CYPRUS

Law and Practice

Contributed by:
Stella Strati
Patrikios Legal

Contents

1. Types of Business Entities, Their Residence and Basic Tax Treatment p.4
1.1 Corporate Structures and Tax Treatment p.4
1.2 Transparent Entities p.4
1.3 Determining Residence of Incorporated Businesses p.4
1.4 Tax Rates p.4

2. Key General Features of the Tax Regime Applicable to Incorporated Businesses p.5
2.1 Calculation for Taxable Profits p.5
2.2 Special Incentives for Technology Investments p.5
2.3 Other Special Incentives p.6
2.4 Basic Rules on Loss Relief p.7
2.5 Imposed Limits on Deduction of Interest p.7
2.6 Basic Rules on Consolidated Tax Grouping p.8
2.7 Capital Gains Taxation p.8
2.8 Other Taxes Payable by an Incorporated Business p.8
2.9 Incorporated Businesses and Notable Taxes p.8

3. Division of Tax Base Between Corporations and Non-Corporate Businesses p.9
3.1 Closely Held Local Businesses p.9
3.2 Individual Rates and Corporate Rates p.9
3.3 Accumulating Earnings for Investment Purposes p.9
3.4 Sales of Shares by Individuals in Closely Held Corporations p.9
3.5 Sales of Shares by Individuals in Publicly Traded Corporations p.9

4. Key Features of Taxation of Inbound Investments p.9
4.1 Withholding Taxes p.9
4.2 Primary Tax Treaty Countries p.10
4.3 Use of Treaty Country Entities by Non-Treaty Country Residents p.10
4.4 Transfer Pricing Issues p.10
4.5 Related-Party Limited Risk Distribution Arrangements p.11
4.6 Comparing Local Transfer Pricing Rules and/or Enforcement and OECD Standards p.11
4.7 International Transfer Pricing Disputes p.11

5. Key Features of Taxation of Non-Local Corporations p.11

5.1 Compensating Adjustments When Transfer Pricing Claims Are Settled p.11
5.2 Taxation Differences Between Local Branches and Local Subsidiaries of Non-Local Corporations p.11
5.3 Capital Gains of Non-Residents p.11
5.4 Change of Control Provisions p.11
5.5 Formulas Used to Determine Income of Foreign-Owned Local Affiliates p.12
5.6 Deductions for Payments by Local Affiliates p.12
5.7 Constraints on Related-Party Borrowing p.12

6. Key Features of Taxation of Foreign Income of Local Corporations p.13

6.1 Foreign Income of Local Corporations p.13
6.2 Non-Deductible Local Expenses p.13
6.3 Taxation on Dividends From Foreign Subsidiaries p.13
6.4 Use of Intangibles by Non-Local Subsidiaries p.13
6.5 Taxation of Income of Non-Local Subsidiaries Under Controlled Foreign Corporation-Type Rules p.14
6.6 Rules Related to the Substance of Non-Local Affiliates p.14
6.7 Taxation on Gain on the Sale of Shares in Non-Local Affiliates p.14

7. Anti-Avoidance p.14

7.1 Overarching Anti-Avoidance Provisions p.14

8. Audit Cycles p.14

8.1 Regular Routine Audit Cycle p.14

9. BEPS p.15

9.1 Recommended Changes p.15
9.2 Government Attitudes p.15
9.3 Profile of International Tax p.16
9.4 Competitive Tax Policy Objective p.16
9.5 Features of the Competitive Tax System p.17
9.6 Proposals for Dealing With Hybrid Instruments p.17
9.7 Territorial Tax Regime p.17
9.8 Controlled Foreign Corporation Proposals p.18
9.9 Anti-Avoidance Rules p.18
9.10 Transfer Pricing Changes p.18
9.11 Transparency and Country-by-Country Reporting p.19
9.12 Taxation of Digital Economy Businesses p.19
9.13 Digital Taxation p.20
9.14 Taxation of Offshore IP p.20

Patrikios Legal is one of the largest law firms in Cyprus, where it is highly recommended for its professional legal services and exceptional client service. With more than 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, as well as in complex litigation and arbitration matters. The highly qualified team is experienced in offering legal advice in any sphere; however, the firm's tax department offers advice in establishing and implementing robust tax planning structures and assists with all Cyprus-related tax matters. In association with Patricianserve Ltd, Patrikios Legal advises on the tax treatment of specific transactions/agreements and the calculation of provisional tax, as well as the preparation and submission of tax forms. The firm's international profile comprises strong alliances with reputable law firms (particularly in Europe, Asia and the USA), memberships in various global organisations, and a worldwide loyal clientele.

Author

Stella Strati is the corporate finance, tax and private client partner at Patrikios Legal. She provides specialised legal advice regarding all tax matters involving trusts, M&A, and private clients, as well as corporate restructurings and reorganisations. Stella has completed the advanced diploma in international tax (ADIT) at the Chartered Institute of Taxation and is a member of the Society of Trust and Estate Practitioners (STEP) and the International Bar Association (IBA). Additionally, she led Pagecorp Group to becoming the tax (private client) member of IR Global.

Patrikios Legal

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

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 Cypriot company is fiscally opaque for tax purposes; therefore, it is taxed as a separate legal entity.

Pursuant to Cypriot law, a company is a legal person with a 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 Cypriot 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

Cypriot 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 transparent 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.

On 15 November 2024, the Council of Ministers of Cyprus exempted individuals whose total gross annual income is below EUR19,500 from the obligation to submit a personal income tax return for the tax year 2024.

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 Cypriot 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, and 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 IP tax regime in Cyprus 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 qualifying 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, in addition to 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 Cyprus' IP tax regime include Cyprus tax-resident taxpayers, tax-resident permanent establishments of non-tax resident persons, and foreign permanent establishments that are subject to tax in Cyprus.

2.3 Other Special Incentives

In addition to the 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 Cypriot 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 Cypriot 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 the SDC.

Incentives for Individuals

Special incentives are also provided to individuals. A tax incentive was introduced in 2022 and amended on 30 June 2023 that provides that a natural person employed in Cyprus (as of 1 January 2022) enjoys a tax exemption of 50% for a period of 17 years from the date of employment, irrespective of whether the individual changed employers during the relevant 17-year period – provided they have previously not been resident in Cyprus for a period of at least 15 consecutive years and earn more than EUR55,000 per year. Previously (ie, before the June 2023 amendment), the exemption was only granted for the first employment of the individual in Cyprus.

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

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

Innovative SMEs

A qualifying person that makes an investment in an innovative SME (as defined by the Cypriot Income Tax Law) may deduct the costs of the investment from the taxable income subject to limitations imposed by the law, such as:

- the tax deduction is limited to 50% of the investor's taxable income in the year in which the investment is made;
- the deductible amount cannot be more than EUR150,000 within a tax year; and
- the investor must retain the relevant investment in the innovative SME for at least three years.

This incentive is available until 31 December 2026.

Start-up visa

On 19 December 2024, the Deputy Ministry of Research and Digital Policy announced the approval of a revised start-up visa scheme, which is applicable as of 1 January 2025. This scheme enables owners and senior executives from third countries to enter, reside and work in Cyprus for the purposes of establishing a new start-up in Cyprus or transferring an existing start-up into Cyprus.

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 Cypriot 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 to 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 Cypriot taxpayer/Cypriot 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 of between EUR5,001 and EUR170,000, the current rate of stamp duty is 1.50% for every 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 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 Cypriot Stamp Duty Law.

2.9 Incorporated Businesses and Notable Taxes

VAT

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.

SDC

The 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 the 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 17% as of 1 January 2024. Rent received by companies and by tax-resident and domiciled individuals is subject to the 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 with 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 Cypriot 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, a 17% SDC and a 2.65% national health contribution must be withheld and paid to the tax authorities.

3.4 Sales of Shares by Individuals in Closely Held Corporations

The gains on the sale of shares are 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 natural person who is a Cyprus tax resident but non-domiciled in Cyprus is exempt from the obligation to pay the 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 Cypriot company are not subject to any SDC.

Since 31 December 2022, Cyprus has applied withholding tax on certain outbound payments of dividends, interest and royalties – subject to specific conditions – in cases where the recipient is a legal entity that has tax residency in a jurisdiction included in the EU list of non-cooperative jurisdictions or is incorporated there but not a tax resident in any other jurisdiction.

4.2 Primary Tax Treaty Countries

Cyprus enjoys a wide network of DTTs, as it has entered into such with 69 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 Cypriot 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 Cyprus transfer pricing rules (as such rules apply from 1 January 2022 onwards) 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, financing transactions and any IP-related transaction, as well as other transactions between related parties. In relation to the definition of the connection between related parties, the 25% relationship test applies.

On 1 February 2024, Cyprus' tax department issued an announcement clarifying that – as from the tax year 2022 onwards – the threshold for financing transactions is EUR5 million and for all other transactions is EUR1 million.

Moreover, transfer pricing documentation compliance requirements have been introduced in relation to Cyprus tax-resident persons and/or permanent establishments 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 re-enforced its transfer pricing regulations by introducing 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 deviate 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, owing 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 when it comes to 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 tax authorities in Cyprus do not have any experience of mutual agreement procedures under a transfer pricing arrangement. Therefore, if an adjustment is made by 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 permanent establishment 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 permanent establishment in Cyprus transfers assets from its Cypriot permanent establishment to its head office or another permanent establishment in another EU 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 EU member state or to a third country, apart from those assets that remain effectively connected to a permanent establishment in Cyprus; and
- a non-Cyprus tax-resident company with a permanent establishment in Cyprus transfers the business carried out by its permanent establishment from Cyprus to another EU 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 Cypriot company. No separate rules or formulas exist to determine their income. As will be discussed, Cypriot 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 Cypriot 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 Cypriot companies on behalf of foreign affiliates will be treated as non-tax-deductible expenses. In addition, the tax authorities in Cyprus could assess that a deemed receivable from the foreign affiliate exists in the Cypriot company's books, 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 Cypriot 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 applicable transfer pricing rules (see **4.4 Transfer Pricing Issues**), a transfer pricing study is required for all transactions between related entities in excess of EUR1 million per category of transaction. For financing transactions between related parties, the threshold is EUR5 million. The 25% relationship test applies 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 taxation in Cyprus 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 Cypriot 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 Cypriot 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 the SDC, unless the passive dividend rule applies. According to this rule, the 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 Cypriot tax burden.

The SDC does not apply to dividends received by a Cypriot 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 the 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-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 with a Cyprus permanent establishment.

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

- the Cypriot 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 the permanent establishment 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 permanent establishment 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 Cypriot 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 Cypriot 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 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.

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 Cypriot-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 – ie, for the tax year of 2022, the annual tax declaration must be submitted by 31 March 2024.

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 recommendations.

As per BEPS Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements, Cyprus has introduced hybrid mismatch rules (see **9.6 Proposals for Dealing With Hybrid Instruments** for further details).

Furthermore, by implementing 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.

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 permanent establishment 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 Apply Measures Related to Tax Treaties to Prevent Base Erosion and Profit Shifting (MLI/BEPS/OECD/G20) (the *"Multilateral Instrument"*, or MLI).

9.2 Government Attitudes

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

It is anticipated that both Pillar One (reallocation of profits) and Pillar Two (global minimum tax) will come into effect in Cyprus. On 12 December 2024, the House of Representatives of Cyprus approved the implementation of Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union (the *"Pillar Two Directive"*) into domestic legislation (the *"GMT Law"*). Furthermore, a public consultation is in place within the framework of a wider tax reform.

At the same time, the Cypriot government intends to provide – and has already provided – further incentives to attract inward investment. This strategy commenced in 2021. As mentioned in **2.3 Other Special Incentives**, the start-up visa scheme has been revised, and is now more effective and flexible. The main goal of the Cypriot government is to enhance innovation and to develop an entrepreneurship-friendly landscape at the local level.

Furthermore, a digital nomad visa for third-country nationals wishing to live in Cyprus yet work for companies operating from abroad is available. The ceiling for people to benefit from this digital nomad visa scheme is 500 resident permits.

Also, the tax benefit provided in relation to investments in innovative SMEs has been extended until 31 December 2026 (see **2.3 Other Special Incentives**).

Further key reforms include:

- the provision of tax exemptions to highly skilled foreign employees;
- 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

There is currently an ongoing public consultation in relation to the upcoming tax reform of the Cypriot tax system. In February 2025, the key proposed tax amendments were announced. As mentioned in **9.2 Government Attitudes**, the GMT Law was passed by the House of Representatives of Cyprus in December 2024.

One of the main proposals of the upcoming tax reform is the increase of the corporate tax rate from 12.5% to 15%. 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 (ie, the reduction of the SDC rate on dividends to 5%, the elimination of the 3% SDC on rental income, the increase of the tax-free threshold for individuals, and the adjustments to the intermediary personal income tax bands, with the highest 35% tax rate applying to income of more than EUR80,000). Green tax reform measures are also expected and, at the same time, the main benefits provided under the current tax legislation will be maintained. The draft bills are expected to be ready for public consultation in May 2025.

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 Cypriot 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; and
- a number of tax exemptions for non-Cyprus tax residents (or non-domiciled).

Moreover, as from October 2021, the Cypriot government is implementing 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 Cypriot tax system. Such implementation has, in fact, contributed to the proper development of the Cypriot 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 Cypriot 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 the SDC) might be reduced or abolished. The reduction of the SDC rate on interest has already taken place.

The aim of the Cypriot government is to promote the creation of substance and transparency while simultaneously providing incentives to foreign business to relocate their headquarters to 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 permanent establishment;
- two or more permanent establishments 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 equivalent Cypriot 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 both to Cyprus tax-resident companies and non-Cyprus tax-resident companies having a permanent establishment in Cyprus. The CFC rule results in the re-attribution of the income of a low-taxed controlled non-Cypriot 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 general anti-avoidance rule 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 Cypriot entities, owing to the fact that various incentives and benefits offered by the Cypriot tax system apply irrespective of the existence of any DTC.

9.10 Transfer Pricing Changes

New transfer pricing rules were introduced in 2022 and were applicable from 1 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.

On 1 February 2024, Cyprus' tax department issued a circular revising the applicable thresholds regarding the obligations to prepare a local file. Under the 2022 rules, this requirement applied if the value of transactions between related parties was more than EUR750,000 per year per type of activity and if the Cyprus tax-resident entity is the ultimate parent or surrogate parent entity of a multinational enterprise falling under the scope of CbC reporting. Pursuant to the 1 February 2024 circular, the threshold has been increased from EUR750,000 to EUR5 million for connected financing transactions and to EUR1 million for all other categories. The revised thresholds are applicable from 1 January 2022. Furthermore, the new rules provide the chance to apply for advance pricing arrangements.

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 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, 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 apart from the implementation, in November 2023, of the Council Directive (EU) 2021/514 (known as *"DAC 7"*) amending Directive 2011/16/EU on Administrative Cooperation and Automatic Exchange of Information in the Field of Taxation. This provided for an automatic exchange of information on certain data to be reported by online platform operators.

The matter of taxation of digital businesses has been under discussion at EU level for many years. Since March 2018, the EC 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; however, 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.