An update on the Cyprus Bailout

Late yesterday afternoon, March 19th 2013, during an extraordinary session, the Cyprus Parliament voted against the bailout plan for the island's economy which was proposed last Saturday March 16th, by the Eurozone Finance Ministers council (the "Eurogroup").

The rejected bailout plan

Deposits haircut

The proposed one-off levy would affect:

- Account holders in Cyprus licensed banking institutions;
- Irrespective of the account holder's nationality, residency or establishment, and
- It would affect all holders of current accounts, deposit accounts and potentially unplaced positions held in investment accounts.

The initial proposal was for a levy per account of:

- 6.75% for accounts with balances up to a EUR100,000 threshold, and
- 9.90% for accounts with balances over the threshold,

Whereas an additional band was added to the bill finally voted on for balances up to EUR20,000 for which no levy was to be imposed in an effort directed to protect the most vulnerable of private depositors.

Increase in tax rates

The proposal included also an increase in the tax rates involving:

- Income Tax rate applying to companies to 12.5% (from 10%), and
- SDC Tax rate on interest income of Cyprus tax resident persons to 20% (from 15%).

At the same time it seems that a financial transaction tax was to be avoided.

Current status

Banking system repercussions

Saturday's announcement of the proposed bailout plan brought about a big sense of uncertainty shared equally by locals as well as foreign investors and markets. This has now however been alleviated by the rejection of the proposal by the Cyprus Parliament.

The Cyprus Government Authorities in cooperation with the Cyprus Central Bank have directed all banking institutions to remain closed for business until a viable solution will be agreed on amid fears over liquidity.

Despite the rejection of the proposal, the European Central Bank has announced that it will continue to guarantee and provide Cyprus banks with the required liquidity to meet all their obligations as these may arise.

In search of alternatives

Many scenarios are being examined in an effort to find a solution to the problem that at the moment seems not to be merely the recapitalization of Cyprus banks or the restructuring of Cyprus' sovereign debt, but more importantly, doing so in a manner that will ensure the return to stability and the re-capturing of investor's confidence.

Remaining unchanged

Tax system benefits

It seems that the system's characteristics enabling Cyprus to pose as an attractive alternative for structuring international investments will remain unaffected, as neither the rejected bailout plan nor any of the alternatives publicized seem to be touching on features such as:

- The broad applying dividend income participation exemption;
- Exemption from taxation of gains from sale of shares and other securities;
- Exemption from withholding taxes on payment of dividends, interest and royalties to non-Cyprus tax residents;
- Application of the IP 'rights box' regime, and
- Application of the Tonnage tax system to shipping activities.

The above, in combination with the country's extensive Double Tax Avoidance Agreements network, along with the prospect of a stabilizing bailout plan will allow for continuation of the island's tradition as an international business and financial center.

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Commentary

Despite the mounting pressures on the island's authorities from the Eurogroup and the IMF to accept the proposed plan, the Republic's Parliament took an important stance in supporting rational economic policy over politics, stability over uncertainty, investor confidence over insecurity.

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