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BENEFITS OF THE CYPRUS AND UAE TAX TREATY

In February 2010, a double tax treaty was signed between Cyprus and the UAE. In January 2012 the tax treaty became effective. The double tax treaty follows the OECD model convention for tax treaties. A double tax treaty aims at avoiding double taxation of residents of both countries and make international tax planning predictable.

The UAE double tax treaties often have a different definition of a "resident", compared to the OECD model convention. This is mainly because countries that conclude treaties with the UAE do not wish to give away too many taxing rights, as income in the UAE is not taxed. Some treaties therefore restrict benefits to nationals of the UAE or government entities and restrict residency to companies and individuals who can benefit from the treaty.

In the treaty between Cyprus and the UAE, an **individual** is considered "resident of the UAE" if so determined under UAE law. In Cyprus, an individual is considered resident if he is liable to tax by reason of residence. The Cyprus criterion follows the OECD model but the UAE criterion does not. This can be favourable because it means that an expatriate in the UAE with a residence visa can be considered resident for the purposes of the treaty. It is unclear in the UAE double tax treaties if a liability for tax requirement arises as one cannot be liable for tax in the UAE since there is no tax. If, on the basis of these criteria, an individual is considered resident in both states, then the treaty determines that the person shall be considered resident in the country where he or she maintains a permanent domicile.

The residency tests for **companies** for the purposes of this treaty is that the UAE considers a company resident if it is formed under the laws of the UAE and this will also include international business (offshore) companies operating in the UAE emirate of Ras Al Khaimah (RAK). Cyprus considers a company resident if the place of effective management is in Cyprus. If the result is that the company is considered resident of both countries, then the place of effective management will be decisive.

If, therefore, UAE tax residence of a company is important and there could be issues as to whether effective management of the company is exercised in Cyprus or not, it is better to use a UAE incorporated company than one incorporated in any other offshore jurisdiction (say BVI) because only the first one has treaty protection.

This is an issue when, for example, a company owned by a Cyprus resident owns real estate in the UAE. Under Cyprus law, if the effective management of

the company is considered to be in Cyprus then the income from the real estate will be subject to 12.5 percent corporation tax in Cyprus. If, however, a UAE company is used to hold the real estate then it is not only the domestic law of Cyprus that applies but the residency of the company will be determined by looking at the double tax treaty. It will not be easy to argue that the company is resident in Cyprus and apply the 12.5 percent tax.

In the absence of a double tax treaty Cyprus levies a 10 percent tax, called a 'special defence contribution' on royalties paid to non-residents if earned on IP rights used in Cyprus. For instance, a franchise fee paid by a Starbucks shop in Cyprus will attract a 10 percent special defence when paid to an offshore company in the BVI, but if paid to a UAE company resident in the UAE, it will not be taxed. Cyprus does not have any withholding taxes on interest and dividend payments to non-resident individuals or companies. When these payments are made to persons who are residents of Cyprus, the special contribution for defence is at 30 and 17 percent, respectively.

But what happens when the payments are made to an offshore company which in turn is owned by a resident of Cyprus? Currently, the practice is not to levy taxes in such cases but it is unclear if it will continue to be so in future. How this uncertainty could be relevant to tax planning for a resident of Cyprus is illustrated as follows: a Cyprus company owner could have his company employ himself, keep his salary low, and pay out remaining compensation and profits as dividends, on which he pays 17 percent tax. Instead, he could hold his shareholding through an offshore company rather than himself and pay zero per cent on the dividends paid to the offshore company.

There is now a solution to prevent this uncertainty and that is to hold the shares by a RAK free zone international company instead of a company formed in an offshore jurisdiction without a treaty (or with a less favourable treaty). As in the case for royalties, the treaty stipulates that Cyprus is not allowed to impose taxes on dividends and interest paid to a company that under the terms of the treaty is considered resident of the UAE. Normally, a provision is included in tax treaties stipulating that the recipient company also has to be the 'beneficial owner' of the dividends.

This key term, beneficial ownership, is a complex issue and some countries have very wide interpretations of beneficial ownership. In the Cyprus-UAE double tax treaty there is no beneficial ownership requirement included with regard to dividends, interest and royalties. So, if the treaty is applicable then it is sufficient to ensure the company is tax resident in the UAE. This can be realized by using a UAE free zone company with local resident directors. This gives certainty to international tax planning structures than planning in the absence of a treaty, or planning with a treaty that does include the beneficial ownership requirement.

Cyprus has low corporate tax rate, VAT and social security taxes and is a major gateway for investment

into the EU, Russia and former USSR countries. This is because Cyprus does not tax incoming dividends from subsidiaries in these countries and has zero withholding taxes on dividends, interest and royalties going out. As an EU member country, it benefits from the EU parent subsidiary directive, which prevents the remitting country from levying a withholding tax on dividends, and the interest and royalty directive which prevents the remitting country from levying withholding taxes on interest and royalties, as long as certain basic conditions are met.

Another interesting aspect, is that Cyprus does not have specific transfer pricing rules. What exists is a general rule that transactions between related companies should be concluded at 'arm's length prices'. This makes it possible to use a Cyprus company as an invoicing vehicle by obtaining an EU VAT number to invoice customers in the EU, if an EU originated invoice is preferred. The profit margin resulting and remaining in Cyprus can be kept low, and will only be taxed at 12.5 percent. Cyprus by virtue of "EU passporting", is also a favourable location for setting up EU compliant mutual funds, private equity funds and securities brokerage firms. Profits realized are largely exempt in Cyprus.

In conclusion, the double tax treaty between Cyprus and the UAE opens a wide array of new tax planning possibilities which benefit many EU and east European entities.

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