

Law and Practice

Contributed by:

Stella Strati

Patrikios Pavlou & Associates LLC see p.18



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1. Types of Business Entities, Their Residence and Basic Tax Treatment

1.1 Corporate Structures and Tax Treatment

Businesses in Cyprus generally adopt a corporate form. The most common type of corporate form is that of a private (or public) limited liability company with shares. A Cyprus company is fiscally opaque for tax purposes; therefore, it is taxed as a separate legal entity.

Pursuant to Cyprus law, a company is a legal person with separate legal personality, distinct from its members and its directors. Thus, its shareholders are not personally liable for the obligations of the company and the liability of the shareholders is limited to the share capital contributed. The existence of the company does not depend on the existence or continuation of its members.

Additionally, a Cyprus company may be limited by guarantee. Usually, companies limited by guarantee are incorporated as non-profit organisations in order to pursue charitable purposes.

1.2 Transparent Entities

Cyprus law allows for the establishment of general and limited partnerships. A partnership is not treated as a separate taxable person. It is a transparent entity and the tax is imposed on the partners and not on the partnership. Partnerships are widely used in joint venture projects and in smaller (usually family-owned) enterprises.

1.3 Determining Residence of Incorporated Businesses

The test used in Cyprus for determining the residence of incorporated businesses and trans-

parent entities is the so-called management and control test. Cyprus income tax legislation does not include a clear provision on how an entity becomes a Cyprus tax resident. General practice looks at the management and control thereof.

The minimum requirements for an entity to be considered a Cyprus tax resident are quite general and include:

- the place of residence of the majority of the directors;
- the place where the meetings of the board of directors are held; and
- the place where the general policy of the entity is formulated.

1.4 Tax Rates

Tax Rates Paid by Incorporated Businesses

The corporation tax rate is 12.5%. Business profits of Cyprus tax resident companies, adjusted in relation to allowances and exemptions, are subject to a flat tax rate of 12.5%.

Individual Tax Rates

Income for individuals is subject to progressive tax rates. The first EUR19,500 is tax-free, the next EUR8,500 is subject to a tax rate of 20%, the next EUR8,300 is taxed at 25%, the next EUR23,500 at 30% and any amount above EUR60,000 at 35%. A number of deductions and personal allowances are available.

Businesses owned directly by individuals are subject to the individual tax rates. The same applies to businesses owned through transparent entities.

2. Key General Features of the Tax Regime Applicable to Incorporated Businesses

2.1 Calculation for Taxable Profits

Business profits of a Cyprus company, adjusted for various disallowances and exemptions, are subject to tax at 12.5%. Cyprus tax residents are taxed on their worldwide income. Profits are taxed on an accrual basis and the International Financial Reporting Standards are followed.

Generally, expenses wholly and exclusively incurred by a company in the production of taxable income are allowable. Private expenses, expenses not matched to taxable income or not validated through proper supporting documentation, provisions (depreciation, amortisation, impairment, obsolete stock), expenses linked to non-taxable assets, and exchange differences are considered as non-deductible expenses. However, capital allowances, balancing allowance calculated on the disposal of a non-current asset, notional interest deduction, and notional loss in related-party transactions are also deductible.

2.2 Special Incentives for Technology Investments

The current Cyprus IP tax regime is applicable as of 1 July 2016. This follows the nexus approach – according to which, a direct link between qualifying income and own qualifying expenses is essential for the IP to qualify. The level of the qualifying profits is positively correlated to the extent that R&D activities are performed by the same entity.

Under the previous IP box regime that applied in Cyprus, an overall 80% deduction on profits was granted. Under the current IP tax rules, 80% of the overall income derived from the qualify-

ing intangible asset is treated as a deductible expense.

A qualifying intangible asset is defined as an asset that, as a result of R&D activities, has been acquired, developed or exploited by a person within the course of carrying out their business. Such assets specifically include:

- patents;
- computer software; and
- other IP that is legally protected and comprises:
 - (a) utility models;
 - (b) IP assets that provide protection to plants and genetic material or orphan drug destinations, as well as extensions of protection for patents; or
 - (c) non-obvious, useful and novel IP assets (which are certified as such by an appropriate authority) where the person utilising such does not generate annual gross revenues in excess of EUR7.5 million from all intangible assets (or EUR50 million for groups).

Qualifying intangible assets specifically exclude trade marks, business names, brand image rights and other IP rights used for the marketing of products and services.

Persons that may benefit from the Cyprus IP tax regime include Cyprus tax-resident taxpayers, tax-resident permanent establishments (PEs) of non-tax resident persons, and foreign PEs that are subject to tax in Cyprus.

2.3 Other Special Incentives

In addition to the Cyprus IP tax regime explained in 2.2 Special Incentives for Technology Investments, there are a number of special incentives

that apply generally – as well as to particular industries – in Cyprus.

Cyprus Holding Companies

Cyprus represents an attractive jurisdiction in which to set up a holding company. Specifically, dividend income received by a Cyprus holding company is generally exempt from any income tax in Cyprus (subject to the hybrid instrument exception explained in **9.6 Proposals for Dealing With Hybrid Instruments**) and from Special Defence Contribution (SDC) (subject to the passive dividend rule explained in **6.3 Tax on Dividends From Foreign Subsidiaries**). Also, no withholding tax applies to any outgoing dividend or other profit distributions or interest, irrespective of the existence of a double-tax treaty (DTT). Furthermore, profits from the sale of shares are tax-exempt. In general, no restrictions on foreign share ownership exist and, as a result, a foreign investor is allowed to be the sole shareholder of a Cyprus company.

Tonnage Tax System

Cyprus tax-resident ship-owners or ship management companies that qualify under the relevant legislation with regard to qualifying ships (as defined therein) engaged in qualifying shipping activities (as defined therein) can fall under the Tonnage Tax System (TTS). The TTS refers to flat given rates of tax based on the net tonnage of the ship – ie, no requirement for a computation of tax-adjusted profits exists. It is also important to note that there is no tax levied on the disposal of qualifying ships and that dividends distributed out of companies under the TTS are not subject to SDC.

Incentives to Individuals

Special incentives are also provided to individuals. In 2022, a tax incentive was introduced that provides that a natural person employed for the

first time in Cyprus (as of 1 January 2022) enjoys a tax exemption of 50% for a period of 17 years – provided they have previously not been resident in Cyprus for a period of at least ten consecutive years and earn more than EUR550,000 per year. Furthermore, individuals who first take up employment in Cyprus after 26 July 2022, with annual emoluments lower than EUR55,000, will be eligible for a 20% or EUR8,550 exemption (whichever is lower) for a maximum period of seven years. An individual must have been employed abroad for at least three consecutive years prior to the commencement of employment in Cyprus in order to claim this exemption, which can be claimed from the year after taking up employment in Cyprus.

Non-doms

Also, individuals who are not tax-resident in Cyprus or individuals who are tax-resident but non-domiciled in Cyprus are not subject to SDC on dividends, interest or rents.

2.4 Basic Rules on Loss Relief

On a company level, tax-adjusted losses can be carried forward and be set off against tax-adjusted profits for the next five years. Losses cannot be carried back.

On a group level (subject to the existence of certain criteria and the formation of a tax group), group members may surrender losses from one loss-making member to another profitable one. A direct or indirect holding of at least 75% for the entire tax year is necessary for a company to be considered as forming part of a tax group. As of 2015, the interception of companies established in the EU – or in countries that either have a DDT with Cyprus or have signed the OECD terms for exchange of information – can be taken into consideration for the calculation of an indirect holding. Furthermore, group relief is available

between companies established in EU member states, provided that the EU subsidiary has exhausted all means of surrendering or carrying forward the losses in its own state.

2.5 Imposed Limits on Deduction of Interest

The Cyprus Income Tax Law provides that any interest relating to (or that is deemed to relate to) the cost of acquiring a private motor vehicle – irrespective of whether it is used in the business – or the cost of acquiring any other asset not used in the business is not deductible for a period of seven years.

The Commissioner of Taxation has taken the position that shares are not an asset used in the business and, as such, any interest on loans to acquire shares is not deductible for a seven-year period. This position is justified on the grounds that any income from the holding of shares (ie, dividends and capital gains) is exempt from corporation tax.

As of 1 January 2012, the above-mentioned provision does not apply in cases where new shares are acquired directly or indirectly in a wholly owned subsidiary – provided that this subsidiary does not own any assets that are not used in the business. If this subsidiary owns assets that are not used in the business, the restriction of interest will only correspond to the percentage of assets not used in the business.

Also, from 1 January 2020, Cyprus tax legislation contains an interest limitation rule (ILR) that limits the otherwise deductible-exceeding borrowing costs of the Cyprus taxpayer/Cyprus group to 30% of adjusted taxable profit (taxable EBITDA). The ILR contains an annual EUR3 million safe harbour threshold.

2.6 Basic Rules on Consolidated Tax Grouping

No rules for tax grouping exist, apart from the basic rules for group tax relief described in 2.4 Basic Rules on Loss Relief.

2.7 Capital Gains Taxation

In Cyprus, no capital gains tax exists, apart from the taxation of gains from the disposal of immovable property situated in Cyprus. The profits from the sale of shares are exempt from any taxation.

Capital gains tax applies only to direct and indirect disposals of real estate situated in Cyprus. The applicable rate is 20% and is applied on gains from the disposal of immovable property or gains from the disposal of shares that directly or indirectly own immovable property situated in Cyprus.

2.8 Other Taxes Payable by an Incorporated Business

A stamp duty fee may be payable by an incorporated business on a transaction. Stamp duty is payable on any document that concerns any property located in Cyprus or on matters to be executed in Cyprus.

For contracts with a value between EUR5,001 and EUR170,000, the current rate of stamp duty is EUR1.50% for each EUR1,000 or part thereof. For contracts with a value of more than EUR170,000, the current rate of stamp duty is EUR2 for every EUR1,000 or part thereof, with a ceiling of EUR20,000. This maximum amount is payable on any document or on any transaction that has several documents; in such case, the parties may choose which of the transaction documents is the main document and only that main transaction document will be subject to the full stamp duty. The other transaction documents may be stamped as secondary docu-

ments, in the amount of EUR2 each – provided they are dated the same day (or very close) as the main transaction document.

A number of instruments carry a fixed stamped duty, as per the provisions of the Cyprus Stamp Duty Law.

2.9 Incorporated Businesses and Notable Taxes

Value Added Tax

Incorporated businesses may be subject to VAT. The standard rate of VAT is 19%; however, reduced rates of 5% and 9% apply to certain supplies.

Special Defence Contribution

SDC is payable on passive income – namely, rents, dividends, and passive interest income – by Cyprus tax-resident companies and individuals who are both tax residents and domiciled in Cyprus.

Dividends received by individuals (resident and domiciled in Cyprus) are subject to an SDC rate of 17%. Dividends received by Cyprus tax-resident companies are not subject to SDC (subject to specific exceptions mentioned in **6.3 Taxation on Dividends from Foreign Subsidiaries**). The SDC rate on interest for both natural and legal persons is 30%. Rent received by companies and by tax-resident and domiciled individuals is subject to SDC at the effective rate of 2.25% (3% on gross rents less 25%).

3. Division of Tax Base Between Corporations and Non-corporate Businesses

3.1 Closely Held Local Businesses

Closely held local businesses usually operate in corporate form – namely, as private limited liability companies with shares. The main reason for this is the lower corporate tax rate compared with the tax rates applicable to individuals or the tax treatment of partnerships.

3.2 Individual Rates and Corporate Rates

The corporate and individual tax rates are included in **1.4 Tax Rates**.

No particular rules exist to prevent individual professionals from earning income at corporate rates. Such professionals have the right to incorporate legal entities and conduct their business through such. If income is earned through such companies, it is taxed at the corporate tax rate. If the individual conducts business in their name, such individual is taxed at individual rates.

For specific professions (eg, advocates and doctors), an authorisation from the relevant regulator (eg, the Legal Council) is required prior to the incorporation of a special purpose company (such as a lawyers' limited company).

3.3 Accumulating Earnings for Investment Purposes

Currently, there are no rules to prevent a Cyprus company from accumulating earnings – provided that the beneficial owner of the same is not a Cyprus tax resident or is a Cyprus tax resident but non-domiciled.

If the beneficial owner is a Cyprus tax resident and domiciled, the deemed distribution rules will come into effect, which provide that 70%

of the accounting profits after the deduction of tax must be distributed two years from the end of the year in which the profits were earned. On such a deemed distribution, 17% SDC and 2.65% national health contributions must be withheld and paid to the tax authorities.

3.4 Sales of Shares by Individuals in Closely Held Corporations

The gain on the sale of shares is exempt from any taxation in Cyprus. Dividends received by individuals (resident and domiciled in Cyprus) are not subject to income tax but are subject to an SDC rate of 17%. A physical person who is a Cyprus tax resident but non-domiciled in Cyprus is exempt from the obligation to pay SDC. This also applies to individuals who are foreign tax residents.

3.5 Sales of Shares by Individuals in Publicly Traded Corporations

See 3.4 Sales of Shares by Individuals in Closely Held Corporations.

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

Cyprus does not apply any withholding tax on dividends or interest paid to non-residents (or to Cyprus tax residents who are non-domiciled). Regarding the payment of royalties to a non-Cyprus tax resident, a maximum 10% withholding tax applies on the gross amount of such payment if the royalty rights were used in Cyprus (5% in relation to films). Also, in relation to dividends, interest and royalties paid to entities incorporated in another EU member state, the provisions of the relevant EU Directives apply.

Furthermore, the gross income derived by an individual who is not tax-resident in Cyprus from the exercise in Cyprus of any profession or public entertainment is subject to a maximum withholding tax of 10% (reduced by any DTT favourable rate). The obligation to withhold the tax lies on the Cyprus tax-resident person that has invited the non-resident professional/entertainer. The maximum withholding tax for services regarding the exploration, extraction or exploitation of the continental shelf – as well as the establishment and use of pipelines and other installations on the ground, seabed and/or the surface of the sea – is 5%.

Also, no withholding tax applies on any outgoing dividend or other profit distributions or interest, irrespective of the existence of a DTT. Furthermore, profits arising from the disposal of titles (shares) are tax-exempt. Non-Cyprus tax residents or non-domiciled Cyprus tax residents who are shareholders of a Cyprus company are not subject to any SDC.

4.2 Primary Tax Treaty Countries

Cyprus enjoys a wide network of DTTs, as it has entered into such with more than 60 countries. The majority of these treaties follow the OECD Model Tax Convention on Income and on Capital (the “OECD Model”) – with the exception of the DTT with the USA, which follows the most recent model of US agreements. Foreign investors usually use Cyprus companies to make investments in local corporate stock or debts.

4.3 Use of Treaty Country Entities by Non-treaty Country Residents

The author is not aware of any cases in which the local tax authorities have challenged the use of treaty-country entities by residents of non-treaty countries.

4.4 Transfer Pricing Issues

The only transfer pricing rules that were applicable in Cyprus up to 2022 related to intra-group financing activities. However, on 30 June 2022, the Cyprus Parliament amended Section 33 of the Cyprus Income Tax Law and introduced new transfer pricing legislation.

The new rules are effective as of 01 January 2022 and cover all types of transactions between related parties in excess of EUR750,000 per category of transaction. The types of transaction include sale and purchase of goods, provision and receipt of services, any IP-related transaction, financing transactions, as well as other transactions between related parties. In relation to the definition of the connection between related parties, the 25% relationship test has been introduced.

Moreover, transfer pricing documentation compliance requirements have been introduced in relation to Cyprus tax-resident persons and/or PEs of non-Cyprus tax-resident entities located in Cyprus that are engaging in local or cross-border transactions. Such transfer pricing documentation must be prepared on an annual basis, prior to the income tax return submission for the relevant tax year, and it must include the Master File, the Local File and the Summary Information Table.

The new transfer pricing rules have also introduced advanced pricing agreement procedures.

4.5 Related-Party Limited Risk Distribution Arrangements

Tax authorities do challenge related-party transactions in general. As already mentioned in 4.4. **Transfer Pricing Issues**, Cyprus has recently re-enforced its transfer pricing regulations by intro-

ducing the requirement for performing transfer pricing studies for all related-party transactions.

4.6 Comparing Local Transfer Pricing Rules and/or Enforcement and OECD Standards

As mentioned in 4.4 **Transfer Pricing Issues**, Cyprus introduced new transfer pricing rules in 2022. Such rules, which are effective as of 2 January 2022, do not vary from OECD standards. Transactions between related companies are obliged to follow the arm's-length principle as set out in the OECD Transfer Pricing Guidelines.

4.7 International Transfer Pricing Disputes

Transfer pricing rules have been adopted since 2017 (and updated in 2022) and, given that this is something relatively new in Cyprus, the author is not aware of any disputes resolved by local authorities. However, due to the fact that extensive reform of the applicable transfer pricing rules in Cyprus took place in 2022, the local tax authorities are expected to be more aggressive on transfer pricing matters from now on.

5. Key Features of Taxation of Non-local Corporations

5.1 Compensating Adjustments When Transfer Pricing Claims Are Settled

The Cyprus tax authorities do not have any experience of mutual agreement procedures (MAPs) under a transfer pricing arrangement. Therefore, if an adjustment is made from a foreign tax authority, the corresponding adjustment will not be allowed/made for Cyprus tax purposes. The reason for this is the absence of a relevant regulatory framework.

5.2 Taxation Differences Between Local Branches and Local Subsidiaries of Non-local Corporations

The taxation of local branches of foreign corporations is no different to that of local subsidiaries of foreign corporations.

5.3 Capital Gains of Non-residents

There is no capital gains tax applicable in Cyprus in relation to profits from the sale of shares. Profits from the disposal of titles are exempt from any tax in Cyprus. Titles are defined as shares, bonds, debentures, founders' shares, and other titles of companies or other legal persons incorporated in Cyprus or abroad (and rights thereon).

5.4 Change of Control Provisions

Any disposal to related parties should be executed on an arm's-length basis. Moreover, Cyprus introduced exit taxation rules in 2020, within the wider implementation of the EU Anti-Tax Avoidance Directive (ATAD).

The relevant provisions stipulate that corporate taxpayers that move assets or their tax residency out of Cyprus will be subject to tax at an amount equal to the market value of the transferred assets at the time of exit – minus their value for tax purposes – in any of the following circumstances:

- a Cyprus tax-resident company transfers assets from its head office in Cyprus to its PE in another member state or in a third country so that Cyprus does not have the right to tax the transferred assets owing to the transfer;
- a non-Cyprus tax-resident company with a PE in Cyprus transfers assets from its Cyprus PE to its head office or another PE in another member state or third country so that Cyprus does not have the right to tax the transferred assets owing to the transfer;

- a Cyprus tax-resident company transfers its tax residence from Cyprus to another member state or to a third country, apart from those assets that remain effectively connected to a PE in Cyprus; and
- a non-Cyprus tax-resident company with a PE in Cyprus transfers the business carried out by its PE from Cyprus to another member state or to a third country so that Cyprus does not have the right to tax the transferred assets owing to the transfer.

5.5 Formulas Used to Determine Income of Foreign-Owned Local Affiliates

The tax treatment of a foreign-owned local affiliate is the same as that of any other Cyprus company. No separate rules or formulas exist to determine their income. As will be discussed, Cyprus companies are taxed on their worldwide income and any foreign tax incurred is credited against the equivalent Cyprus tax on the foreign income.

5.6 Deductions for Payments by Local Affiliates

The general principle pursuant to the Cyprus Income Tax Law is that for an expense to be allowed as a deduction, it must have been incurred wholly and exclusively for the production of taxable income for the specific taxpayer – something that needs to be supported by the relevant documentation.

Therefore, any expenses paid by Cyprus companies on behalf of foreign affiliates will be treated as non-tax-deductible expenses. In addition, the Cyprus tax authorities could assess that a deemed receivable exists in the Cyprus company's books from the foreign affiliate, represented by the value of the expenses paid on which they will seek to impose and tax deemed interest at market interest rates.

5.7 Constraints on Related-Party Borrowing

Pursuant to Section 33 of the Cyprus Income Tax Law, all transactions between related parties must – for tax purposes – be carried out on an arm’s-length basis (ie, at fair values and on reasonable commercial terms). This is described as the “arm’s-length principle”.

More specifically, under the arm’s-length principle, where conditions are made or imposed upon the commercial or financial relations between two businesses that differ from those that would have been made between independent parties, any profits that would have accrued to one of the parties had the two businesses been independent – but have not so accrued – may be included in the profits of that business and taxed accordingly. These provisions also apply to any transactions between related parties.

Pursuant to the new transfer pricing rules introduced in 2022 (see 4.4 **Transfer Pricing Issues**), a transfer pricing study is required for all transactions between related entities in excess of EUR750,000 per category of transaction. The 25% relationship test has been introduced to define the concept of related parties.

6. Key Features of Taxation of Foreign Income of Local Corporations

6.1 Foreign Income of Local Corporations

Local corporations are taxed on their worldwide income. However, any foreign tax incurred is credited against the equivalent Cyprus tax on the foreign income. The tax credit in respect of the foreign tax cannot exceed the equivalent Cyprus tax in any circumstances. Credit is

always granted to Cyprus tax residents on foreign tax incurred on foreign income, irrespective of the existence of a DTT.

6.2 Non-deductible Local Expenses

As mentioned in 6.1 **Foreign Income of Local Corporations**, Cyprus tax-resident companies are taxed on their worldwide taxable income, as Cyprus taxation is based on the management and control of the company and not on the source of the income.

If an income is exempt (eg, dividends under conditions, sale or disposal of shares), any direct expenses associated with the specific activity are not allowed for tax purposes. Also, any indirect expenses should be allocated to each activity of the Cyprus company and be part of such activity. If the activity will generate exempt income, then the corresponding allocation of the indirect expenses will not be treated as tax-allowable.

6.3 Taxation on Dividends From Foreign Subsidiaries

Dividends received by Cyprus companies from foreign subsidiaries are not subject to corporation tax in Cyprus. Nevertheless, an exception applies in that dividends received from a foreign company will be subject to corporation tax if paid out from hybrid instruments.

Moreover, dividends received by Cyprus tax-resident companies from foreign entities are not subject to SDC, unless the passive dividend rule applies. According to this rule, SDC is applicable if:

- the company distributing the dividend engages directly or indirectly in more than 50% of activities leading to investment income; and

- the foreign tax burden on the income of the paying company is substantially lower (less than 6.25%) than the Cyprus tax burden.

SDC does not apply to dividends received by a Cyprus company from a local company, subject to the four-year non-exemption rule. However, a dividend indirectly paid after four years from the end of the year in which the profits were generated is subject to SDC.

6.4 Use of Intangibles by Non-local Subsidiaries

Intangibles developed by local corporations can be used by non-local subsidiaries in their business, provided that such intangibles are licensed to the non-local subsidiaries on an arm's-length basis. Withholding taxes apply (10%) if the intangible is used in Cyprus by the non-local subsidiaries.

6.5 Taxation of Income of Non-local Subsidiaries Under Controlled Foreign Corporation-Type Rules

The controlled foreign companies (CFC) rule is applicable in Cyprus as of 1 January 2019. The application of this rule results in the re-tribution of the income of a low-taxed controlled non-Cyprus subsidiary to its parent company in order to avoid revenue diversion to a jurisdiction with a more favourable tax regime. The CFC rules apply to Cyprus tax-resident companies and non-Cyprus tax-resident companies with a Cyprus PE.

A CFC is defined as a low-taxed non-Cyprus tax-resident company or PE in which the:

- Cyprus taxpayer, alone or together with its associated enterprises, holds a direct or indirect interest of more than 50%; and

- the actual corporate tax paid on the profits of the company or PE is lower than 50% of the tax that would be paid in Cyprus.

The non-distributed income of a CFC that results from non-genuine arrangements is added to the taxable income of the Cyprus tax-resident controlling company. The CFC rule is not applicable when the company or the foreign PE has either:

- accounting profits of no more than EUR750,000 and non-trading income of no more than EUR75,000; or
- accounting profits of no more than 10% of its operating costs for the tax period.

In any case, the Cyprus controlling entity can claim credit for any foreign tax imposed on the CFC profits that are included in its tax base.

6.6 Rules Related to the Substance of Non-local Affiliates

No rules related to the substance of non-local affiliates apply in Cyprus.

6.7 Taxation on Gain on the Sale of Shares in Non-local Affiliates

As mentioned in 5.3 **Capital Gains of Non-residents**, the definition of titles under Cyprus law includes shares, bonds, debentures, founders' shares and other titles of companies or other legal persons incorporated in Cyprus or abroad (and rights thereon). Therefore, the gains on the sale of shares in non-local affiliates will be exempt from any taxes in Cyprus.

7. Anti-avoidance

7.1 Overarching Anti-avoidance Provisions

A general anti-abuse rule (GAAR) has applied since 1 January 2019 and was introduced as part of the general implementation of the ATAD. This rule provides that non-genuine arrangements – the main purpose of which is to procure a tax advantage – are ignored. Such arrangements are considered to be “non-genuine” as their mere existence does not reflect valid commercial reasons or economic reality.

introduced hybrid mismatch rules (see 9.6 **Proposals for Dealing With Hybrid Instruments** for further details).

Furthermore, by implementing both the BEPS recommendations and the ATAD, Cyprus has introduced the CFC rule and the ILR.

Pursuant to BEPS Action 5: Harmful Tax Practices, Cyprus has abolished the old IP box regime. It has also introduced new rules regarding tax benefits granted towards genuine IP activity, as per the nexus approach.

8. Audit Cycles

8.1 Regular Routine Audit Cycle

Cyprus companies are obliged to submit an annual tax declaration, which is prepared based on audited financial statements. Such financial statements should be audited and signed by a Cyprus-qualified and licensed auditor. Currently, the deadline for the submission of such declaration is 15 months from the end of the relevant tax year. A tax year is the same as a calendar year – namely, for the tax year of 2022, the annual tax declaration must be submitted by 31 March 2024.

In order to prevent the granting of treaty benefits in inappropriate circumstances, Cyprus has opted for the principal purpose test (see 9.9 **Anti-avoidance Rules** for more details).

Moreover, in light of the BEPS recommendations to prevent artificial avoidance of PE status, Cyprus has transposed all relevant new definitions into its legislation, including definitions of commissionaire and similar arrangements.

Cyprus has also introduced transfer pricing rules, legislated country-by-country (CbC) reporting and signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the “Multilateral Instrument”, or MLI).

9. BEPS

9.1 Recommended Changes

The commitment of Cyprus to follow the recommendations of the OECD/G20 Base Erosion and Profit Shifting Project (BEPS) is evident, given that it has already implemented various changes in line with the BEPS Actions.

9.2 Government Attitudes

The general attitude of Cyprus is to effectuate the BEPS recommendations by improving transparency but at the same time maintain the competitiveness of the Cyprus tax regime by providing various incentives to Cyprus tax residents (both domiciled and non-domiciled).

As per BEPS Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements, Cyprus has

It is likely that both Pillar 1 (reallocation of profits) and Pillar 2 (global minimum tax) will come into

effect in Cyprus. There are already discussions regarding increasing the corporate tax rate to 15% within the framework of a wider tax reform.

At the same time, the government intends to provide further incentives to attract inward investment. By way of an example, in October 2021, the government of Cyprus presented an action plan that aims to encourage foreign companies and highly skilled personnel to relocate to Cyprus. The implementation of this new strategy commenced in 2022.

In summary, the key reforms announced include the introduction of a digital nomad visa for third-country nationals wishing to live in Cyprus yet work for companies operating from abroad. On 3 March 2022, the Cyprus Council of Ministers increased the ceiling for people to benefit from this digital nomad visa scheme to 500 resident permits.

Further key reforms include:

- the provision of tax exemptions to highly skilled foreign employees (see **2.3 Other Special Incentives**);
- the provision of incentives for highly skilled foreign employees to apply for naturalisation after five years of residence and work in Cyprus; and
- the establishment of a Business Facilitation Unit that will operate as the focal point of contact for:
 - (a) companies with foreign interests wishing to relocate to Cyprus; and
 - (b) businesses operating in specific areas of economic activity (eg, hi-tech or innovation companies, pharmaceutical and shipping companies, and companies operating in the field of biogenetics and biotechnology).

9.3 Profile of International Tax

During the winter of 2022–23, there has been an ongoing discussion in relation to the possible tax reform of the Cyprus tax system. The Cyprus Ministry of Finance has recently asked stakeholders for an official consultation.

One of the proposed changes is the increase of the corporate tax rate from 12.5% to 15%. This is in line with the international tax discussions. Nevertheless, for the purpose of maintaining the competitiveness of the Cyprus tax regime, the Cyprus government intends to adopt other measures to mitigate and counteract the proposed increase of the corporate tax rate.

This is not likely to influence any of the BEPS recommendations, given that Cyprus has introduced numerous changes aiming to incorporate such recommendations in the local tax legislation.

9.4 Competitive Tax Policy Objective

Cyprus is viewed as having a competitive tax system that offers a number of incentives and advantages. The benefits of the Cyprus tax regime include:

- an absence of restrictions on foreign share ownership;
- lack of withholding taxes on dividends or interest;
- the sale of shares and other titles is exempt from tax;
- one of the lowest corporate tax rates in the EU;
- a number of tax exemptions for non-Cyprus tax residents (or non-domiciled).

Moreover, in October 2021, the Cyprus government announced an action plan designed to attract foreign companies to operate from – or

expand their activities in – the country (see **9.2 Government Attitudes**).

However, as has been analysed in **9.1 Recommended Changes**, Cyprus has shown its commitment to follow the BEPS recommendations and remain OECD-compliant. The implementation of the BEPS recommendations on a local level has so far been balanced against the various advantages provided by the Cyprus tax system. Such implementation has, in fact, contributed to the proper development of the Cyprus tax regime by enhancing transparency.

9.5 Features of the Competitive Tax System

As outlined in **9.4 Competitive Tax Policy Objective**, Cyprus has a competitive tax system offering various incentives to local and foreign investors. The more vulnerable areas of the Cyprus tax regime (such as the old IP box regime) have been abolished or modernised. Also, a wide reform of the Cyprus tax system is now being discussed – pursuant to which, the corporate tax rate will be revised to 15%. However, at the same time, other applicable taxes (such as SDC) might be reduced or abolished.

The aim of the Cyprus government is to promote the creation of substance and transparency while simultaneously providing incentives to foreign business to relocate their headquarters in Cyprus.

There are limited approved state aid schemes in Cyprus. However, such schemes cannot be considered constraints on the tax system, given that the majority of them aim to enhance productivity in specific areas (eg, rural tourism and hi-tech and innovative enterprises).

9.6 Proposals for Dealing With Hybrid Instruments

As mentioned in **9.1 Recommended Changes**, Cyprus has had legislation dealing with hybrid instruments in place since 2016. Specifically, an exception applies in that dividends received from a foreign company will be subject to corporation tax if paid out from hybrid instruments.

Furthermore, as of January 2020, hybrid mismatch rules apply that aim to tackle the usual tax effects of hybrid mismatches, including a double deduction or a deduction with no inclusion. These new provisions apply only where there is sufficient connection between the parties. This includes mismatches that arise between:

- a taxpayer and its associated enterprises;
- associated enterprises;
- a head office and a PE;
- two or more PEs of the same entity; and
- mismatches resulting from a structured arrangement involving a taxpayer.

The reverse hybrid entity rule is also effective as of 1 January 2022.

9.7 Territorial Tax Regime

Cyprus does not have a territorial tax system. All companies that are tax residents in Cyprus are taxed on income accrued or derived from all sources in Cyprus and abroad. Cyprus always grants credit to Cyprus tax residents on foreign tax suffered on foreign income, irrespective of the existence of a DTT. Effectively, a comparison is made between the Cyprus equivalent tax on the foreign-sourced income and the foreign tax incurred – with credit granted being the lower of the two.

In any case, the ILR was introduced in 2019 as part of the wider implementation of the ATAD.

The aim of the ILR is to limit the provision of financing facilities to companies (which are based in high-tax jurisdictions) in low-tax jurisdictions through subsidiaries belonging to the same group. The ILR requires that the excess borrowing cost (EBC) that is greater than 30% of taxable income before EBITDA is not deductible for income tax purposes. As such, it limits the otherwise deductible EBCs to 30% of taxable EBITDA. However, the ECB is deducted up to a de minimis threshold of EUR3 million per fiscal year. Standalone entities (not part of a group) are excluded from the ILR. In any case, grandfathering has been provided for loans concluded before 17 June 2016.

Moreover, a group equity “escape” or “carve-out” is provided. If the Cyprus resident company is part of a consolidated group for financial reporting purposes, the taxpayer may be given the right to fully deduct its EBCs – provided that the ratio of its equity over its total assets is equal to (or even up to 2% lower or higher than) the equivalent ratio of the group.

9.8 Controlled Foreign Corporation Proposals

As already mentioned in **9.7 Territorial Tax Regime**, Cyprus does not have a territorial tax regime. However, it has implemented the CFC rule, as part of the wider implementation of the ATAD. The CFC rule has been explained in **6.5 Taxation of Income of Non-local Subsidiaries under Controlled Foreign Corporation-Type Rules**.

This CFC rule applies as from 1 January 2019 to both Cyprus tax resident companies and non-Cyprus tax resident companies having a PE in Cyprus, and results in the re-attribution of the income of a low-taxed controlled non-Cyprus subsidiary to its parent company in order to

avoid revenue diversion to a jurisdiction with a more favourable tax regime.

9.9 Anti-avoidance Rules

As previously mentioned in **7.1 Overarching Anti-avoidance Provisions**, a GAAR is applicable in Cyprus as of 1 January 2019.

Also, further to the signing of the MLI, Cyprus has opted for the principal purpose test. Such test is incorporated in the latest double taxation conventions (DTCs) entered into by Cyprus. Specifically, the DTT between Cyprus and the Netherlands signed on 1 June 2021 provides that a benefit under the relevant DTC shall not be granted if it is reasonable to conclude – having regard to all relevant facts and circumstances – that obtaining the benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in such benefit. The only DTC entered into by Cyprus that includes the limitation of benefits test is the one with the USA.

These rules do not have any impact on inbound and outbound investors operating through Cyprus entities, owing to the fact that various incentives and benefits offered by the Cyprus tax system apply irrespective of the existence of any DTC.

9.10 Transfer Pricing Changes

New transfer pricing rules were introduced in 2022 and are applicable as of 01 January 2022 (as explained in **4.4 Transfer Pricing Issues**). Such rules include the requirement for related parties to maintain documentation files in relation to intra-group transactions. This requirement applies if the value of transactions with related parties are more than EUR750,00 per year per type of activity and if the Cyprus tax-resident entity is the ultimate parent or surrogate

parent entity of an MNE group falling under the scope of CbC reporting. Furthermore, the new rules provide the chance to apply for advance pricing arrangements. In general, pursuant to the new transfer pricing legislation, all related-party transactions in excess of EUR750,000 are subject to transfer pricing rules.

9.11 Transparency and Country-by-Country Reporting

In general, Cyprus has implemented a number of OECD and BEPS recommendations to promote transparency. As per the BEPS Action 13: Final Report, Cyprus has implemented CbC reporting by amending the applicable tax legislation pursuant to the Assessment and Collection of Taxes Law (Exchange of Information in the context of the Multilateral Competent Authority Agreement for the exchange of Country-by-Country reports) Decree of 2017.

Generally, the OECD guidance on the implementation of CbC reporting issued from time to time is used to interpret the Cyprus CbC reporting legislation for the purposes of ensuring a consistent and standard approach to CbC reporting. CbC reporting requirements apply in Cyprus as of 1 January 2016. However, in the event of conflict, the Cyprus CbC reporting legislation takes precedence.

9.12 Taxation of Digital Economy Businesses

Cyprus has not implemented any reforms addressing the taxation of digital businesses; however, this matter has been under discussion at EU level. Since March 2018, the EU Commission has proposed the adoption of new rules on the imposition of a digital service tax (DST) in order to tax digital business activities in a fairer and more growth-friendly way between all EU members.

The general principle is that profits generated in a territory – even without the businesses' physical presence there – are to be taxed in the EU member state within which companies engage in such digital activities. There are several thresholds proposed on revenues and what will be taxable where it is envisaged that profit attribution will consider the market values of profits from user data and services connecting users online, as well as other more “traditional” online digital services (such as subscriptions to streaming services).

In general, a DST is expected to apply on revenues created from activities where users are an important part of the creation of value. Also, a second proposal affecting indirect taxation is the application of interim tax on certain revenues arising from digital activities that currently elude current/traditional tax frameworks. This is expected to include revenues from selling online advertising space, intermediary activities, and sales of data. Certain EU member states have already implemented the above-mentioned proposals and it is expected that other EU countries will follow.

9.13 Digital Taxation

A consultation regarding the adoption of digital taxation in Cyprus was initiated in August 2019, although the DST itself has yet to be adopted. It is expected that digital taxation in Cyprus will be enacted (along with the introduction of other developments) as part of a much wider tax reform, aimed at further simplifying the taxation of individuals and entities in Cyprus.

9.14 Taxation of Offshore IP

As mentioned in 4.1 **Withholding Taxes**, the payment of royalties to a non-Cyprus tax resident is subject to a maximum 10% withholding tax on the gross amount of such payment if the royalty rights were used in Cyprus.

Contributed by: Stella Strati, Patrikios Pavlou & Associates LLC

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Author



Stella Strati is the deputy CEO of Pagecorp Group, which is affiliated through common ownership with Patrikios Pavlou & Associates LLC – where she is the corporate finance, tax and

private client partner. Stella provides specialised legal advice regarding all tax matters involving private clients, trusts, M&A,

corporate restructurings and reorganisations. She has completed the Advance Diploma in international tax at the Chartered Institute of Taxation and is a member of Society of Trust and Estate Practitioners (STEP) and the International Bar Association (IBA). Additionally, Stella led Pagecorp Group to becoming the tax (private client) member of IR Global.

Patrikios Pavlou & Associates LLC

332 Agiou Andreou Street
3035 Limassol
Cyprus

Tel: +357 25 871 599
Fax: +357 25 344 548
Email: info@pavlaw.com
Web: www.pavlaw.com



**PATRIKIOS PAVLOU
& ASSOCIATES LLC**

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