

Recent developments in the international services sector and how they affect Cyprus

Significant global reforms have taken place in the financial services sector which will not only affect their main target, the so-called tax havens, but also mainstream international financial centres such as Cyprus.

While these initiatives are usually implemented by national legislation, they generally have their origins in high-level decisions and resolutions of supranational organizations and bodies such as the Organization for Economic Cooperation and Development (OECD), the OECD's Forum on Transparency and Exchange of Information, the so-called G20 and the European Commission.

The main issues which these bodies aim to address include tax evasion, unfair tax competition, aggressive tax planning and the inappropriate exploitation of loopholes in double taxation avoidance agreements and certain European directives. They do so by promoting a network of preventive measures and the consolidation of business substance requirements, backed up by increased exchange of information between jurisdictions.

In the new environment that is evolving it has become impossible, or at least pointless, for companies to be established without the necessary degree of business substance, i.e. companies that do not have real and qualified directors who are able to exercise independent judgement as well as real management and control over the companies, companies which lack any form of functional and operational infrastructure as well as those established without any genuine economic and business rationale, other than to obtain tax advantages.

In this respect, Cyprus has shown remarkable zeal and a commitment to introducing national legislation to implement these reforms.

It has adopted the common reporting standard (CRS) in respect of the automatic exchange of information framework which will be implemented as of this year in relation to taxpayers of other countries participating in the CRS network, with Cyprus being among the early adopters.

Moreover, new measures have been introduced into the Cyprus legal order to implement the enhanced requirements of the latest EU Parent Subsidiary Directive, something that is also directly connected to the issue of substance.

At the same time, Cyprus has made significant progress in gradually introducing the comprehensive set of measures, actions and safeguards of the OECD initiative aimed at combating the erosion of the tax base and the shifting of corporate profits (the BEPS initiative).

For example, it has already introduced rules to deny the granting of tax relief to wholly artificial structures set up without any genuine economic purpose, as well as to structures involving the use of hybrid instruments which have no purpose other than to achieve double non-taxation.

Furthermore, Cyprus has effectively modernized its "intellectual property box" regime, which provides tax incentives to Cypriot companies that are active in the development of specific forms of intellectual property. The new regime is fully aligned with Action 5 of the BEPS action plan, which introduces the modified nexus approach, linking tax relief to genuine activity. The new regime as established in Cyprus retains its attractive discount of 80% from the relevant taxable income available under the previous regime, which was closed to new entrants on 30 June 2016. The discount is now available in respect of a more narrowly defined class of intellectual property assets, which include software patents.

Finally, on 30 December 2016, in the context of enhancing fiscal transparency within its jurisdiction, Cyprus issued a Decree implementing country-by-country reporting. The Decree incorporates the provisions of Directive 2011/16/EC (as amended) concerning the mandatory and automatic exchange of country-by-country information. This development is consistent and in line with the recommendations of

Action 13 of the Base Erosion and Profits Shifting Action Plan.

In the new environment, Cyprus closely monitors international developments and challenges and responds appropriately, ensuring that it continues to be at the forefront of reputable international financial centres. The introduction of additional significant tax incentives such as the “non-domiciled” Cyprus tax resident regime and the notional interest deduction scheme have been welcomed and taken up by investors who wish to use Cyprus as a springboard for the establishment of their headquarters on the island. Such an objective could also be combined with their strategic plans to access new markets and therefore also utilize Cyprus’s important geographical position. Such incentives also help to attract valuable human capital resources, helping businesses to meeting their operational and functional requirements and also strengthening their administrative and operational substance for tax purposes.

It is evident that the future of the international business sector in Cyprus will greatly depend on the full compliance of the island with international trends, developments and regulations and its focus will be on quality and on attracting high quality clients who wish to take advantage of a broader network of infrastructural assets and benefits of the island. This is a welcome prospect, as it is expected to deliver significant long-term benefits on various levels both for Cyprus itself and for investors who continue to place their trust in the island.