

# Luxembourg as an alternative to Cyprus

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**A**fter the Cyprus bank crisis of March 2013 many experts agreed that Cyprus would be shortly abandoned by the investors, mostly of Russian origin, for the jurisdictions with the better environment for conducting business. What is the prognosis regarding the Russian-Luxembourg business relationship, and what could be done for the improvement of the Luxembourg positions?

Since March 2013 the Luxembourg bankers and lawyers along with the Dutch, Swiss and Irish companies fled to Cyprus and Russia with the view to catch as many clients as possible, expecting a quick profit. The governments did not fall behind the business. In particular, Luxembourg Economy Minister Etienne Schneider met with some of the potential investors and with the Russian Prime Minister in Moscow in the end of February, and then with the official delegation from Russia in April.

Later in his interview in April Mr. Schneider highlighted that Luxembourg has all the prerequisites needed for a successful development of business, including the financial infrastructure and the logistical advantages. Notably, he signified the importance of internships for the Russian students at the Luxembourg educational establishments in order to prepare the specialists for a development of long-term cooperation and business between the two countries<sup>1)</sup>.

With the time passed since the crisis it appeared, however, that a substantial number of investors are yet unsure in whether or not to leave Cyprus, and that the legal experts are not advising on taking the quick decisions. The Cyprus providers of banking services, though, were immediately replaced by the

more reliable ones in Latvia, Hong Kong or Singapore. Several banks and large groups controlled from Russia announced the decision to proceed doing business in Cyprus underlying that there is no need for a rapid change of jurisdiction and no evidence of a high risk of threat to their business to expect from the Cyprus government. One of them, the Russian Commercial Bank, a member of VTB Group, particularly mentioned on its website that the restrictions on banking services are temporary and the resume of banking services in full is anticipated. Yet the investors are looking around and considering the available options.

Cyprus traditionally offers the Russian-speaking investors a superior client service for the reasonable price: the services are rendered in Russian, often by the Russian or Ukrainian experts-professionals who would be particularly familiar with the business culture of their clients. The connections were established in many areas of Cyprus economy, including the banking sector, tourism, real estate and consumer sectors.

Cyprus became a popular place for business-and-vacation trips, a summer destination for the businessmen's families and a harbor for receiving the residency permits to access the EU. Those rights are too strong to cut off, especially for the middle and small size business due to the high cost and other visible disadvantages of the relocation. Not unless there is another jurisdiction in the EU that can offer similar benefits without too many complications.

More importantly, Cyprus has been offering the better tax regime for the Russians. The Russia-Cyprus double tax treaty offers a withholding tax rate at 5% against the 10% rate provided in the Russia-Luxembourg double tax treaty. It is expected that the rate will be comparable to the Luxembourg one starting next year, providing the amendments to the Russian-Luxembourg double tax treaty are approved by the Luxembourg Parliament and signed by the Grand Duke during this year. However, Cyprus will still prevail by not imposing a withholding tax on the dividends paid to the non-residents even when the new tax rates are in force between Russia and

Luxembourg. This is a significant advantage of the Cyprus jurisdiction over most of the other EU jurisdictions, including other Luxembourg closest competitors - the Netherlands and Switzerland. It is also worth mentioning that in April 2013 Malta signed a double tax treaty with Russia offering tax rates comparable to Cyprus including no tax on the dividends paid to non-residents.

Another argument that deserves the attention is the Cyprus law. The investors and their attorneys are very pleased to contract based on the Cyprus law which is a derivative of the English common law. As some of them testify, the Cyprus applicable law helps the investors in structuring the complex cross-border transactions through using the instruments that may be unavailable in the civil law system. Furthermore, those contracts are often subject to a convenient dispute resolution mechanism of the London Court of International Arbitration.

This scheme gives the Russian investors a perception of secure business relationships that would be unachievable if using the Russian applicable law and/or the Russian courts or arbitral institutions. The Russian investors also appreciate the idea of being protected by the high UK-like or US-like legal standards at a lower cost and in Russian. The neutrality of the Cyprus judicial system is one of the investor's biggest concerns.

In May the Cyprus Supreme Court rejected the claim of the bank clients demanding a judicial review of the constitutionality of the Cyprus government's actions resulting in a unilateral withholding of the funds from the client's bank accounts. The Supreme Court has based its decision on the idea that the question lays within the regulation of the Cyprus contract law and the governmental actions fall within a force majeure stipulation. There is no doubt that such position will further undermine the trust of the investors, and will tip the scale towards the decision to leave for good a jurisdiction that justifies such expropriation.

Meanwhile, the substantial redistribution of the shares in the foreign direct investments in Russia took

place in 2012. According to the report released by the Russian Central Bank in May, the Luxembourg direct investments in Russia in 2012 increased by almost USD 7 billion, whereas the Cyprus direct investments in Russia dropped by USD 9.7 billion. It shows that for the time being Luxembourg is being actually recognized as an alternative to Cyprus by the investors who voted with their feet. It also proves that Luxembourg could tempt the Russian investors remaining in Cyprus especially if it further improves the legal and business environment.

One of the unique features of Luxembourg is a multinational legal community advising on the investments for years and to clients from all over the world, making contracts controlled by the Luxembourg civil code as easily as the contracts controlled by the common law-like rules and standards. The number of the big and small service providers had open the Russian/CIS desk with the view of attracting the investors from the CIS region, which is a fair step in improving the services for the Russian-speaking business. It is expected that the number of Russian holdings will increase significantly once the new tax rates are in force.

While it is apparent that Luxembourg has an alternative to offer, and that the substantial amount of the investors moved or consider moving their headquarters from Cyprus to Luxembourg, it is also apparent that Luxembourg needs to further improve its positions among Russia's most wanted business partners. The soonest ratification of the double tax treaty amendments by Luxembourg, and introducing a direct flight to Russia should be given a priority.

Minister Schneider expressed his confidence that Luxembourg should become a "springboard for Russian business into Europe", and we cannot agree more. After all, Luxembourg has the substantial capacities as one of the largest investment fund platforms in the world, the reputation of a reliable partner, and is associated with a successful business.

1) ITR-TASS News Agency 2) Ibid.

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