The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

Havens Retain Allure For Firms Seeking Flexibility Offshore

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May 14, 2013

Cyprus Still Has Advantages For Tax And Investment Planning Despite Concerns Over The Island's Banking System, Say Consultants.

Depositors may be licking their wounds, and hoping for some kind of structured assistance by Russia to crippled Cypriot banks, but only a small number of Russian companies are leaving the island.

Lawyers told The Moscow Times that deposit and tax risks or the political environment are prompting companies to reassess their presence in Cyprus.

"A lot are considering moving and some did move for various reasons but there is no marathon streaming towards the exit. It depends on the company's business," said Mark Rovinskiy, deputy head of tax practice at Egorov Puginsky Afanasiev & Partners.

"Some use Cyprus as a housing for Russian or other assets. They are not so much affected. If they have trading activities or have monetary funds there, they may have problems with bank transfers."

As well as a levy on deposits over 100,000 euros, the corporate tax rate rose from 10 to 12.5 percent. To add to the noise, the past month has seen a flood of conferences and seminars by Cypriot lawyers and tax accountants trying to extinguish the panic, assuring investors that nothing really has changed.

The decisions of Russian investors will be driven by their motives, which are exaggerated or misrepresented, not least by EU politicians who accused Cyprus of laundering Russia's "dirty money", lawyers say.

From a purely tax perspective, the only logic of going offshore is deferral of tax, said Boris Bruk, Of Counsel at Dentons. "When you pump out the profits from a Russian company to any other jurisdiction the lowest applicable rate under the treaty will be at least 5 percent witholding tax. If you do the same to a Russian individual you will pay 9 percent. To the extent you want to reinvest money, you will be paying 4 percent less. But if any money taken out of the business goes back to Russian citizens they will have to pay 9 percent." More, in total, than the rate of Russian income tax.

Andrey Goltsblat, managing partner, Goltsblat BLP, the Russian practice of BLP, said the case for paying taxes through Cyprus had not altered. "I would even say the argument never disappeared as the corporate and tax structure hasn't been changed. They just raised corporate tax, which will have no impact on business, which uses Cyprus as an investment vehicle."

Some investors are thinking about opening new structures in different jurisdictions rather then changing the existing ones, Goltsblat said. Companies can, of course, be registered in Cyprus but open accounts in non-Cypriots banks.

If companies are seeking somewhere with greater stability, it may not be the conventional tax havens. Malta recently agreed a double taxation treaty (DDT) with Russia but is still on the Ministry of Finance offshore blacklist. Jersey does not have a DDT with Russia. Cyprus has an advantage, Goltsblat said, so long as its DDT with Russia remains in force.

Rovinskiy said that for those who run businesses through Russia there was no other jurisidiction that provided the same conditions as Cyprus. "Still they could go to Switzerland, Singapore, or the Netherlands. Companies without significant operations in Russia could go to Malta. They might want to avoid the EU zone, however. It is an EU crisis not just one of Cyprus."

Anti laundering regulations and the obligation to disclose beneficial owners exist in some jurisdictions but they would not worry a businessperson who was not trying to hide assets, he said.

Bruk said the unratified double taxation treaty ruled out Malta, leaving Switzerland, the Netherlands, Luxembourg and Ireland as options. "It is also important to consider their taxation of Intellectual Property. Some countries in Europe compete to get IP management companies onshore. These are Luxembourg, Cyprus, Ireland and a couple of others. This is helpful to normal companies that possess and manage intellectual property, software, and exclusive rights on their IP objects."

If companies are considering moving, experts said they could implement one of several scenarios: Change the country of tax residence but not the country of incorporation; merge their Cyprus assets into a sister company in another jurisdiction; transfer the legal seat of the company so it changes nationality; or simply move bank accounts to another country.

Most governments are highly suspicious of asset transfers. "Assets and capital are flowing away from their sovereignty and it is their last chance to tax them. This will be considered as capital gains. It is really an issue of tax competition between states," said Rovinskiy.

Fortunately for the owners of such assets, the Cypriot authorities have a relaxed attitude towards taxation of dividends or capital gains and since 2006, Cyprus has allowed redomicile, as opposed to closing a company and reopening it elsewhere.

The EU-sponsored levy on deposits of more than 100,000 euros will be the subject of international arbitration in the European courts. Depositors have petitioned the Cyprus supreme court to rule whether the action was constitutional.

This is moot for many wealthy Russians. "Some of our clients had inside information that the crisis would happen a year ago and they shifted money to Switzerland and other places," said Bruk.

Russia may have the last laugh. Having refused to contribute to the bail out of Cypriot banks (though it it did lend the country three billion euros) Russia may extend further loans in return for assets such as natural gas, Cypriot finance minister Michael Sarri told reporters last month.

There could even be advantages to remaining in Cyprus, said Boris Bruk of Dentons. "Cyprus realizes it is vulnerable in terms of the psychology of businesses. Cypriot tax authorities are very relaxed about how they audit companies and what they pay attention to. Probably they will be more flexible than ever."

Cyprus offers the benefits of English common law, which businesses often consider to be more flexible when drawing up contracts. "Russia should be blamed for not allowing people the level of comfort they wish," said Bruk. "As with high tax countries like Germany or France, if you pressure people to pay high levels of tax, why blame Cyprus for creating a low-tax jurisdiction? The way to stop cash outflow is to make tax legislation fair and easy to deal with."

Vladimir Gidirim, partner, International Tax, Ernst & Young, said companies would take the risk of a further deterioration in the Cyprus tax system but smaller and medium-sized companies in particular would not leave the jurisdiction. However larger companies might make use of holding companies in additional jurisdictions.

"There is no alternative to Cyprus as a jurisdiction. The tax system for holdings is far too advanced and flexible. The Netherlands and Luxembourg do contain some features, but those conditions are still not as favorable for investors. There is no direct matching. You cannot simply take a Cyprus company and replace it like a piece of Lego in Luxembourg. You would need to use several jurisdictions, with several layers of holding companies in order to achieve a cascading system of tax distributions."

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