Use of Cypriot Trusts and Funds in tax planning

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INTRODUCTION TO CYPRUS ICIS

- A Cyprus ICIS fund provides an attractive mechanism for tax efficient investment in various jurisdictions.

- The establishment, operation and regulation of ICIS are governed by Law No. 47 (I) of 1999 and regulated by the Central Bank of Cyprus.

- The ICIS operates under the EU framework and offers investors a great deal of protection with respect to safety of assets, regular fund valuations and financial reporting.

- No restrictions on how much money can be raised or in what types of assets the money will be invested.
Taking into account the investment policy and the particular investment objectives, an ICIS may be designated as one of the following:

1. **Marketed to the general public** (regulated by the Cyprus Securities and Exchange Commission)

2. **Marketed solely to experienced investors** (regulated by the Cyprus Securities and Exchange Commission, can have more than 100 investors, and Investment Manager with EU license is required), or

3. **Private ICIS or PICIS** (maximum of up to 100 investors)

Our presentation will focus on the **private ICIS (PICIS)**.
FORM OF PICIS

An **ICIS** may take one of the following four legal forms:

1. International Variable Capital Company (IVCC)
2. International Fixed Capital Company
3. International Unit Trust Scheme
4. International Investment Limited Partnership Scheme
1. International Variable Capital Company (IVCC)
   - The most commonly used ICIS legal form
   - A limited company incorporated under companies law, its capital can be issued and redeemed as investors buy in and out of the fund
   - Can have fixed or unlimited duration
   - Unit holders can be individuals or entities

2. International Fixed Capital Company
   - Same as IVCC, except that its share capital cannot increase or decrease (defined upon formation)
FORM OF PICIS (continued)

3. **International Unit Trust Scheme**
   - Is an international trust created under the International Trusts Law
   - A trust is legally defined as a relationship by a person (the settlor) who places assets under the control of the trustee for the benefit of a third party (the beneficiary/ies). These assets are separate and are not part of the trustee’s own estate

4. **International Investment Limited Partnership Scheme**
   - Is a limited partnership that is registered under the Partnership and Business Names Law
   - The partnership must appoint a general partner who has responsibility for the actions of the business, can legally bind the business and is personally liable for all the business's debts and obligations.
   - The investors are Limited partners of the scheme and their liability is limited to the amount they have contributed to the scheme.
   - A legal entity can act as General or Limited Partner
COMMON USES OF CYPRUS FUNDS

Clients who set up and operate ICIS include real estate companies, financial services companies, fund managers, investment firms and high net worth individuals. The following are the most common uses of a Cyprus fund:

- Property funds for investing in real estate ideally situated in the EU or tax treaty countries (Russia, India, Poland, etc)
- Funds for investment in securities, realizing gains at zero tax
- Fund of funds consolidating a specific objective, target return and risk profile
- Accumulation of funds of high net worth individuals in a private fund.

In the case of Polish projects, we will now see ICIS being used to hold various types of Polish operating companies in the form of Spolka komandytowo-akcyjna SKA, or “Joint Stock Limited Partnership”.
ADVANTAGES OF PICIS

Tax Advantages

- Treated as a regular Cyprus company, thus subject to CIT of 10%, being the lowest rate in the EU. However, in practice, most PICIS earn only income which is exempt from tax in Cyprus e.g. dividend income, capital gains, etc.
- No tax on disposal of securities as defined by the Cyprus Income Tax Law.
- Participation exemption system on dividends and profits from PE abroad with no minimum holding period.
- No withholding taxes on payments of dividends, interest, and royalties paid to non residents (subject to some conditions in the case of royalties)
- No thin capitalisation rules.
- Wide network of double tax treaties (DTT)
- Transfer of shares by way of donation to a PICIS is non taxable, although share-for-share exchange is preferable.
ADVANTAGES OF PICIS (continued)

Non-Tax Advantages

- Operates in an EU member state and compliant with EU laws and regulations
- A Cyprus fund can list easily on most stock exchanges within the EU
- Has access to Global Markets
- Minimum regulation and statutory requirements can be limited to quarterly Net Asset Valuation (NAV) report, audited annual financial statement, unaudited 6 month balance sheet
- Greater operational flexibility, in terms of both the choice and structuring of the investment portfolio, and in relation to the internal structuring of the fund itself
- Dividends can be paid out without audited accounts or auditor confirmation
- Less red tape and can pursue more aggressive investment strategies than a fund registered in a traditional jurisdiction which is usually a higher tax country
- Licensing in Cyprus and the existence of a regulatory framework improves transparency and legitimacy with regard to shareholders, authorities and others
Getting started

- A few corporate and/or individual investors are required, with each contributing cash or in kind a minimum of EUR€50,000

- In the case of a corporate investor, the Central Bank of Cyprus (CBC) does not require details of Beneficial Owner (although administrator of fund is legally required to have such KYC information)

- At least one management shareholder

- Minimum of 2 Cypriot executive Directors

- A sound business strategy the Private Offering Memorandum (POM). This is typically a 25-35 page document detailing structure of fund, details of assets and liabilities, strategy, and risks to investors

- Appointment of Fund Manager is optional
Investor Shareholders

- Investment shares cannot be sold to third parties
- Can be redeemed at prevailing Net Asset Value per share (subject to any restrictions which are stated within the M&AA and Private Offering Memorandum).
- Can have more than one class of investor shares for different projects
- Maximum 100 private investors.
Management Shareholders

- No rights to dividends and not redeemable
- On winding up have subordinate capital status
- Right to vote on the following matters:
  1. The appointment or removal of any Director
  2. The winding up of the Fund
  3. Any amendment to the Memorandum and Articles of Association of the Fund affecting the foregoing matters subject to the provision of the relevant companies’ law
  4. To cancel/create/convert one or more additional classes and sub-classes of shares or other shares of such number, par value and denomination. This can be for management shares or investment shares
Fund Manager

- It is possible, but not a requirement, to appoint a fund manager which must be approved by the Central Bank of Cyprus

- Manager is recommended when volume of investment decisions is high

- Manager can be foreign entity

- Manager will provide investment advice and recommendation to the Board of Directors of the fund and is required to have an established place of business in Cyprus

- The fund manager does not in any way release the Directors of their statutory duties of liability

- Useful way to extract fees from the Fund which are tax allowable
Benefits

- Exemption of income from taxation in Poland
- A Polish Joint-Stock Partnership (SKA) is treated as tax transparent and its profits are subject to Polish corporation tax in the hands of its partners. Under current practice, the Polish Tax Authorities treat a SKA as a permanent establishment in Poland within the meaning of double tax treaties. The income of a SKA is taxable in the hands of the partners on the grounds that it is attributable to a PE in Poland. However, if the partner is a PICIS, the profit of the SKA attributed to it is exempt from corporation tax in Poland under the Polish tax law provisions.
- Distributions from PICIS, profits from disposal and redemption of PICIS’s units exempt from taxation in Cyprus
- No withholding tax on dividend and interest payments to FP
- Advance tax rulings can be obtained in both Cyprus and Poland

Client profile

- Multinational group with activities in Poland
- Structure can also be used by private equity investors
Trust is an agreement whereby a Settlor settles property into the trust and the property is held by one or more persons (the Trustees) either for the benefit of a third person or persons (the Beneficiaries) or for specified purposes. The Settlor can also be a Beneficiary.

The concept of the Trust is Anglo-Saxon and is unique to such legal systems. The Cyprus Trustees Law Chapter 193, is based on the English Trustee Act. The English equitable principles on Trusts are applicable in Cyprus as well, because Equity is part of the law of Cyprus.

A Trust may be created by the owner of property during his lifetime by Deed or upon his death by a letter of wishes.

The Trust Property can include all kinds of assets situated anywhere in the world.

Length of the trust period can be varied, as can the income accumulation and distribution periods.

Trustees can accept further property as part of the Trust property.
TYPES OF TRUSTS

There are no particular formalities for the creation of a Trust and indeed the categories of Trusts that can be created is restricted only by the result that the Settlor ultimately wishes to achieve

- A discretionary trust is a trust whereby the Trustee manages assets/income distributions to the beneficiaries

- Non-Discretionary (Fixed) whereby the Trustee acts on Instructions, but there could be exemptions

- Protective trust whereby, for example, life interest becomes effective upon bankruptcy of a beneficiary

- Trading Trust, usually owns a Ltd co which has powers to carry on business

- Charitable Trust
USES OF DISCRETIONARY TRUSTS

- Privacy

- Protection of Private Wealth
  - Can provide flexibility over the identity of the beneficiaries and the extent of the interest taken by them in order to take account of future developments
  - Where the Settlor wishes to give a more positive guidance, it is possible to include a further party into the Trust Deed who is known as the "Protector" or "Nominator". The Protector's role is negative in that he can only prevent the Trustees from exercising their discretion in certain circumstances

- Tax Planning

- Change of nature at home country/ inheritance tax

- Pension or remuneration plans are typically set up as a trust, with the employer as settlor, and the employees and their dependents as beneficiaries

- Reducing payroll costs

- Charities
USES OF DISCRETIONARY TRUSTS (continued)

- Acquisitions – mostly used for joint acquisitions
- Regulate relationships between partners and profit sharing
- Individuals who have income arising overseas may not wish to remit to country of residence, can remit to their trust settlement
- Individuals may wish to divest personal assets for fiscal or other reasons
- Anonymity and Confidentiality, particularly for trading and financial activities
- Elaborate Documentation
- Buy out clauses for disposal or acquisition of share in the Trust
NON-DISCRETIONARY TRUSTS

- Trustee holds the shares of the Trust Co under the Trust Agreement
- Trustee acts on instructions e.g. when appointing the Director/General Manager of Investee Companies
- Trust Co resolves on certain issues of Investee Companies independent of Director/General Manager
TAXATION OF TRUSTS

Position of IR and tax practice unclear

Problems

- Who do you tax?
  - Trust
  - Trustees
  - Beneficiaries

- When do you tax?

- What do you tax?

- Income from sources in the Republic/outside the Republic
The Cyprus Income Tax Law

- Tax is imposed on persons
- Person includes individuals & companies
- Definition of company is wide
- Trusts are not taxed, “looked through”
- The tax burden is borne by the beneficiaries
- Tax can be imposed on Trustees on behalf of the beneficiaries
TAXATION OF TRUSTS (continued)

- Silent on timing of taxation
- Silent on what you tax
- Silent on income from former IBCs

The Assessment and Collection of Taxes Law

- Trustees responsible for filing returns & for payment of taxes
- Tax is imposed on the trustees when they act for non resident beneficiaries at the corporate tax rate
- Beneficiaries can file a return and pay tax at income tax rates
TAXATION OF TRUSTS (continued)

- Trusts can not be registered as shareholders/owners of property
- Trusts can not have a bank account in their own name
- Taxation of dividends
- Taxation of interest
- Taxation of rents
TAXATION OF TRUSTS UNDER DTTs

OECD Model Treaty

- General Definitions
  - Company and any other body of persons
  - Company is any entity treated as body corporate for tax purposes
- Resident
  - Any person liable to tax under local legislation
- Trusts generally qualify under other body of persons but resident issues
  - Is the trust itself taxable?
  - Is taxation restricted to sources within the state?
  - Where is the trust deemed to be resident?
Contacts

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