

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, 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 transpar-

ent entities is the so-called management and control test.

The 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 as 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 by individuals directly are subject to the individual tax rates; the same applies for 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, amongst others, as non-deductible expenses. However, capital allowances, balancing allowance computed 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 research and development activities are performed by the same entity.

Under the previous IP Box Regime that was applicable in Cyprus, an overall 80% deduction on profits was granted. Under the current IP tax rules, 80% of the overall income derived from

the qualifying intangible asset is treated as a deductible expense.

A qualifying intangible asset is defined as an asset that has been acquired, developed or exploited by a person within the course of carrying out their business that is the result of research and development activities.

Such assets specifically include (i) patents, (ii) computer software and (iii) other intellectual property that is legally protected and comprises of utility models, intellectual property assets that provide protection to plants and genetic material, orphan drug destinations and extensions of protection for patents or 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 Cyprus there are a number of special incentives applicable in general as well as to particular industries (in addition to the Cyprus IP tax regime explained in **2.2 Special Incentives for Technology Investments**).

The Cyprus Holding Company

Cyprus constitutes an attractive jurisdiction in which to set up a holding company. Namely, dividend income received by a Cyprus holding

company is generally exempt from any income tax in Cyprus (subject to the hybrid instrument exception explained below) and Special Defence Contribution (SDC) (subject to the passive dividend rule explained below). Also, no withholding tax applies on 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; as a result, a foreign investor is allowed to be the sole shareholder of a Cyprus company.

The Tonnage Tax System

Cyprus tax resident ship-owners or ship management companies that qualify under the relevant legislation in relation 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 dividends distributed out of companies under the TTS are not subject to SDC.

Incentives to Individuals

Special incentives are also provided to individuals. Natural persons that were not Cyprus tax residents for any three out of the last five years prior to commencement of employment in Cyprus and at the same time were not Cyprus tax residents in the previous year, and provided that they receive emoluments over EUR100,000 per year, are granted a tax deduction of 50% on emoluments for a period of ten years.

Non-doms

Also, non-Cyprus tax resident individuals or Cyprus tax residents 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 subsequent 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 from 2015, the interception of companies established in the EU or in countries with which Cyprus has a DTT or that 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 acquisition of a private motor vehicle, irrespective of whether it is used in the business, or on the cost of acquisition of 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 from 1 January 2012, the above 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, the 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, except for 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 over 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 documents, 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 value added tax (VAT). The standard rate of VAT is 19%, while reduced rates of 5% and 9% apply to certain supplies.

Special Defence Contribution

SDC is payable by Cyprus tax resident companies and individuals who are both tax residents and domiciled in Cyprus on passive income;

namely, rents, dividends and passive interest income.

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 for 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 in comparison to the tax rates applicable for 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, 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 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 should be distributed at the end of 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 should be withheld and paid over 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 but 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. 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.

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 Cyprus tax residents but not domiciled, who are shareholders of a Cyprus company are not subject to any SDC.

4.2 Primary Tax Treaty Countries

The Republic of 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 Convention (with the exception of the DTT with the USA, which follows the most recent model of United States agreements).

Foreign investors usually use Cyprus companies to make investments in local corporate stock or debts. The countries of origin of such investors typically include the Russian Federation, Kazakhstan and other CIS countries.

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 non-treaty country residents.

4.4 Transfer Pricing Issues

The only transfer pricing rules applicable in Cyprus relate to intra-group financing activities. Such rules apply as from 1 July 2017.

As a result, inbound investors operating through a local corporation need to apply such transfer pricing rules and follow the arm's-length principle in relation to financing transactions between related companies.

The said rules apply to Cyprus tax resident entities and PEs that are involved in back-to-back intra-group financing transactions. Such transactions have been defined by the tax authorities as the granting of loans or cash advances to related companies remunerated by interest (or should be) and are financed by financial means and instruments, such as debentures, private loans, cash advances and bank loans.

A transfer pricing study, prepared by a transfer pricing expert, should be provided to the Cyprus tax authorities, evidencing that the conducted intra-group financing transaction (and the agreed remuneration; ie, interest) complies with the arm's-length principle.

However, a simplification measure was also introduced. If a group financing company pursues a purely intermediary activity (intercompany loans receivables and payable) and has an actual presence in Cyprus (economic and physical substance), then the transactions are deemed to comply with the arm's-length principle and the minimum return accepted is 2% after tax on assets (profit after tax), which effectively

means a minimum taxable profit of 2.2857% on assets. Nevertheless, the use of a simplification measure could probably trigger reporting under DAC6.

4.5 Related-Party Limited Risk Distribution Arrangements

Tax authorities do challenge related-party transactions in general. As already mentioned, currently there are no transfer pricing regulations in Cyprus, except in relation to back-to-back financing arrangements. However, it is expected that during 2022, transfer pricing rules covering all related-party transactions will be introduced. It is further anticipated that transfer pricing reporting obligations will be implemented. In that respect, a transfer pricing study for such arrangements should be prepared beforehand, to tackle any possible challenges from the tax authorities.

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

It was mentioned above that the only transfer pricing rules adopted in Cyprus are in relation to intra-group financing activities. Such rules, which are effective as from 1 July 2017, do not vary from OECD standards. Financing 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 since this is something relatively new in Cyprus, the author is not aware of any disputes resolved by local authorities.

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 relating to mutual agreement procedures 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

There is no difference in the taxation of local branches of foreign corporations to 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 to include 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, less 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 due 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 due to the transfer;
- a Cyprus tax resident company transfers its tax residence from Cyprus to another member state or to a third country, except for 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 on 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 due 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 any other Cyprus company. No separate rules or formulas exist to determine their income. As will be mentioned below, 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, being at fair values and on normal 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 of 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.

A transfer pricing study is always suggested for the justification of price or interest imposed on an intercompany transaction (however, such transfer pricing study is not mandatory pursuant to the current tax laws of Cyprus).

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. In no case can the tax credit in respect of the foreign tax exceed the equivalent Cyprus tax. 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 above, 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 be treated as non-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, if the company distributing the dividend engages directly or indirectly in more than 50% 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, then SDC is applicable.

Dividends received by a Cyprus company from a local company are not subject to SDC, subject to the four-year non-exemption rule; 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 from 1 January 2019. The application of this rule 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. The CFC rules apply to Cyprus tax resident companies and non-Cyprus tax resident companies having 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 the 50% of the tax that would be paid in Cyprus.

The non-distributed income of a controlled foreign company that is the result of 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 (i) accounting profits of no more than EUR750,000, and non-trading income of no more than EUR75,000, or (ii) 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

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

As from 1 January 2019, a general anti-abuse rule (GAAR) is applicable and it was intro-

duced as part of the general implementation of the ATAD. This rule provides that non-genuine arrangements, having as a main purpose the procurement of a tax advantage, are ignored. Those arrangements are considered to be "non-genuine" as their mere existence does not reflect valid commercial reasons or economic reality.

8. AUDIT CYCLES

8.1 Regular Routine Audit Cycle

Cyprus companies are obliged to submit annually a 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 will need to be submitted by 31 March 2024.

9. BEPS

9.1 Recommended Changes

The commitment of Cyprus to follow the BEPS recommendations is evident, since it has already implemented various changes in line with the BEPS action plans.

As per BEPS Action 2: Neutralising the effects of hybrid mismatch arrangements, Cyprus has introduced legislative measures applicable as from 1 January 2016 in relation to the effect of deduction with no inclusion of income caused by hybrid dividends. Hybrid mismatch rules are also applicable as from January 2020, to tackle the usual tax effects of hybrid mismatches, including a double deduction or a deduction with no inclusion.

Moreover, the reverse hybrid entity rule is effective as of 1 January 2022.

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

In light of Action 5: Harmful tax practices, Cyprus has abolished the old IP Box Regime and it has introduced new rules regarding tax benefits granted towards genuine IP activity, as per the nexus approach.

To prevent the granting of treaty benefits in inappropriate circumstances, Cyprus has opted for the principal purpose test.

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

Also, Cyprus has introduced transfer pricing rules, it has legislated country-by-country (CbC) reporting and has signed the Multilateral Instrument to Modify Bilateral Tax Treaties (MLI).

9.2 Government Attitudes

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

It is likely that both Pillars One (reallocation of profits) and Pillar Two (global minimum tax) will be given some 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 intention of the government is to provide further incentives to attract inward investment. Namely, 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 is expected to commence during 2022.

In summary, the key reforms announced include the introduction of a digital nomad visa for third-country nationals wishing to live in Cyprus but work for companies operating from abroad; the establishment of a Business Facilitation Unit that will operate as the focal point of contact for companies of foreign interests wishing to relocate to Cyprus, as well as for businesses operating in specific areas of economic activity, including hi-tech or innovation companies, pharmaceutical and shipping companies, and companies operating in the field of biogenetics and biotechnology; and the provision of tax exemptions to foreign high-skilled employees, as well as incentives to such employees to apply for naturalisation after five years of residence and work in Cyprus.

9.3 Profile of International Tax

During the past few months 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, the Cyprus government intends to adopt other measures to mitigate and counteract the proposed increase of the corporate tax rate, for the purposes of maintaining the competitiveness of the Cyprus tax regime.

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

9.4 Competitive Tax Policy Objective

Cyprus is considered to have a competitive tax system. The Cyprus tax system offers a number of incentives and advantages, while the Cyprus corporate tax rate is one of the lowest within the EU.

The benefits of the Cyprus tax regime include that no restrictions on foreign share ownership exist, there are no withholding taxes on dividends or interest, the sale of shares and other titles is exempt from tax, and the corporate tax rate is one of the lowest in the EU, while non-Cyprus tax residents (or non-domiciled) enjoy a number of tax exemptions.

Moreover, in October 2021 the Cyprus government announced an action plan for attracting foreign companies to operate from, or expand their activities in, Cyprus (as explained in **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 the 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 since it has contributed to the enhancement of transparency.

9.5 Features of the Competitive Tax System

As has been analysed above, 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 and at the same time to provide 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 as constraints on the tax system, since the majority of them aim to enhance productivity in specific areas, such as rural tourism, hi-tech and innovative enterprises.

9.6 Proposals for Dealing with Hybrid Instruments

Cyprus has legislation dealing with hybrid instruments in place as from 2016. Namely, an exception applies in that dividends received from a foreign company will be subject to corporation tax if paid out from hybrid instruments.

Furthermore, hybrid mismatch rules are applicable as from January 2020, 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.

Also, the reverse hybrid entity rule is 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 of 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 (i) the Cyprus equivalent tax on the foreign-sourced income and (ii) the foreign tax incurred, with credit granted being the lower between 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, according to which, where 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, Cyprus does not have a territorial tax regime. However, it has implemented the CFC rule, within the wider implementation of the ATAD. 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. The CFC rule has been explained in **6.5 Taxation of Income of Non-local Subsidiaries under Controlled Foreign Corporation-Type Rules**.

9.9 Anti-avoidance Rules

As already mentioned in **7.1 Overarching Anti-avoidance Provisions**, a GAAR is applicable in Cyprus as from 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; namely, 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 that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit. The only DTC entered into by Cyprus that includes the limitation of benefits test is the one with the US.

These rules do not have any impact on inbound and outbound investors operating through Cyprus entities, due 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

It is anticipated that additional detailed transfer pricing rules will be introduced in 2022. Such rules will include the requirement for related parties to maintain documentation files in relation to intra-group transactions. This requirement will most probably apply when the accumulated intra-group transactions per category will exceed EUR750,000 per tax year. Furthermore, the new rules will provide the chance to apply for advance pricing arrangements. In general, the intention is for all related-party transactions to be 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.

Cyprus has implemented CbC reporting as per the BEPS Action 13 Final Report, 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 from 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 the EU level. Since March 2018, the EU Commission has proposed the adoption of new rules on the imposition of digital service tax (DST) 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 as well as 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).

DST in general 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 currently escaping from 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 proposals and it is expected that other EU countries will follow.

9.13 Digital Taxation

A consultation regarding the adoption of DST in Cyprus has been initiated since August 2019, although the tax itself has yet to be adopted. It is expected that the introduction of DST in Cyprus will be enacted together with other developments that will be introduced within the framework of a more wider tax reform, which will aim to further simplify the taxation of individuals and entities in Cyprus.

9.14 Taxation of Offshore IP

As mentioned above, 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.

Patrikios Pavlou & Associates LLC is one of the largest law firms in Cyprus, highly recommended for its professional legal services and exceptional client service. With nearly 60 years of experience in the local and international legal market, the firm is renowned for its involvement in some of the largest cross-border transactions and complex litigation and arbitration matters. The team is highly qualified and experienced in offering legal advice in any sphere, while the tax and international tax planning department of the firm offers advice in establishing and im-

plementing robust tax planning structures and assists on all Cyprus-related tax matters. In association with Pagemark Ltd, member company of the affiliated Pagecorp Group, the firm advises on tax treatment of specific transactions/agreements, calculation of provisional tax, preparation and submission of tax forms and others. The firm's international profile comprises of strong alliances with reputable law firms, particularly in Europe, Russia, USA and Asia; memberships in various organisations globally; and a loyal clientele worldwide.

AUTHOR



Stella Strati is the Corporate Finance, Tax and Private Client Partner of Patrikios Pavlou & Associates LLC and the Deputy CEO of Pagecorp Group, affiliated with the law firm

through common ownership. Stella provides specialised legal advice regarding all taxation matters involving M&A, corporate restructurings and reorganisations.

She has completed the Advance Diploma in International Tax of the Chartered Institute of Taxation (CIOT), is an International Tax Affiliate of CIOT and is a member of STEP and the IBA. Additionally, she led Pagecorp Group to becoming the Tax (Private Client) member of IR Global and was the National Reporter for Cyprus of the Taxes Committee of the IBA until 2017.

Patrikios Pavlou & Associates LLC

332 Agiou Andreou str.
3035 Limassol
Cyprus

Tel: +357 25871599
Fax: +357 25 344548
Email: info@pavlaw.com
Web: www.pavlaw.com



PATRIKIOS PAVLOU
& ASSOCIATES LLC

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