

Corporate Tax - Cyprus

Overview (October 2011)

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Basis of taxation

Income tax

Social insurance

Special defence contribution

Capital gains tax

Double taxation agreements

Advance rulings

Capital duty

Annual levy on companies

Stamp duty

Value added tax

Immovable property tax

Fees on transfer of immovable property

Levy on credit institutions

Taxation of international shipping and ship management activities

The Cyprus taxation system was thoroughly overhauled in 2002 in preparation for EU membership. As a result, Cyprus benefits from a simple, modern tax system that is fully compliant with the Organisation for Economic Cooperation and Development (OECD) and EU requirements. In a recent survey of tax professionals Cyprus emerged as the most attractive tax regime in Europe on account of its combination of consistency in interpreting tax legislation, stability in resisting frequent changes to tax laws and comparatively low tax rate.

Basis of taxation

The tax year for individuals and companies is the calendar year. Liability to Cyprus tax in any year of assessment is based on residence. For individuals, residence is determined by physical presence, while for companies it is determined by the locus of management and control.

Income tax

The Income Tax Law 2002 completely changed the system of company taxation and abolished the separate taxation system that had previously been available to international business companies (ie, companies incorporated in Cyprus, owned by non-Cypriots and trading exclusively outside Cyprus). There is now:

- a single corporation tax rate of 10% for all companies registered in Cyprus;
- no geographical limitation on the exercise of a company's activities - income may be derived from any source, including Cyprus; and
- no restriction on the ownership of a company's shares.

Liability for tax

Liability to corporate income tax is based on residence. Cyprus resident companies are liable to tax on worldwide income and non-resident companies are liable to tax on any Cyprus-source income.

For companies, the test for residence is the locus of management and control. A company is regarded as resident in Cyprus if it is managed and controlled in Cyprus. Mere registration or incorporation in Cyprus will not be enough to render a company liable to tax in Cyprus. A majority of resident directors on the board establishes a *prima facie* rebuttable presumption of management and control being exercised in Cyprus.

The criteria for management and control have not been formally defined, but the following are generally accepted as the key factors determining whether the management and control of a company are exercised in Cyprus:

- Are a majority of the directors resident in Cyprus?
- Are all strategic decisions affecting the company demonstrably made in Cyprus by the board of directors?
- Does the company maintain its headquarters in Cyprus?
- Does the company operate an account with a bank in Cyprus?

A company should have economic substance in terms of staff, premises and equipment and sufficient competence in Cyprus to make necessary business decisions. Finally, it should provide a service that is genuinely required by the group

and not "devoid of an economic purpose". Otherwise, payment for such services could be viewed as an artificial transfer of profits from one company to another.

Cyprus branches of foreign companies are subject to tax on worldwide income if the locus of management and control of the branch is in Cyprus. If the locus of management and control is overseas, the branch is liable to corporation tax on profits accruing or arising in Cyprus.

Under the OECD Model Double Taxation Treaty, the definition of a 'permanent establishment' includes:

- a place of management;
- a branch;
- an office;
- a factory;
- a workshop;
- a mine; and
- a building site or construction or installation project if it lasts for more than three months.

The retention of a law firm or similar service provider in Cyprus for management, domiciliation, legal or other services and the opening of an account with a bank in Cyprus do not constitute a permanent establishment.

Taxable income

A company resident in Cyprus is taxable on its worldwide income derived or accruing from:

- gains or profits from any trade or business;
- interest earned in or closely related to the normal activities of the business;
- rents, royalties, premiums or other profits arising from property; and
- any other income (eg, gain on sale of goodwill).

Expenditure disallowed for tax purposes

All expenses wholly and exclusively incurred for the production of the relevant income are deductible, with the following exceptions:

- contributions to the Social Cohesion Fund (see below);
- private motor vehicle expenses;
- professional tax;
- immovable property tax;
- interest paid in respect of the acquisition of non-business assets or private motor vehicles (even if used for business purposes); and
- business entertainment costs in excess of the lower of €17,086 or 1% of gross income.

Where the income consists of both taxable and non-taxable income, expenses directly incurred in earning the non-taxable income are not allowed and indirect expenses are apportioned on the basis of the income earned.

Rate of tax

Tax is charged at 10% on the profits of a company's business and gains on trading in immovable property in Cyprus.

Loss relief

Trading losses incurred by one group company may be set off against trading profits of another group company to give group relief, provided that the losses and profits were accrued in the same year of assessment and both companies were resident in Cyprus and members of the same group for the whole of the tax year concerned.

Two companies are deemed to be members of a group if one is the 75% subsidiary of the other or both are 75% subsidiaries of a third company. A 75% subsidiary holds at least 75% of the voting shares with beneficial entitlement to at least 75% of the income and 75% of the assets on liquidation.

Exemptions and special cases

The following exemptions are available:

- profit from the sale of securities;
- dividends;
- income of any company formed exclusively for the purpose of promoting art, science or sport, and of certain educational and charitable companies;
- income of any approved pension or provident fund; and
- profits from a permanent establishment situated entirely outside Cyprus, unless the permanent establishment directly or indirectly engages more than 50% in activities which lead to investment income and the foreign tax burden is substantially lower than the tax burden in Cyprus.

Interest other than that earned in, or closely related to, the normal activities of the business is subject not to corporate income tax, but to special defence contribution (SDC) tax (currently 15%).

Royalties or any other payments to a non-resident for intellectual or industrial property rights are liable to a 10% withholding tax, subject to relief under any applicable double taxation treaty. No tax need be withheld if the rights are used exclusively outside Cyprus.

Rental payments made to a person not resident in Cyprus in respect of films shown in Cyprus are subject to withholding tax at 5% of the gross amount.

There is a separate, highly favourable tonnage tax system for international shipping and ship management activities.

Reorganisations

Transfers of assets and liabilities can be made without giving rise to a tax liability within the framework of a reorganisation (including mergers, demergers, partial divisions, share exchanges and transfers of seat) and any tax losses can be carried forward by the receiving entity.

Payment of tax

On August 1 each year companies must submit a provisional tax return for the year, accompanied by a remittance for one-third of the estimated tax liability. The remaining balance must be paid in equal instalments on September 30 and December 31. The final tax liability must be paid no later than August 1 following the end of the tax year and a final tax return must be submitted no later than the following December 31.

Relief or credit may be available under a double taxation treaty for tax paid abroad. Where no double tax treaty is in place, the Cyprus tax authorities normally allow unilateral relief for foreign tax paid.

Social insurance

Under the Social Insurance Scheme, the employer and employee each contribute 6.8% of the employee's earnings up to a current maximum of €4,342 per month (adjusted annually) - a total of 13.6%. The government pays a further 4.3%, making an aggregate of 17.9%.

A self-employed person contributes 12.6% and the government pays 4.3% on income within a lower and upper earnings threshold that varies according to the nature of the trade.

Voluntary contributions may be paid at 14.8% on insurable income; the contributor pays 11% and the government pays 3.8%. An individual who is ordinarily resident in Cyprus, but is working abroad for a Cyprus-resident employer, may pay voluntary contributions of 13.6%. In this case the government contributes 4.3%.

Employers must also pay 1.7% of their employees' earnings up to a maximum of €4,342 per month to the Industrial Training Fund and Redundancy Fund and 2% (with no upper earnings limit) to the Social Cohesion Fund, which is used to make social grants.

Contribution rates are reviewed at five-year intervals, with the next scheduled review due to take place in 2014.

Special defence contribution

SDC tax is payable by Cyprus resident (determined in the same way as for income tax) individuals and companies on interest, dividend and rentals received at the following rates.

Nature of income	Rate
Dividends	17%
Interest	15%
Rents	2.25%

Dividends

Dividends received by a resident company (or a permanent establishment of a non-resident company) from overseas are exempt from SDC tax in accordance with the EU Parent-Subsidiary Directive and domestic law. There are no controlled foreign company provisions under Cyprus law - the only limitation to the exemption for overseas dividends is where:

- the investment income is more than 50% of the paying company's activities; and
- the foreign tax burden on the income of the paying company is substantially lower than the Cyprus tax burden.

Dividends received by one resident company from another are exempt from SDC tax. Dividends received by a foreign shareholder (individual or company) from a resident company are also exempt. This gives Cyprus a real advantage over other European holding company regimes, which generally impose a withholding tax - even when reduced by a double taxation treaty - of at least 5%.

Interest

Interest received in or closely related to the normal course of business is exempt from SDC tax. Other interest is subject to SDC tax at 15% on the whole amount received, with no deduction for the costs of earning the interest.

Rent

Rents are subject to SDC tax at 3% on 75% of the gross rent, giving an effective rate of 2.25%. No deduction for expenses is allowed.

Deemed dividend distribution

If a Cyprus resident company does not distribute a dividend within two years of the end of a tax year, a 'deemed dividend distribution' is calculated, which is 70% of post-tax profits for that tax year, reduced by any dividends that have been paid out of those profits. SDC tax is charged on only the proportion of the deemed dividend distribution that is applicable to Cyprus-resident shareholders.

When an actual dividend is paid after the deemed dividend distribution, SDC tax is payable only on any dividend paid over and above the deemed dividend distribution.

Companies are generally required to submit an annual return on Form IR 623 for the purpose of calculating deemed dividends. Where the entire share capital of a Cyprus-resident company is ultimately owned by non-residents, the directors of the company may make a declaration to this effect, have it certified by the company's auditors or lawyers and forward it to the tax authorities. When the declaration has been accepted by the tax authorities, the company will no longer be required to make returns for deemed distribution purposes.

If part of the share capital is ultimately owned by Cyprus residents, an annual return must still be submitted, but the profits ultimately attributable to non-resident shareholders will be excluded.

Payment of SDC tax

Any person or company paying a dividend or interest is required to deduct SDC tax and pay the SDC tax to the Inland Revenue department with a statement of tax deducted. SDC tax on deemed distributions must be paid within two years and one month after the end of the accounting year.

Companies, partnerships and national or local government bodies which pay rent to Cyprus-resident landlords are required to deduct SDC tax from rental payments and remit it to the tax authorities. The amount to be deducted and paid over to the tax authorities is 3% of 75% (ie, 2.25%) of the gross rental amount.

On each June 30 and December 31 the tenant must provide the landlord with a statement of tax withheld. Tenants must also submit with their annual tax return a list of the landlords from which SDC was withheld.

Persons or companies receiving rent are responsible for ensuring that the amount of SDC withheld is correct. They must pay any further SDC due (eg, in the event of under deduction or on rents paid by individuals) by self assessment on June 30 and December 31.

There is no requirement to withhold and account for SDC tax on rent paid to non-residents, subject to the landlord providing the tenant with the necessary confirmation of non-residence.

Relief or credit against SDC tax will be allowed in respect of any foreign tax paid, either under a double taxation treaty or by way of unilateral relief.

Capital gains tax

Subject to certain exemptions and reliefs, net gains from the disposal of immovable property in Cyprus and of shares of unlisted companies owning immovable property in Cyprus are taxable at 20%. All other gains are exempt.

The following categories of disposal of real estate are exempt from capital gains tax:

- transfers by reason of death;
- gifts between relatives up to the third degree of kinship;
- gifts to family companies (limited companies whose only shareholders at the time of the gift and for the entire period of five years thereafter are members of the family of the donor);
- gifts by family companies to their shareholders, but only in cases where the property given was originally acquired by the company as a gift;
- gifts to charitable institutions or to the state;
- exchanges of immovable property; and
- compulsory acquisitions.

In assessing the gain, the following will be deducted from the price received:

- the market value of the property at January 1 1980 or, if it was acquired after that date, the price paid or the consideration given for the acquisition of the property;
- the cost of any major improvements;
- the subsequent increase in the value of the property due to inflation, calculated by reference to the Retail Price Index issued every month by the Department of Statistics; and
- expenses related to the acquisition and disposal of the property such as transfer fees and legal costs.

Individuals may deduct from the resultant gain the following lifetime exemptions:

- in the case of sales of agricultural land by farmers, the first €25,629 of the sale price, provided that the farmer was residing in the same area at the time of the sale;
- in the case of sales of property used as a residence by the vendor, the first €85,430 of the sale price, provided that the property has been used as the vendor's residence for at least five years prior to the sale; and
- in the case of any other disposal, the first €17,086 of the sale price.

Many of Cyprus's double taxation treaties tax capital gains only in the country of residence of the company or individual disposing of the asset. The exemption from capital gains tax in Cyprus could therefore lead to complete elimination of any tax liability (eg, in the case of a capital gain made by a Cyprus-resident company from a sale of its foreign subsidiary's shares, which will be exempt from tax both in Cyprus and in the country where the subsidiary and the shares are based).

As the gain from a sale of goodwill is subject to corporation tax at 10%, it is usually beneficial to transfer goodwill to a newly formed company and sell the shares of that company. Any capital gain on the sale of the shares (which will include the value of the goodwill) will be exempt from tax.

Double taxation agreements

Cyprus has a comprehensive network of double taxation agreements.⁽¹⁾

All the treaties provide relief from double taxation by applying the credit method to the taxation of dividends and interest. Cyprus residents' liability for Cyprus income tax and SDC is reduced by tax paid or payable in the other country, so that the taxpayer pays only the higher of the two rates of tax and is not taxed twice on the same income.

Even where there is no double tax treaty in place, the Cyprus tax authorities will allow unilateral relief in the form of a tax credit against Cyprus tax in respect of foreign tax on the same income charged in the country of origin.

Advance rulings

The commissioner of income tax provides written replies on interpretation of the Cyprus tax law provisions. This practice is not incorporated in the Cyprus tax legislation and it is not an official ruling regime as used in other EU member states. Even so, the interpretations should be binding on the tax authorities if the full facts are disclosed on the ruling request. It is hoped that the advance ruling practice will be extended, so that taxpayers will be able to obtain binding advance decisions on the tax consequences of proposed transactions.

Capital duty

On incorporation of a Cyprus registered company, capital duty of €103 plus 0.6% of the authorised capital is payable to the registrar of companies. Any subsequent increase in share capital is liable to capital duty at 0.6%.

Annual levy on companies

For 2011 and subsequent years, an annual levy of €350 is payable to the registrar of companies by all companies incorporated in Cyprus. Dormant companies, companies own no assets and companies owning property in the occupied areas of Cyprus are exempt. For groups of companies there is a ceiling of €20,000.

The levy for 2011 is payable by the end of that year; for subsequent years the levy is payable by June 30.

Penalties will be imposed in the event of late payment. If the levy is paid no later than two months after the due date, a penalty of 10% will be charged. If the levy is paid between two and five months after the due date, a penalty of 30% will be charged. Companies that have not paid within five months of the due date may be struck off the register. They can be restored to the register only by paying an increased levy of €500 per year, if they are restored within two years, or €750 per year, if they are restored to the register after more than two years.

Stamp duty

Stamp duty is payable on contracts relating to property or business in Cyprus. On the first €170,860, the revenue stamp is €0.02 per €17.09 or part thereof, and on any excess above €170,860, the revenue stamp is €0.03 per €17.09 or part thereof. Stamp duty is capped at €17.086 per document. Where no amount is specified in the contract, the stamp duty is €34.

A number of categories of document are exempt from stamp duty, including documents relating to corporate reorganisations (which are exempt from all forms of taxation) and ship mortgage deeds or other security documents.

Value added tax

Cyprus's standard value added tax (VAT) rate of 15% is the lowest in the European Union and reduced rates of 5% and 8% apply to certain goods and services. The VAT registration threshold is €15,600 per annum. VAT returns must be submitted quarterly and any tax due paid by the 10th day of the second month following the quarter-end date. If input tax is greater than output tax, the difference may be refunded or carried forward to the next return. Companies that do not have trading activities within the European Union need not register for VAT, but they will be unable to recover input tax.

Immovable property tax

Immovable property tax is payable each year on the market value as at January 1 1980 of all immovable property registered in the name of the taxpayer at the start of the year. Progressive rates of taxation are charged on each tranche of the total value, as follows.

Tranche	Rate
0 - €120,000	0
€120,000 - €170,000	0.4%
€170,000 - €300,000	0.5%
€300,000 - €500,000	0.6%
€500,000 - €800,000	0.7%
€800,000 and above	0.8%

Fees on transfer of immovable property

The Department of Land and Surveys, which is responsible for property registration in Cyprus, charges a fee for the transfer of immovable property. The fee is calculated at progressive rates on each tranche of the purchase price or market value as follows.

Tranche	Rate
First €85,430	3%
Between €85,430 and €170,860	5%
Above €170,860	8%

No transfer fees are payable in respect of company reorganisations.

Exemptions and reductions are available in respect of transfers between family members and between family members and family companies.

Levy on credit institutions

With effect from 2011, credit institutions operating in Cyprus are required to pay a levy of 0.095% on their customer deposits as at December 31 of the preceding year. Inter-bank deposits are not subject to the levy. The levy will be payable by:

- Cyprus banks in respect of their banking activities in Cyprus (overseas branches and subsidiaries will not be subject to the levy);
- the Cyprus operations of foreign (EU and third-country) banks and credit institutions; and
- cooperative credit institutions.

The levy is not deductible for the purpose of calculating taxable profits, but it will be taken into account in calculating profits subject to deemed dividend distribution.

The declaration of taxable deposits on the preceding December 31 must be made by March 31 each year. The levy will be collected in four equal instalments at the end of each quarter, starting March 31.

The levy is limited to 20% of taxable profits for the year in respect of which it is paid. The tax authorities are required to issue final income tax assessments within six months of the date on which the corporate income tax return was submitted. Any overpayment above the 20% limit must be refunded within a month of the issue of the final income tax assessment.

Taxation of international shipping and ship management activities

The Merchant Shipping (Fees and Taxing Provisions) Law 2010 gives qualifying Cyprus-resident shipping and ship management companies the option to be taxed on the basis of the tonnage of the vessels they operate, simplifying and reducing the tax burden. It widens the range of exempt gains to include profits on the disposal of vessels, interest earned on funds and dividends paid directly or indirectly from shipping-related profits, in addition to profits from shipping operations (for further details please see "[Cyprus's new shipping tax regime](#)" and "[New circular clarifies ring fencing provisions of Tonnage Tax Law](#)").

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Endnotes

⁽¹⁾ As of October 2011 double tax agreements were in operation between Cyprus and Armenia, Austria, Azerbaijan, Belarus, Belgium, Bulgaria, Canada, China, Czech Republic, Denmark, Egypt, France, Germany, Greece, Hungary, India, Ireland, Italy, Kuwait, Kyrgyzstan, Lebanon, Malta, Mauritius, Moldova, Montenegro, Norway, Poland, Qatar, Romania, Russia, San Marino, Serbia, Singapore, Slovakia, Slovenia, South Africa, Sweden, Syria, Tajikistan, Thailand, Ukraine, the United Kingdom, the United States and Uzbekistan.

Treaties are under negotiation, or awaiting ratification, with a number of other countries, including Algeria, Bangladesh, Brazil, Estonia, Finland, Indonesia, Iran, Jordan, Kazakhstan, Latvia, Libya, Lithuania, Malaysia, Moldova, Netherlands, Portugal, Seychelles, Spain, Sri Lanka and Vietnam.

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