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Cyprus – Ukraine: a strong bond for the future

1 Introduction

1.1 Cyprus and Ukraine have enjoyed a long-lasting relationship on a number of aspects as their close historical affiliation and shared religion and cultural heritage stretches back to the Byzantine Empire. In recent years their common economic interests have been magnified and are continuing the trend of ever closer collaboration.

1.2 This publication outlines the business landscape between Cyprus and Ukraine, in the context of the recently adopted Cyprus-Ukraine Double Tax Treaty (the "**DTT**"), the benefits investors stand to gain via the use of Cypriot companies as holding, financing and/or licencing entities and also how the use of a Cyprus International Trust can enhance wealth protection and maintenance.

2 Cyprus – Ukraine DTT

2.1 Following the trend of strengthening of economic ties between the two countries, on 8 November 2012 Cyprus and Ukraine have signed a new DTT (the "**2012 DTT**") which replaced the former Cyprus-USSR DTT. The 2012 DTT entered into force on 1 January 2014. Due to policy reasons in Ukraine, an amending Protocol to the 2012 DTT (the "**2015 Protocol**") was signed in December 2015. Cyprus ratified the 2015 Protocol in December 2015 and the Ukrainian Cabinet of Ministers has approved the 2015 Protocol's submission to the Ukrainian Parliament for ratification. The 2015 Protocol is scheduled to be effective from 1 January 2019 at the earliest.

2.2 The main features and rates of the 2012 DTT and the 2015 Protocol are set out in the table below. Note that these rates are applied for payments made from Ukraine to Cyprus, where the relevant conditions are met. With respect to payment from Cyprus, in accordance with Cyprus tax legislation, there are no Cyprus withholding taxes on payments of dividend, interest or royalties not used in Cyprus towards non-Cyprus residents.

Item	2012 DTT	2015 Protocol	What is changing
Dividends	• 5% Withholding Tax (“**WHT**”) if beneficial owner holds at least 20% of the capital of the dividend payment company OR has invested in the acquisition of shares or other rights of the dividend paying company of at least €100,000. • 15% WHT in all other cases.	• 5% WHT if beneficial owner is a company holding directly at least 20% of the capital of the dividend payment company AND has invested in the acquisition of shares or other rights of the dividend paying company of at least €100,000. • 10% WHT in all other cases.	• Lower rate only available to corporate shareholders • Both conditions have to be satisfied (rather one of the two) • Higher rate reduced from 15% to 10%.
Interests	• 2% WHT	• 5% WHT	• Revised upwards (but still very low)
Royalties	• 5% WHT with respect to royalties relating to copyrights of scientific work, patents, trademarks, secret formulae, process or information concerning industrial, commercial or scientific experience. • 10% WHT in all other cases.	• 5% WHT with respect to royalties relating to copyrights of scientific work, patents, trademarks, secret formulae, process or information concerning industrial, commercial or scientific experience. • 10% WHT in all other cases.	• No amendment
Capital Gains on shares or other movable property	• Taxing rights on disposal of all shares (including property rich companies) with the State where the person making the disposal is a tax resident.	• Primary taxing rights on disposal of shares in companies deriving more than 50% of their value directly or indirectly from immovable property are with the State where the immovable property is situated (but only for the part of the gain relating to the immovable property). • Exceptions apply*	• Certain Ukraine property rich companies may be taxed in Ukraine.

* Exceptions apply for:

- Cyprus entities being (i) public entities (ii) provident funds (iii) pension funds (iv) and/or listed in a stock exchange.
- Ukrainian entities being (i) listed in a stock exchange (ii) in the course of corporate re-organisation (iii) where the immovable property from which the shares derived their value is immovable property in which the business is carried on (iv) public companies and (v) similar interests in Real Estate Funds.

3 Features of Cyprus Tax System Enhancing Tax Benefits of DTTs

3.1 Cyprus tax legislation provides for numerous tax advantages that greatly enhance the tax efficiency of structures at the Cyprus level. In addition, Cyprus' tax and legal system are in compliance with EU and OECD requirements, which means that Cyprus is included in the 'White List' of international cooperative jurisdictions. Key features of the Cyprus tax system are the following:

3.1.1 corporation tax rate of 12.5% (one of the lowest in the EU);

3.1.2 inbound dividends (i.e. from subsidiaries of Cypriot companies) are tax exempt;

3.1.3 Cyprus Income Tax Law provides for the following:

(i) outbound dividends (i.e. declared by Cypriot companies) are not subject to any withholding taxes and totally tax exempt if paid to a non-Cypriot shareholder (otherwise subject to Special Defence Contribution ("**SDC**"));

(ii) 0% withholding tax on interest paid by Cypriot company; and

(iii) 0% withholding tax on royalties;

3.1.4 no tax on gains from the sale of shares in Cypriot companies (unless they relate to immovable property in Cyprus);

3.1.5 full implementation of EU Directives, resulting in acquiring the tax benefits granted to intra-community transactions; and

3.1.6 no inheritance tax.

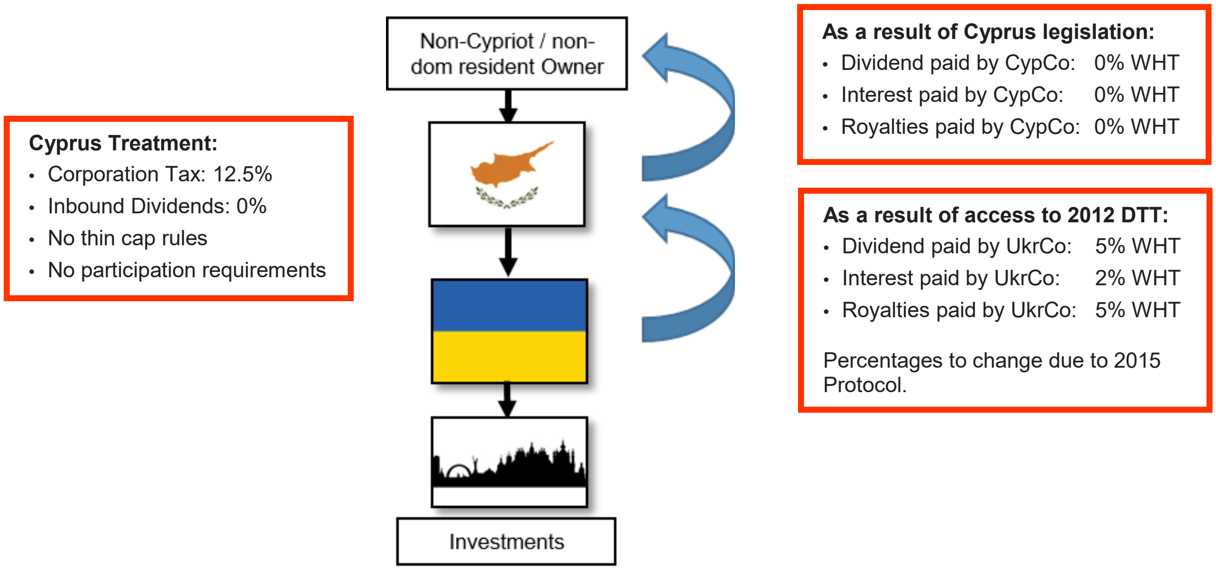
4 CRS (Common Reporting Standard)

4.1 In the new world we are living in of globalisation and exchange of information, 96 separate tax jurisdictions (55 early adopters and 41 late adopters) have decided to proceed with the exchange of information with respect to the beneficial owners' bank accounts balances (and the ones of the entities beneficially owned by him that are classified as 'passive' entities) from 1st January 2016 and 1st January 2017 respectively and with reporting dates 31st March 2017 and 31st March 2018 respectively.

4.2 Ukraine, unlike Cyprus, is not part of CRS reporting so with respect to beneficial owners having bank accounts in Cyprus, no information will be exchanged to the Ukrainian tax office.

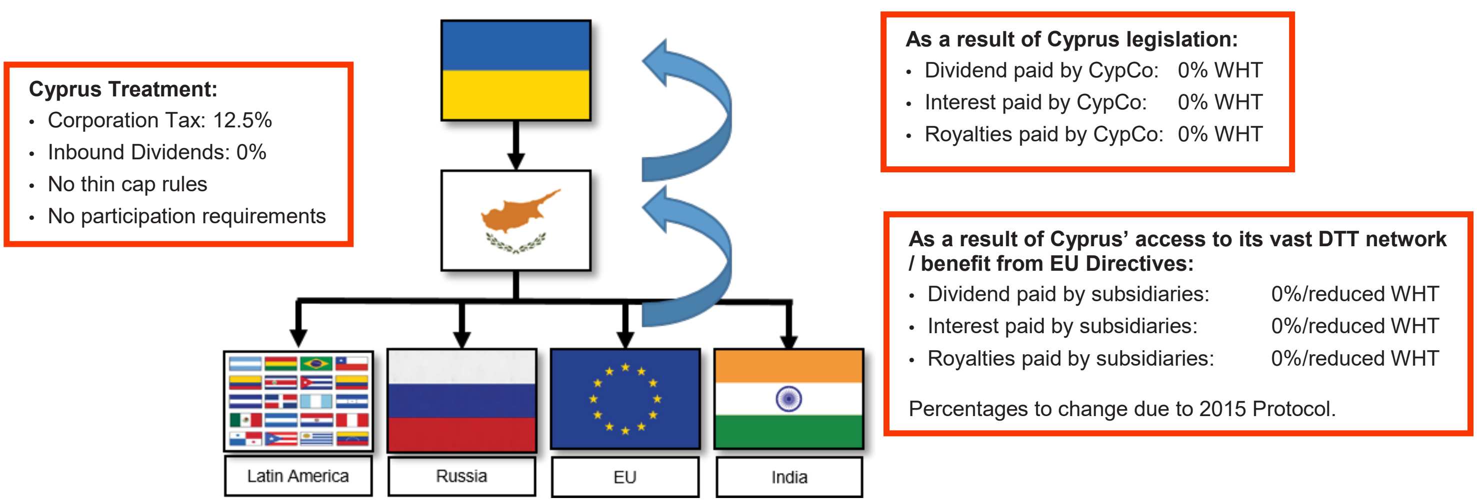
4.3 It is strongly advisable to closely monitor any changes in the CRS Reporting standards in order to be able to swiftly reach and consider the structures already in place with a view to maintain tax efficiency.

5 Inward investments to Ukraine via the use of Cyprus holding companies



A non-Cypriot owner can be a Ukrainian tax resident where he will receive dividends back to Ukraine or can leave profits to accumulate at the Cyprus level, or indeed may choose to become a non-domicile resident and enjoy the numerous tax advantages afforded by such status (see paragraph 7.4 for more information)

6 Outward / international investments from Ukraine via Cyprus holding companies



The above diagram outlines an efficient use of Cypriot holding companies for Ukrainian investors investing outside of Ukraine. The use a Cypriot holding company effectively grants access to jurisdictions where Ukraine does not have a DTT. Cyprus therefore can be considered as a 'gateway' of international investments by Ukrainian investors.

7 Use of Cypriot companies in back-to-back financing structures

7.1 Traditionally Cyprus companies have been utilised as finance investment vehicles for intra-group financing structures leading to efficient accumulation of interest income.

7.2 The typical structure would be for a Cypriot company to be (i) a subsidiary of a foreign company incorporated in a zero / very low corporate income tax jurisdiction (e.g. Seychelles, BVI) and the parent of the Ukrainian operating / investment company. A loan from the parent offshore company was passed to the Cypriot company and then on to the Ukrainian company with respective interest received.

7.3 However, given the implementation of the Common Reporting Standards (CRS) and Automatic Exchange of Information, the passive nature of interest income effectively negates the benefits gained via the use of the above structures for most beneficial owners. For the moment, Ukrainian tax residents can still enjoy this structure given that there is no CRS implemented yet in Ukraine. But this should be closely monitored so that the structure can be effectively shifted into either using the non-domicile tax residency (see paragraph 7.4) or via the notional interest deduction rules (see paragraph 8).

7.4 An investor may, however, keep all the benefits of using this structure if he considers relocating to Cyprus and utilises the tax advantages gained by the recently adopted non-dom regime, which include:

7.4.1 0% tax on passive interest income;

7.4.2 0% tax on rental income;

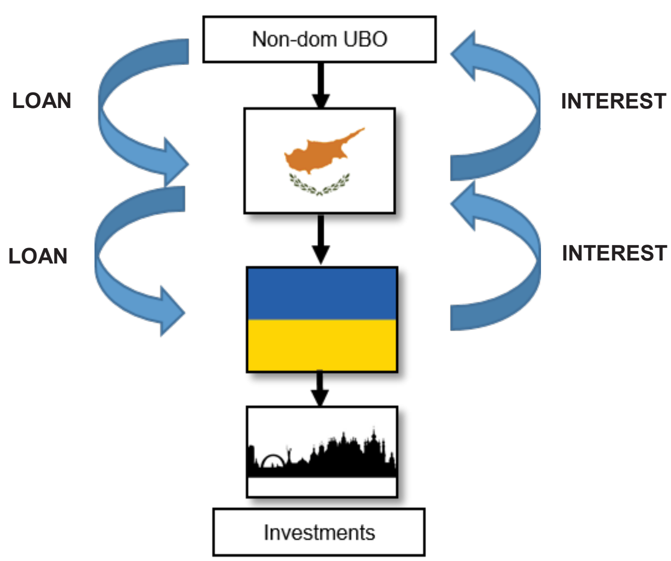
7.4.3 0% on dividends income;

7.4.4 50% exemption on employment income in case this is over €100,000;

7.4.5 100% exemption on the entire amount gained from the disposal of titles such as shares, bonds, debentures, futures, options and others;

7.4.6 no Capital Gains Tax on the sale of immovable property situated out of Cyprus; and

7.4.7 no Capital Gains Tax from the sale of immovable property situated in Cyprus which was acquired between 16/07/2015 and 31/12/2016.



Cyprus Treatment:

- Corporation Tax on income received from intra-group lending: 12.5%
- No thin cap / debt-to-equity restrictions
- No transfer pricing legislation in place, however, loans have to be advanced on an arm's length basis
- With respect to back-to-back financing, Cypriot tax authorities have accepted minimum interest margins as follows:
  - Less €50m: 0.35%
  - €50m - €200m: 0.25%
  - Over €200m: 0.125%

8 Use of Cypriot financing companies in conjunction with Notional Interest Deduction

8.1 The implementation of the Notional Interest Deduction ("**NID**") rule in Cyprus since July 2015 has created a powerful tool to local and international organisations seeking new options to finance their operations. By using NID, businesses have the opportunity to deleverage and realise a new, tax efficient return on new equity, via the deduction of a 'notional' interest expense against their taxable income.

8.2 Equity financing in Cyprus can therefore constitute a very useful alternative to debt financing (thus avoiding the use of, now inefficient, offshore financing parents of the Cypriot company). The use of NID can achieve effective tax rates in Cyprus of up to 2.5%.

8.3 The NID rate is equal to the higher of:

8.3.1 3% plus the yield on the 10-year government bonds (as at 31 December of the year preceding the tax year the NID is claimed) of the country where the funds are deployed (e.g. in Ukraine); and

8.3.2 3% plus the yield on 10-year government bonds of Cyprus.

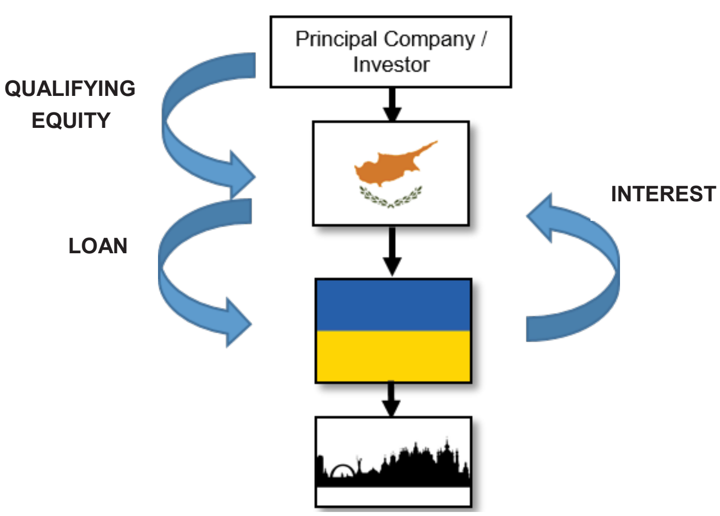
8.4 The NID rule works as follows:

8.4.1 qualifying equity[1] is contributed to the Cypriot company;

8.4.2 a tax deduction is allowed following the application of the NID rate to the amount of qualifying equity contributed to the Cypriot company (the deduction is made in a similar manner as if it was actual interest expense i.e. only if it is used to finance business assets);

8.4.3 NID is deducted following the determination of the taxable profit of the company, which can be up to a maximum of 80% of the taxable profits of the company. This deduction is made annually and in perpetuity.

PROPOSED STRUCTURE



WORKED EXAMPLE

For the purposes of the below example, we have assumed that Qualifying Equity of €1,000,000 is contributed to CypCo and that 8.5% NID rate is applicable:

	No NID	With NID
Taxable profit	€100,000	€100,000
NID		€80,000
Taxable Profit	€100,000	€20,000
Tax	€12,500	€2,500
Effective Tax Rate	12.5%	2.5%

[1] Qualifying equity is generally equity contributed (in cash or in kind): (i) as from 1 January 2015 in the form of paid up share capital of share premium; or (ii) pre-existing shareholder reserves which are converted into share capital.

9 Cyprus Royalties Company – the IP Box

9.1 IP is undoubtedly a very valuable asset of most businesses. Thus, choosing the appropriate regime and location for structuring the exploitation of IP assets is paramount for businesses striving to achieve business development, effective IP protection and maximum tax optimisation.

9.2 A Cypriot sub-licensing company may be interjected between the non-resident beneficial entity / non-dom beneficial owner and the licensee company which will actually exercise the rights on the IP. As a result, royalty payments will be made by the licensee to the Cypriot sub-licensing entity.

9.3 In Cyprus, the net royalty profits are subject to 12.5% corporation tax and any gains from the sale of shares of the Cypriot royalty company are totally exempt from tax. In addition, under new tax incentives implemented in Cyprus, provided the majority of the actual work for developing the IP takes place in Cyprus:

9.3.1 80% of any income (net of any direct expenses) generated from the IP rights is exempt from corporation tax; and

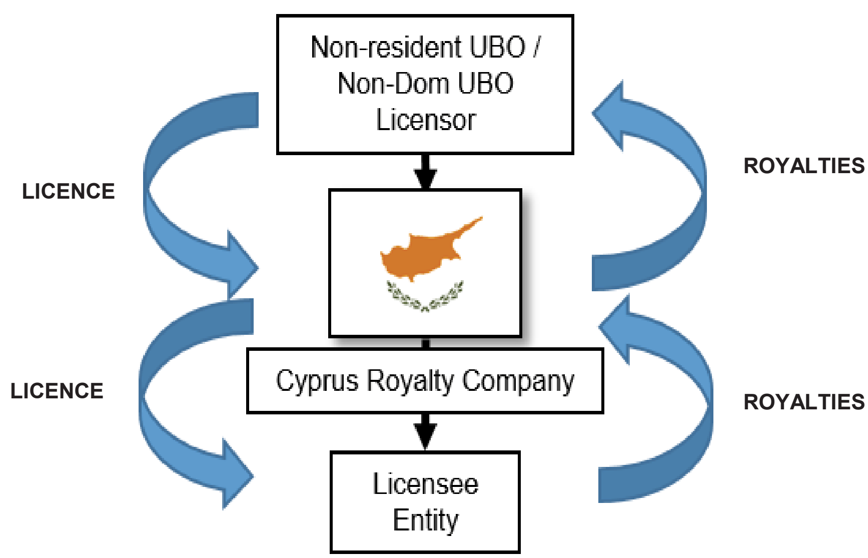
9.3.2 80% of profit (net of any direct expenses) generated from the disposal of IP by Cypriot companies is exempt from corporation tax.

9.4 Furthermore, royalty payments are exempt from withholding taxes in Cyprus provided that the rights are exercised abroad and not in Cyprus.

Cyprus Treatment:

- Net royalty profits are subject to 12.5% corporation tax
- provided the majority of the actual work for developing the IP takes place in Cyprus:
  - 80% of any income (net of any direct expenses) generated from the IP rights is exempt from corporation tax
  - 80% of profit (net of any direct expenses) generated from the disposal of IP by Cypriot companies is exempt from corporation tax

PROPOSED STRUCTURE



10 Cyprus International Trust – a powerful wealth management and preservation tool

10.1 Cyprus International Trusts ("**CITs**") can be created under an enhanced and re-developed legislative framework which was enacted in Cyprus in recent years. They are very powerful and efficient tools for wealth management but also crucially for wealth protection and preservation. For example, the assets settled under a CIT are shielded from interference by actions and events such as divorce, death / inheritance issues and separations. CITs are also exceptionally useful for the purpose of passing down assets for the benefit of future generations and the management of these assets in various, tax-beneficial manners.

10.2 There are a number of features of a CIT which make it a highly desirable vehicle for wealth management and wealth preservation:

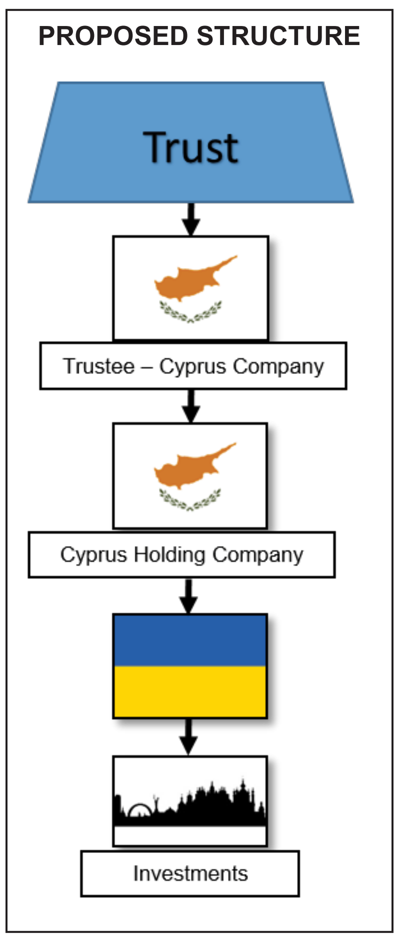
10.2.1 the duration of the CIT is not subject to any time limitations;

10.2.2 the CIT is exempt from estate duty, inheritance tax, income tax, capital gains tax or any other taxes in Cyprus (provided that the CIT assets do not include immovable property in Cyprus);

10.2.3 the confidentiality of the settlor and beneficiaries is ensured with minimum registration requirements; and

10.2.4 the safe management of the CIT can be ensured by appointment of 'protectors' and 'enforcers' appointed under the trust instrument by the settlor. In addition, the settlor may choose to retain the right to revoke/amend the terms of the CIT.

Cyprus Treatment:
- No inheritance or estate duty tax
- No withholding taxes on dividends, royalties and interest received in or paid from Cyprus
- No capital gains tax provided no immovable property in Cyprus
- 12.5% corporate income tax on net profits
- after the passing of two years from the date assets are settled under the CIT, no action can be brought against the trustee and the trust assets (i.e. the assets are then considered to be unassailable).



Requirement for setting up a CIT:
- the settlor (i.e. the person setting up the trust) is not a resident of Cyprus during the calendar year prior to the creation of the CIT;
- at least one of the trustees is a resident of Cyprus for the whole duration of the CIT; and
- no beneficiary is a resident of Cyprus during the calendar year prior to the creation of the CIT (but can become subsequently).

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11 Conclusion

11.1 It is evident that Cyprus offers one of the most attractive tax regimes in the world.

11.2 With an extended network of double tax treaties, one of the lowest corporation tax rate in the European Union and a very competitive regime on dividends, interest and royalty payments, Cyprus is an obvious and ideal choice for international group structures and high-net worth individuals.

11.3 Cyprus also enjoys a unique geographical location in the south-eastern part of Europe and at the crossroad of three continents thus giving it an unparalleled ability to act as a gateway to and from Europe, the Middle East, Africa and Asia.

11.4 The 2012 DTT and the 2015 Protocol confirm the ever closer cooperation between Cyprus and Ukraine and the magnified investment opportunities that exist between the two countries.

11.5 Kaimakliotis LLC is well placed to provide legal and structuring advice on putting in place new, reviewing existing and if necessary restructuring structures.

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