Investing in Ukraine via Cyprus

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Many clients ask me, in my role as a lawyer, the following direct question: "Which is the best jurisdiction through which to invest in Ukraine?" Of course, every individual who asks me this question has his unique set of circumstances.

According to official Ukrainian statistics, the growth of foreign direct investment (FDI) in 2005 hit a record high of USD7.328 billion, which is 4.7 times more than in 2004. As of 1st July 2006, according to the Ukrainian Statistics Committee, the largest share of FDI to Ukraine came from Germany (USD5.503 billion or 29.9%), Cyprus (USD2.042 billion or 11.1%), Austria (USD1.506 billion or 8.2%), the UK (USD1.435 billion or 7.8%) and the US (USD1.322 or 7.2%).

Looking at our long experience in international tax planning and Cyprus' numerous advantages, we can declare that Cyprus compares favourably with many other similar locations. What makes us believe so? Its strategic geographic location, excellent commercial infrastructure, political stability, favourable tax incentives, high standard of living and European lifestyle have all contributed towards its development as an important financial centre.

Geographic location

Cyprus has one of the most strategic geographic locations in the world. The island is situated at the crossroads of Europe, Asia and Africa. In addition, the Island's time zone is convenient to all other regional centres and this is enhanced by its excellent telecommunication links. Cyprus is also within easy flying time of the rest of Europe and the Middle East.

Stability

Though located in the often stormy Middle East area, Cyprus is a centre of democracy and stability where business people from all over the world may can their affairs in a harmonious and friendly environment.

Commercial infrastructure

The commercial infrastructure of Cyprus, which is well developed, lends itself ideally to all forms of business activities. The English legal system, practice and procedures, which Cyprus acquired during the time it was a British colony, have continued after independence despite the subsequent promulgation of further legislation. Moreover, although the official languages of the Republic are Greek and Turkish, English is spoken by the majority of the population.

International relations

The Cypriot authorities are firmly committed to forging and maintaining strong bonds of friendship with all neighbouring states and with countries further abroad. In addition, the official policy is one of fostering and promoting good relations with all international organisations.

Cyprus is a member of numerous international associations, including the United Nations, the Council of Europe, the Commonwealth, and the Non-Aligned Movement.

Tax framework

Legislation effective from 1st January 2003 regulates the tax treatment of Cyprus companies. This legislation aims to conform to European Union (EU) law and the EU Code of Conduct and to abide by Cyprus' commitment to the Organisation of Economic Co-operation and Development to eliminate harmful tax practices.

The main features of the current tax system are as follows:

- The taxable profit of all Cypriot companies is taxed at the rate of 10%.
- Dividend income from abroad to Cyprus is wholly exempt from corporation tax provided the direct holding is at least 1% of the share capital of the overseas company. This exemption will not apply if the company paying the dividend engages more than 50% of its activities in producing investment income and the foreign tax burden on the income of the company paying the dividends is substantially lower than that in Cyprus.
- There is no withholding tax on the payment of dividends, interest and royalties from Cyprus to non-residents of Cyprus.
- In order to conform to the EU, the new tax legislation adopts the appropriate EU directive which enables reorganisations, mergers, acquisitions and amalgamations of companies without tax implications.
- Dividend income and profits from the sale of securities and shares are exempt from corporation tax.
- With two exceptions, profits from a permanent establishment abroad are exempt from corporation tax.
- The treaties for the avoidance of double taxation which Cyprus has signed remain in force. There are currently 34 such treaties (please see Table 1). The existence of these treaties, combined with the low tax paid by a Cyprus company offer the possibilities for effective international tax planning as we will indicate in the examples below. The main objective of double tax treaties is to avoid the double taxation of income earned in any of the two contracting countries. This is done through the tax sparing provisions whereby tax is credited against the tax that must be paid in the contracting state. The treaties also provide for reduced withholding taxes for dividends, interest and royalties.

The aim in Cyprus has always been not to create a "tax haven" but a tax incentive country. Therefore, regulations have always been adhered to. Permission from the Central Bank is necessary before a company can be established while at the end of each fiscal year audited accounts and annual returns must be submitted to both to the Central Bank and the tax authorities. Having said that, applications for the incorporation of a Cyprus company are processed efficiently by the Central Bank and the Registrar of Companies and the procedure can be completed in about a week. Local law firms and accountancy firms can provide nominee services for the administration of the company thus securing anonymity for the actual owner, where this is required. Instructions for the incorporation of a company can be given by fax or e-mail and the presence of the owner in Cyprus is not required.

With EU accession in May 2004, the status of a Cyprus holding company was enhanced further as it enjoys the reputation and privileges attached to a European company.

Foreign investors require from a holding company several things including the following provisions:

The holding company must extract value from the operating company by way of dividends or gains preferably free from withholding tax and capital gains tax, by means of a tax treaty or under the EU Parent/Subsidiary Directive and the domestic laws of the holding company jurisdiction must exempt such dividends and capital gains from local tax.

It should be possible to take dividends out of the holding company without giving rise to any charge to tax in the holding company jurisdiction.

All these requirements are met in Cyprus, which is why Cyprus is used as the location for the ultimate holding company and why it is a particularly suitable location for investment vehicles.

With regard to Ukraine, the following is a list of the international documents currently protecting Cypriot investors:

- Convention on Settlement of Investment Disputes between States and Foreign Entities (effective from 18.05.1965);
- Partnership and Co-operation Agreement between the EU and Ukraine (effective from 01.03.1998);
- Treaty between the Government of the USSR and the Government of the Republic of Cyprus on the avoidance of double taxation with respect to taxes on income and estate (effective from 26.08.83);
- Agreement between Ukraine and Cyprus on legal assistance in civil cases (effective from 18.03.2006); and
- Trade agreement between the Government of Ukraine and the Government of Cyprus (effective from 21.02.2000).

Cyprus has always been one of the main sources of investments into Ukraine. Generally the advantages can be divided into several areas:

- protection of assets,
- tax optimisation, and
- tax-free gains on disposal.

The highest level of confidentiality is provided with the use of another offshore structure. Royalties, dividends and interest paid from Ukraine to Cyprus are not taxed at all. Mergers and acquisitions may be carried out without taxes.

All the foregoing reasons make Cyprus a highly attractive jurisdiction for investment into Ukraine. Of course, every scheme is different, so it is always better to seek advice from a professional in the sphere of tax planning.

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Table 1: Cyprus's Double Tax Treaty Network

Austria	France	Malta	Sweden
Belarus	Greece	Mauritius	Syria
Belgium	Germany	Norway	Thailand
Bulgaria	Hungary	Poland	United Kingdom
Canada	India	Romania	U.S.A.
China	Ireland	Russia	Yugoslavia
Czech Republic	Italy	Singapore	C.I.S. Countries
Denmark	Kuwait	Slovakia	
Egypt	Lebanon	South Africa	