustees for the time being is, during the whole duration of the trust, a resident of Cyprus; and

c no beneficiary (whether a natural or legal person) other than a charitable institution is a resident of Cyprus for the calendar year prior to the creation of the trust.

All references to the term 'resident' of Cyprus in the amended law now have the same meaning as under the Income Tax Laws, 118(I)2002 as amended. Moreover, the removal of the prohibition against residence in Cyprus ensures full compliance with EU law regarding the free movement of persons and capital, and freedom of establishment. The removal of the prohibition on ownership of immoveable property in Cyprus avoids any difficulties that might otherwise arise if the settlor or any beneficiary were subsequently to take up residence in Cyprus.

Asset protection features of the Cyprus international trust

Asset protection trusts ring-fence the settlor's assets from persons who may have a claim against him or her. They developed as a response to the substantial amounts of damages awarded by juries in civil liability cases in the United States, particularly in medical malpractice claims. Notwithstanding the availability of professional indemnity insurance, some professions still involve a high risk of being on the receiving end of a claim which could be financially disastrous. An asset protection trust adds another layer to the defences. They are also invaluable in a variety of other contexts. In personal life, in the light of the substantial awards that courts in certain jurisdictions are making, an asset protection trust may be used to provide added reassurance against claims on breakdown of marriage or civil partnership, particularly for individuals from jurisdictions where pre-nuptial agreements are ineffective. Many countries have forced heirship provisions in their succession law, reserving a specified portion of the deceased's estate for relatives, and an asset protection trust may provide a means of regaining freedom of testation.

By their nature, all trusts provide an element of asset protection, by segregating the assets held in trust from the settlor's general assets, which would be available to satisfy his or her debts or, in the worst-case scenario, would pass to his or her trustee in bankruptcy. However, the Cyprus international trust has several further advantages.

The first is that the International Trusts Law contains a very strong presumption against avoidance of a Cyprus international trust. Unless the court is satisfied that the trust was made with intent to defraud persons who were creditors of the settlor at the time when the payment or transfer of assets was made to the trust, the trust will not be void or voidable, notwithstanding the provisions of any bankruptcy or liquidation laws of Cyprus or any other country and notwithstanding the fact that the trust is voluntary

and without consideration or that it is for the benefit of the settlor or his family members. The burden of proof of the settlor's intent to defraud lies with the person who is seeking to set aside the transfer. Furthermore, any action for avoidance of the trust or setting aside of the transfer must be commenced no later than two years after the assets were transferred to the trust.

These provisions, particularly the requirement to prove intent to defraud on the part of the settlor, set the bar very high for the claimant trying to set aside a transfer to a Cyprus international trust. Even though the standard of proof is the balance of probabilities, rather than the criminal standard, the claimant must still establish that the trust was more likely than not a fraud. This is a difficult standard to meet in practice and the burden of proving fraud is higher than is usual for civil cases. In practice, the claimant would need very strong evidence to show that the settlor intended to defraud his or her creditors. A claimant domiciled outside the EU without assets in Cyprus would be required to provide security for costs under Order 60 of the Civil Procedure Rules.

Protection against forced heirship and similar claims is provided by Section 3(i) of the 1992 Law, which stipulates that the laws of Cyprus or of any other country relating to inheritance or succession will not in any way affect any disposition of assets to a Cyprus international trust.

The Amending Law of 2012 strengthens these defences by explicitly providing that any question relating to the validity or administration of an international trust or a disposition to an international trust will be determined by the laws of Cyprus without reference to the law of any other jurisdiction. It also makes clear that the trustees' fiduciary powers and duties of trustees and the powers and duties of any protectors of the trusts are governed exclusively by Cyprus law. Furthermore, it provides that dispositions to a trust may not be challenged on the grounds that they are inconsistent with the laws of another jurisdiction, for example regarding family and succession issues, or on the grounds that the other jurisdiction does not recognise the concept of trusts.

Finally, the Amending Law of 2012 entrenches jurisdictional protection by providing that an international trust containing a choice-of-law clause in favour of Cyprus law is fully protected from unfounded foreign judicial claims as a matter of public policy and order.

These provisions further reinforce the already formidable asset protection features of the Cyprus international trust.

In another area, Cyprus has a distinct advantage over many other Commonwealth countries, in particular the Caribbean islands and Bermuda, in that it is not a party to the arrangements set out in Section 426(4) and (5) of the Insolvency Act 1986, in terms of which British courts and the courts of certain other jurisdictions are required to assist each other in insolvency cases.

Furthermore, it should also be noted that the Charitable Uses Act 1601 (also known as the Statute of Elizabeth), which invalidates arrangements made to hide assets from future creditors, is expressly negated in Cyprus.

Reserved powers and interests

The Amending Law of 2012 introduces a new section to the International Trusts Law, which allows the settlor of a trust to reserve powers to himself or herself, to retain a beneficial interest in trust property, or to act as the protector or enforcer of the trust, all without affecting the validity of the trust. The powers which may be reserved are extensive, and include the power to revoke, vary or amend the terms of the trust, to apply any income or capital of the trust property, to act as a director or officer of any corporation wholly or partly owned by the trust, to give binding directions to the trustee in connection with the trust property and to appoint or remove any trustee, enforcer, protector or beneficiary. The settlor may impose a general stipulation that the trustees' powers are exercisable only with the consent of the settlor or any other person specified in the terms of the trust. The settlor may also reserve the power to change the governing law of the trust.

These new provisions, which are similar to the corresponding provisions of Jersey and Guernsey law, give settlors great flexibility to adapt to changes in circumstances or objectives.

Duration of trusts

As was usual at the time, the 1992 Law restricted the maximum life of international trusts to 100 years from the date on which the trust came into existence. Only charitable trusts and non-charitable purpose trusts were allowed to exist in perpetuity. In the intervening period this restriction on the maximum life of trusts came to be seen as a disadvantage of trusts compared with foundations and several jurisdictions have removed any restriction on the duration of trusts.

The Amending Law of 2012 removes the restriction, by providing that from the date the amendment takes effect and subject to the terms of the trust, there will be no limit on the period for which a trust may continue to be valid and enforceable, and no rule against perpetuities or remoteness of vesting or any analogous rule will apply to a trust or to any advancement, appointment, payment or application of property from a trust. Except where the terms of a trust expressly provide to the contrary, no advancement, appointment, payment or application of income or capital from the trust to another trust is invalidated solely by reason of that other trust continuing to be valid and enforceable beyond the date on which the first trust must terminate.

Cyprus international trusts may, therefore, be established with unlimited duration.

Trustees' investment powers

The 1992 Law gave trustees freedom in terms of investment powers, merely requiring them to be exercised in accordance with the trust instrument and with the diligence and the prudence which a reasonable person would be expected to exercise when he makes investments. The Amending Law of 2012 extends trustees' investment powers, giving them the same investment powers as those of an absolute owner, allowing them to invest in a broader range of investments for the best interests of the beneficiaries. This brings trustees' investment powers into line with those of a trustee in England and Wales, and other trust jurisdictions which have followed the English Trustee Act 2000.

The Amending Law of 2012 also removes any doubt regarding trustees' ability to invest in Cyprus by including a new section specifically empowering trustees to invest in moveable and immoveable property both in Cyprus and overseas, including shares in companies incorporated in Cyprus. The abolition of the prohibition on investment in Cyprus will remove an obstacle to inward investment and provide a boost to the real estate market, which has stagnated since the onset of the global economic crisis.

Confidentiality

Section 11 of the International Trusts Law, as amended, sets out strict confidentiality obligations. It provides that, subject to the terms of the instrument creating the trust, the trustee, protector, enforcer or any other person may not provide any documents or information which disclose the name of the settlor or any of the beneficiaries or which relate to the trustees' deliberations regarding the exercise or proposed exercise of their powers and the discharge of their duties, or which relate to the financial position of the trust, except in accordance with a court order requiring disclosure. It gives the trustees power to provide a beneficiary with financial statements or any documents or information relating to their receipts and payments which form part of those accounts if the beneficiary has requested them and if, in the trustees' opinion, disclosure is necessary and in the best interests of the trust. Disclosure is limited to the accounts and the underlying documents and information concerning receipts and payments.

In order to remove any uncertainty over the consistency of these provisions with Cyprus's anti-money laundering legislation the Amending Law of 2012 introduced a clause specifically requiring trustees to comply with and implement the relevant provisions of the Prevention and Suppression of Money Laundering Activities Law.

Taxation of Cyprus international trusts

Section 12 of the International Trusts Law as amended provides for a uniform tax regime applicable to all persons on the basis of a tax residency test. In the case of a beneficiary who is resident in Cyprus the worldwide income and profits of the trust are subject to Cyprus tax. In the case of a non-resident beneficiary only income and profits earned from sources within Cyprus are subject to Cyprus tax.

Any beneficiaries who elect to become Cyprus tax residents will be subject to taxation on their worldwide income, like any other Cyprus tax resident. Non-resident beneficiaries will be subject to Cyprus taxation only on any Cyprus-source income.

For trusts which have only resident beneficiaries or only non-resident beneficiaries the application of these principles is very straightforward. Where a trust has both resident and non-resident beneficiaries, the tax authorities will determine the tax treatment by reference to the scope of rights that the respective beneficiaries have in the trust, as set out in the trust instrument.

Regulation of fiduciary service providers

A new draft law on regulation of fiduciaries, administration businesses and company directors is currently going through the legislature. Its objectives are to implement the Third EU Anti-Money Laundering Directive, which extends to trust and company service providers, and to protect users of trust and fiduciary services by putting in place a robust regulatory system and accounting requirements.

Its key provisions are as follows:

a trustee and company management service providers must be run by at least two individuals of skill and experience;

b they must be licensed and authorised as fit and proper by the Capital Markets Commission;

c they must have adequate internal controls, policies and procedures;

d they must meet prescribed accounting and reporting requirements as regards settlors, trustees and beneficiaries;

e they must act with integrity and skill.

Persons or organisations intending to provide trustee and company management services on a commercial basis must apply for licences, unless they are:

a advocates practising in Cyprus;

b persons qualified to be appointed as auditors in Cyprus;

c entities controlled and where the majority interest is beneficially owned by locally-registered advocates, banks, investment firms or cooperative credit societies as defined in the respective domestic legislation;

d any person regulated by a competent regulator in any other EU Member State, provided that there is reciprocity between Cyprus and the Member State.

These exemptions relate only to the requirement to apply for registration: there are no exemptions as regards licensing, supervision and other duties and obligations.

Persons carrying on any regulated activity by way of business may continue to do so on a transitional basis provided they are qualified and have applied for registration and licensing.

Service providers will be subject to continuous monitoring and the Capital Markets Commission may appoint inspectors to investigate the affairs of a licensed fiduciary or other business offering fiduciary services.

Service providers must put in place adequate arrangements to segregate and account for clients' funds and they must comply fully with all anti-money laundering legislation, including having a clear understanding and evidence of the client's identity and the pattern of the client's business.

V CONCLUSIONS AND OUTLOOK

The International Trusts Law of 1992 gave Cyprus a state of the art international trusts regime, with excellent tax mitigation and asset protection features. It was very well received, as evidenced by the large number of trust service providers established in Cyprus and Cyprus's continuing popularity with settlors from the former Soviet Union. Over the ensuing 20 years, as other jurisdictions modernised their trusts legislation, Cyprus lost some of its competitive edge, though the basic structure provided by the International Trusts Law remained sound. The 2012 amendments bring the Cyprus international trust regime back to the cutting edge internationally, giving Cyprus the most modern and favourable trust regime in Europe, and providing settlors and beneficiaries with the highest possible degree of protection, confidentiality, flexibility and assurance.

Appendix 1

ABOUT THE AUTHORS

ELIAS NEOCLEOUS

Andreas Neocleous & Co LLC

Elias Neocleous is head of the corporate and commercial department of Andreas Neocleous & Co LLC. He is a graduate of Oxford University and a barrister of the Inner Temple, and was admitted to the Cyprus Bar in 1993. He is a founder member of the Franchise Association of Greece, a member of the International Bar Association and the International Tax Planning Association, an honorary member of the Association of Fellows and Legal Scholars of the Center for International Legal Studies, honorary secretary of the Limassol Chamber of Commerce and Industry and serves on the committee of STEP Cyprus. His main areas of practice are banking and finance, company matters, intellectual property law, international trade, tax and trusts and estate planning, and he has many publications to his credit in the fields of corporate, taxation and trust law.

PHILIPPOS ARISTOTELOUS

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Philippos Aristotelous is a senior associate in the corporate and commercial department of Andreas Neocleous & Co LLC. Philippos graduated in Law from the University of Kent in 2003. He is a barrister of the Inner Temple and was admitted to the Cyprus Bar in 2005. Philippos specialises in international taxation and trusts. He was the national reporter to the Tax Committee of the International Bar Association for the period 2009–2011 and he is a member of the Society of Trust and Estate Practitioners and the International Tax Planning Association.

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