The Inward Investment and International Taxation Review

Eleventh Edition

Editor
Tim Sanders

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THE

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Eleventh Edition

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PREFACE

This edition has been revised to describe domestic tax changes that have occurred in each jurisdiction since the last edition, including those made, and proposed, in response to the covid-19 pandemic. Where appropriate, the contributors also update the progress made in their respective jurisdictions in implementing laws to comply with the Base Erosion and Profit Shifting (BEPS) Actions.

The pandemic's economic impact has been profound, and while temporary reliefs have been introduced in many countries, and are described, at this stage it is unclear how countries will change their tax laws in the longer term and balance the need to recover the enormous costs of the pandemic with the desire to stimulate economic growth in contracting economies. How this conflict will evolve and be resolved seems likely to be the major tax story of 2021. This preface will make some tentative observations in this area.

As will be seen from the chapters herein, in 2020, countries continued to implement changes to their domestic laws to comply with BEPS Actions notably in respect of hybrid entities and instruments, controlled foreign companies and transfer pricing. One key area highlighted last year, which has progressed in 2020, is the taxation of the digital economy. In October 2020, the OECD published two blueprints and launched a public consultation as part of its work on the taxation of the digital economy. These blueprints are key developments in the international conversation on the challenges of taxing the digital economy. However, although the OECD has progressed efforts in 2020 to find a consensus, many countries, frustrated by the lack of concrete law, are progressing their own unilateral measures to tax the digital economy. For example, Spain's 'Google Tax' is due to come into force on 16 January 2021 and the United Kingdom has already introduced a Digital Services Tax. Pressure for unilateral action is likely to increase as countries look for new tax sources to recover revenue spent on fighting covid-19. Potentially taxation of digital companies allows many economies to raise material amounts of tax revenue without an adverse economic impact on the recovery in their own jurisdictions, where the digital taxpayers often have minimal presence and pay little tax. However, that analysis must factor in whether the US, that has most to lose (as many of the largest digital companies are US-based), will take retaliatory action. The previous political regime showed that it is willing to impose tariffs on goods imported from countries that unilaterally impose a digital tax. This is an area to watch carefully in 2021. The increased pressure to tax the digital economy because of the covid-19 pandemic has been acknowledged by the OECD, with the OECD Secretary-General stating on an online press conference on 12 October 2020 that digital businesses that are thriving during the pandemic would 'be the targets' of countries looking for resources to 'make ends meet'.

Many countries have introduced packages of short-term tax measures to help businesses and individuals through the pandemic. These may comprise deferring tax payments and

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extending filing deadlines, to subsidies such as those afforded to businesses that furloughed staff and measures allowing more generous loss carry-back. The question countries must face in 2021 is how long they can afford to provide these short-term reliefs and what will replace them. There is a lot of pressure to help certain sectors particularly hard hit by the pandemic such as tourism and hospitality and, for example, Austria's reduction in VAT to 5 per cent on restaurants, and admission to cultural events for 2021 is the sort of measure one might expect to be introduced elsewhere.

The wider question is how countries can reconcile the desire to provide economic support and stimulus for growth after the pandemic with the need to recover the budget deficit caused by covid-19 pandemic-related costs: how to raise additional tax from shrinking economies, without stifling any recovery. As referred to above, one obvious target is to tax the digital economy; another possible avenue is to introduce measures that encourage inward investment. It is also likely that in the drive to increase tax revenues, many tax authorities will take a far more aggressive and proactive approach to recover tax and penalties from tax payers regarded as non-compliant or participating in perceived tax avoidance. However, it would be naïve to imagine that these sorts of measures alone will be enough and even if one factors in tax changes in areas such as personal capital taxes, it seems likely that some increase in business and personal income taxes will be needed.

How US tax reform in 2021, post the presidential election, evolves is another factor likely to impact the wider tax landscape and is an area that needs to be kept under review.

It is hoped that this volume will prove to be a useful guide to the tax rules in the jurisdictions where clients conduct their businesses. Each chapter aims to provide topical and current insights from leading experts on the tax issues and opportunities in their respective jurisdictions. While specific tax advice is always essential, it is also necessary to have a broad understanding of the nature of the potential issues and advantages that lie ahead; this book provides a guide to these.

I should like to thank the contributors to this book for their time and efforts, and above all for their expertise. I would also like to thank the publisher and the team for their support and patience. I hope that you find the work useful, and any comments or suggestions for improvement that can be incorporated into any future editions will be gratefully received.

The views expressed in this book are those of the authors and not of their firms, the editor or the publishers. Every endeavour has been made to ensure that what you read is the latest intelligence.

Tim Sanders
London
January 2021

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Chapter 8

CYPRUS

Stella Strati[1]

I INTRODUCTION

Cyprus has a very advantageous environment for inward investment, providing various incentives to encourage non-residents to set up a business in, or invest through, Cyprus. In a nutshell, 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, the corporate tax rate is one of the lowest in the European Union (EU), while non-Cyprus tax residents (or non-domiciled) enjoy a number of tax exemptions. These, and other characteristics of the Cyprus tax system, shall be further analysed below.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

The most common type of business entity used is the private limited liability company. Various benefits surround the existence, operation and tax treatment of a limited company; these will be examined below.

i Corporate

Businesses usually adopt a corporate form; that of a private (or public) limited liability company with shares. A Cyprus company is fiscally opaque for tax purposes. Pursuant to Cyprus law, a company is a legal person with a separate legal personality, while its members are not personally liable for its debts and obligations (their liability is limited to the share capital contributed). A Cyprus company is a legal entity distinct from its members and as such it enjoys rights and is subject to duties that are not the same as those of its shareholders. Furthermore, the existence of the company does not depend on the existence or continuation of its members, as stipulated by the principle of perpetual succession. All the above constitute the Cyprus company as a flexible corporate form for the purposes of conducting business.

ii Non-corporate

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

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Also, Cyprus recognises the concept of trusts and in particular Cyprus international trusts (for settlors and beneficiaries who are non-Cyprus tax residents during the year preceding the year of the trust settlement). A Cyprus trust is not a taxable person. The income of a trust is assessed in the name of the trustee; however, because the beneficiaries are the persons entitled to the income, they are liable for any tax thereon. Trustees need to follow a matching approach when making distributions to the beneficiaries, so that any Cyprus tax is deducted and paid. Hence, a look-through approach must be applied.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

Business profits of a Cyprus company, adjusted for various disallowances and exemptions, are subject to tax at 12.5 per cent. 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, exchange differences, are considered among others as non-deductible expenses. However, capital allowances, balancing allowance computed on the disposal of a non-current assets, notional interest deduction and notional loss in related party transactions are also deductible.

Capital and income

The corporation tax rate is 12.5 per cent. For individuals, the progressive rates for income tax are provided below. No capital gains tax exists, apart from the taxation of gains from the disposal of immovable property situated in Cyprus.

Losses

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 per cent for the entire tax year is necessary for a company to be considered as forming part of a tax group. As from 2015 onwards, the interception of companies established in the EU or in countries with which Cyprus has a double tax treaty or have signed the Organisation for Economic Co-operation and Development (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 an EU Member State, provided that the EU subsidiary has exhausted all means of surrendering or carrying forward the losses in its own state.

Rates

Business profits of Cyprus tax resident companies, adjusted in relation to allowances and exemptions, are subject to a flat tax rate of 12.5 per cent.

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Income for individuals is subject to progressive tax rates. The first €19,500 is tax free, the next €8,500 is subject to a tax rate of 20 per cent, the next €8,300 is taxed at 25 per cent, the next €23,500 at 30 per cent and any amount above €60,000 at 35 per cent. A number of deductions and personal allowances are available.

Administration

The key tax authority in Cyprus is the Tax Department (under the Ministry of Finance). The Tax Department deals with all matters that relate to direct and indirect taxation. Local or municipal taxes are paid to the local municipalities, as applicable.

The Cyprus tax year is the calendar year, both for legal and physical persons.

For income tax purposes, records must be retained for six years after the end of the relevant tax year. Taxpayers are required to submit tax returns once a year. All tax returns can be submitted electronically, and taxes can be paid online.

Legal persons are required to prepare audited accounts based on generally accepted audit standards. Companies should be registered online and submit their annual tax returns electronically. The submission deadline of the income tax return for companies for a given tax year is 31 March of the second year following the year end. The provisional tax payment for entities is made in two instalments on 31 July and 31 December each year. The payment of the final corporation tax under the self-assessment method is done by 1 August of the following year. This also applies for individuals preparing audited financial statements (i.e., having an income above €70,000).

Self-employed individuals who are not required to prepare audited financial statements must submit electronically their personal income tax return by 30 September of each year.

Employers are required to pay the employee's income tax through the PAYE (pay as you earn) system one month after the salary payment. Salaried individuals must submit their personal income tax return by 31 July, while employers are required to submit their return of payments to employees and tax deducted for each tax year no later than 31 July of the following year.

The Cyprus tax process is that of self-assessment. Following the filing of a tax return, the Cyprus tax authorities have six years from the end of the relevant tax year to raise an enquiry (or 12 years in case of fraud or willful default).

Tax authorities' decisions can be challenged by applying to the Tax Tribunal, which is an independent body, not forming part of the Tax Department. Such application must be filed within 45 days from the notification of the relevant decision of the Tax Commissioner. The Tribunal must issue a decision within a year from the submission of the application. Also, taxpayers may submit a petition to the Administrative Court, which has jurisdiction to review at first instance the lawfulness of decisions, actions or omissions of any executive or administrative authority and has the power to validate or nullify any such decisions. The decisions of the Administrative Court are subject to appeal before the Supreme Court.

Tax grouping

No rules for tax grouping exist, except for the basic rules for group tax relief, described above.

ii Other relevant taxes

Other taxes in Cyprus include Value Added Tax (VAT), Special Defence Contribution (SDC), Capital Gains Tax and Stamp Duty.

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The standard rate of VAT is 19 per cent, while reduced rates of 5 per cent and 9 per cent apply to certain supplies.

SDC is payable by Cyprus tax resident companies and individuals that 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 per cent. Dividends received by Cyprus tax-resident companies are not subject to SDC (subject to specific exceptions mentioned below). The SDC rate for interest for both natural and legal persons is 30 per cent. Rents received by companies and by tax resident and domiciled individuals are subject to SDC at the effective rate of 2.25 per cent (3 per cent on gross rents less 25 per cent).

Capital gains tax applies only to direct and indirect disposals involving immovable property situated in Cyprus. It is imposed at the rate of 20 per cent on gains from the disposal of immovable property or gains from the disposal of shares in companies that directly or indirectly own immovable property situated in Cyprus.

Stamp duty is payable on any document that concerns any property located in Cyprus or on matters to be executed there. For contracts the value of which ranges between €5,001 and €170,000, the current rate of stamp duty is €1.50 cent for each €1,000 or part thereof; for contracts the value of which is over €170,000, the current rate of stamp duty is €2 for every €1,000 or part thereof, with a ceiling of €20,000. 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 €2 each, provided they are dated the same day (or very close) as the main transaction document. A number of instruments carry a fixed stamp duty, as per the provisions of Cyprus Stamp Duty law.

Furthermore, individuals are obliged to pay contributions for the General Healthcare System (GHS) on, among others, emoluments, pensions, rental, interest and dividend income. GHS contributions are also applicable to non-domiciled individuals. These contributions are capped at an annual income of €180,000.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

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: (1) the place of residence of the majority of the directors; (2) the place that the meetings of the board of directors are held; and (3) the place where the general policy of the entity is formulated. Therefore, it is possible for a non-locally incorporated entity to become a Cyprus tax resident if the above criteria are met.

ii Branch or permanent establishment

A non-Cyprus entity can have a fiscal presence in Cyprus through a branch or a permanent establishment (PE). The definition of a PE as included in Cyprus legislation generally follows that of the OECD model tax treaty. Therefore, for an entity to be deemed to have a Cyprus PE a 'fixed place of business' is required to be established there (i.e., branch, office, etc).

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Cyprus also recognises the concept of the agency PE. The relevant legislative provisions state that where a person – other than an agent of an independent status - is acting on behalf of an enterprise and has and habitually exercises in Cyprus an authority to conclude contracts in the name of the enterprise, that enterprise will be deemed to have a PE in Cyprus in respect of any activities which that person undertakes for the enterprise. An enterprise shall not be deemed to have a Cyprus PE merely because it carries business there through a broker, general commission agent or any other agent of an independent status, provided that they are acting in the ordinary course of their business. Usually, an agent is considered to be independent if such person does not act upon detailed instructions of the enterprise; is subject to entrepreneurial risk; and provides similar services towards other enterprises.

In case a foreign entity has a Cyprus PE, then that PE will be subject to tax in Cyprus on income accrued or derived from the business activity that is carried through such PE and on income arising from sources therein.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

A number of features of the Cyprus tax system can encourage inward investment. These include, among others, the IP regime, the Tonnage Tax System, the absence of withholding taxes, the expatriate relief and others mentioned below.

i Holding company regimes

No particular regimes exist in relation to Cyprus holding companies. However, a number of tax law provisions identify Cyprus as an attractive holding jurisdiction. 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 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. Furthermore, profits arising from the disposal of titles are tax exempt. Non-Cyprus tax residents, or Cyprus tax residents but not domiciled, shareholders of a Cyprus company are not subject to any SDC. Also, no restrictions on foreign share ownership exist; thus, a foreign investor can be the sole shareholder of Cyprus entity.

ii IP regimes

As of 1 July 2016, a new IP tax regime is applicable in Cyprus. This follows the nexus approach, according to which a direct link between qualifying income and own qualifying expenses is essential for the intellectual property 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 regime, an overall 80 per cent deduction on profits was granted. Under the new rules, 80 per cent of the overall income derived from the qualifying intangible asset is treated as a deductible expense. A qualifying intangible asset is an asset that has been acquired, developed or exploited by a person within the course of carrying out their business, which is the result of research and developments activities. Such assets specifically comprise of patents, computer software, and 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 patterns or

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non-obvious, useful and novel (which are certified as such by an appropriate authority) where the person utilising these does not generate annual gross revenues in excess of €7.5 million from all intangible assets (or €50 million for groups). Qualifying intangible assets specifically exclude trademarks, business names, brands image rights and other intellectual property rights used for the marketing of products and services. Persons that may benefit from the Cyprus IP regime include Cyprus tax resident taxpayers, tax resident PEs of non-tax resident persons, as well as foreign PEs that are subject to tax in Cyprus.

iii State aid

There are limited approved state aid schemes in Cyprus; however, the majority of these aim to enhance productivity in specific areas, such as rural tourism, high tech and innovative enterprises.

iv General

There are a lot of characteristics rendering the Cyprus tax system attractive.

Apart from the new IP regime described in V.ii above, 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 (i.e., no requirement for a computation of tax adjusted profits exist). Also, 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.

Furthermore, various benefits are provided for natural persons. Individuals 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 €100,000 per year, are granted a tax deduction of 50 per cent on emoluments for a period of 10 years.

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.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding outward-bound payments (domestic law)

Cyprus does not apply any withholding tax on dividends or interest paid to non-residents. Regarding the payment of royalties to a non-Cypriot tax resident, a maximum 10 per cent 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.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

Cyprus does not apply any withholding taxes on dividends, interest or royalties, save as mentioned above. The EU parent/subsidiary directive and the EU parent interest and royalties directive are fully applicable in Cyprus.

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iii Double tax treaties

The Republic of Cyprus enjoys a wide network of double tax treaties (DTTs), as it has entered into these 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).

iv Taxation on receipt

Dividends are generally exempt from income or corporation tax in Cyprus. There is an exception in that dividends received from a foreign company will be subject to corporation tax if paid out from hybrid instruments; this applies from 2016 onwards.

Dividends are subject to SDC if received by a natural person Cyprus tax resident and domiciled. The relevant SDC rate is 17 per cent. Dividends received by a Cyprus tax resident company from a foreign entity are usually not subject to SDC unless the passive dividend rule applies; namely, that the company distributing the dividend engages directly or indirectly in more than 50 per cent 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 per cent) than the Cyprus tax burden. Dividends received by a Cyprus company from another Cyprus 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.

Any foreign tax suffered is credited against the equivalent Cyprus tax on the foreign tax suffered. 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 suffered on foreign income irrespective of the existence of a double tax treaty or not.

Underlying tax relief applies only for Cyprus tax resident companies in relation to dividend income received from such companies from foreign sources. A number of double tax treaties entered into by Cyprus allow for relief from both withholding tax suffered and for underlying tax paid by the foreign paying out entity. However, because the majority of dividend income received is exempt from any Cyprus taxes, underlying tax relief is not common.

VII TAXATION OF FUNDING STRUCTURES

i Thin capitalisation

No thin capitalisation rules exist. Nevertheless, interest limitation rules (ILR) were introduced in 2019 as part of the wider implementation of the EU Anti-Tax Avoidance Directive (ATAD).

The underlying purpose of the ILR is to limit the provision of financing facilities to companies (based in high-tax jurisdictions) in low-tax jurisdictions through subsidiaries belonging to the same group. To do so, the ILR requires that the excess borrowing cost (EBC) which is greater than 30 per cent of taxable income before interest, tax, depreciation and amortisation (EBITDA), not to be deductible for income tax purposes. As such, it limits the otherwise deductible EBCs to 30 per cent of taxable EBITDA. However, the ECB is deducted up to a *de minimis* threshold of €3 million per fiscal year. Standalone entities (not part of a group) are excluded from the ILR. Moreover, grandfathering has been provided for loans concluded before 17 June 2016. Finally, a group equity 'escape' or 'carve-out' is provided, according to which, where the Cyprus resident company is part of a consolidated

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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 per cent lower) or higher than the equivalent ratio of the group.

ii Deduction of finance costs

In general, expenses wholly and exclusively incurred by a Cyprus company in the production of taxable income are deductible and allowable.

Interest expense and charges are generally allowable expenses provided they do not specifically match to the acquisition of non-taxable assets. Non-taxable assets include private assets, saloon cars, paintings, etc. A restriction of interest expense exists if the company has acquired such non-taxable assets. Generally, this restriction is calculated by applying the average borrowing rate of the company to the cost of the non-taxable assets. The result of this calculation is compared with the actual interest and charges appearing in the profit or loss of the relevant company. The lower between the calculation and the actual expenses is disallowed for tax purposes. Further specific rules also apply for the calculation of this interest restriction.

iii Restrictions on payments

Generally, there are no restrictions on the distribution of dividends. Nonetheless, the payment of dividends from a Cyprus company to its shareholders should only be made out of realised profits.

iv Return of capital

The share capital of a Cyprus company, or the share premium attached to shares, can be returned to the shareholders thereof following a reduction of capital or share premium as per the provisions of the Cyprus Companies Law, Cap. 113 as amended (the Companies Law). In order for a Cyprus company to reduce its share capital or share premium: (1) a shareholders' special resolution must be passed (at least 75 per cent majority); (2) a court order sanctioning the reduction must be issued; and (3) the relevant court order, along with the special resolution approving the reduction, must be filed with the Cyprus Registrar of Companies (ROC), as the reduction will have no effect unless and until it is registered with the ROC.

There is a requirement in relation to the protection of creditors; namely, a list of creditors needs to be drawn up or published in the official gazette of the Republic giving notice to any creditor or interested party of the hearing date of the court application, enabling any such person to file an objection. This can be overcome if the consent of all creditors is obtained and produced to the court, along with the relevant application.

Return of capital or share premium to the shareholders (to the extent that such capital or premium was paid or contributed by the shareholders in exchange of shares) is tax-neutral.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

There is no limitation for foreign investors acquiring shares in Cyprus companies. They can acquire such shares on their name or use a foreign or a local entity for this purpose. Profits from the disposal of titles are exempt from any tax in Cyprus; hence, the actual structuring

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of the payment of the consideration is irrelevant with respect to the sale of shares. 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.

From the tax tear 2015 (inclusive) and onwards, notional interest deduction (NID) is available in Cyprus. NID is granted on new equity as a tax allowable deduction. NID can essentially reduce effective corporate tax rate to as low as 2.5 per cent. However, deduction granted can in no case exceed 80 per cent of tax adjusted profits.

After the introduction of NID, it became more appealing for buyers to structure financing through equity. Financing through loan is also possible; the overall transaction structure will need to be considered before investors decide what best suits the needs of the specific acquisition.

ii Reorganisation

Cyprus allows for the reorganisation of entities both on the local and on the European level. Reorganisations are attractive from a tax perspective as they result in a total exemption from tax in Cyprus, provided that they fall within the scope of the Cyprus Income Tax Law No. 118(I)/2002 (the Income Tax Law).

The definition of reorganisations includes a number of types thereof, such as mergers (by acquisition, by the creation of a new company and by way of a holding company absorbing a subsidiary), divisions, partial divisions, transfers of assets and share exchanges.

The Income Tax Law classifies all the above types of reorganisations as arrangements, all of which are carried out pursuant to Sections 198 to 201 of the Companies Law, relating to compromises and reorganisations. Local reorganisations must also receive court approval before they can be effected.

An approved reorganisation has a number of tax benefits. No balancing statement is required for assets transferred, no capital gains or corporation tax on the transfer of Cyprus immovable property is applied, any losses carried forward of a transferring company can be transferred to the receiving company, no transfer fees or stamp duty is applied and there are no taxes whatsoever on the transfer of any assets.

Cross-border mergers are possible on the EU lever pursuant to the EU Directive 2017/1132/EC relating to certain aspects of company law, which repealed the EU Directive on Cross-Border Mergers (2005/56/EC). Cross-border mergers can be performed between limited liability companies incorporated in accordance with the legislation of an EU Member State that have their registered office, central administration or principal place of business in the EU, provided at least two of them are governed by the laws of different member states.

The consequences of a cross-border merger are contained in Article 131 of the said directive. In all cases, all assets and liabilities are transferred without the need for any other action (save for any necessary notifications) and likewise, the company or companies being absorbed cease to exist. From a tax perspective, an application can be made to the tax authorities, accompanied by the reorganisation plan and relevant information on the merging entities, for a reorganisation certificate, confirming the exemption from taxes. The tax authorities retain the discretion to issue a tax exemption certificate if they take the view that the merger or reorganisation was at arm's length and reflected economic reality.

There is no procedure in relation to the reorganisation of Cyprus companies with third country entities (i.e., outside the EU). However, such third country entities can first be re-domiciled into Cyprus and, following their re-domiciliation, can enter into an arrangement with a Cyprus company.

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iii Exit

In June 2020, a new law was adopted to implement the ATAD provisions in relation to exit taxation rules.

A Cyprus tax resident company or a PE of a foreign entity will be subject to tax at an amount equal to the market value of the transferred assets at the time of exit of the assets, less their value for tax purposes, in cases where:

a a Cyprus tax resident company transfers assets from its Cyprus head office to its PE in another EU member state or a third country, in so far as Cyprus no longer has the right to tax the transferred assets due to the transfer;

b a PE in Cyprus transfers assets to its head office or a PE in a member state or a third country, in so far as Cyprus no longer has the right to tax the transferred assets;

c a Cyprus tax resident company transfers its tax residence abroad, except for those assets which remain effectively connected with a PE in Cyprus; and

d a PE in Cyprus transfers its business abroad in so far as Cyprus has no longer the right to tax the transferred assets.

Under certain conditions, temporary transfers of assets are excluded from the scope of the exit taxation provisions.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

As from 1 January 2019, a general anti-abuse rule (GAAR) is applicable, and it was introduced as part of the general implementation of the ATAD. Cyprus legislation now 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.

ii Controlled foreign corporations

The Controlled Foreign Companies (CFC) rule, applicable as from 1 January 2019, results in the re-attribution of the income of a low-taxed controlled non-Cyprus subsidiary to its parent company to avoid revenue diversion to a jurisdiction with a more favourable tax regime. The CFC rules apply to both Cyprus tax resident companies and non-Cyprus tax resident companies having a PE in Cyprus.

A CFC is a low-taxed non-Cyprus tax resident company or PE in which the (1) Cyprus taxpayer, alone or together with its associated enterprises, holds a direct or indirect interest of more than 50 per cent, and (2) the actual corporate tax paid on the profits of the company or PE is lower than the 50 per cent of the tax that would be paid in Cyprus. The non-distributed income of a CFC 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: (1) accounting profits of no more than €750,000, and non-trading income of no more than €75,000; or (2) accounting profits of no more than 10 per cent of its operating costs for the tax period.

It is possible for the Cypriot controlling entity to claim credit for any overseas tax imposed on the CFC profits that are included in its tax base.

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iii Transfer pricing

Cyprus has adopted transfer pricing rules only in relation to intra-group financing activities. Such rules are effective as from 1 July 2017. Therefore, financing transactions between related companies are obliged to follow the arm's length principle as set out in the OECD Transfer Pricing Guidelines.

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 should be provided to the Cyprus tax authorities, evidencing that the conducted intra-group financing transaction (and the agreed remuneration; i.e., interest) complies with the arm's length principle. A transfer pricing report should be prepared by a transfer pricing expert and submitted to the tax authorities by a person who has a licence to act as an auditor of a company according to the Companies Law and is required to carry out an assurance control confirming the quality of the transfer pricing report.

Nevertheless, a simplification measure was also introduced. In case 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 per cent after tax on assets (profit after tax) which effectively means a minimum taxable profit of 2.2857 per cent on assets.

iv Tax clearances and rulings

It is possible to obtain advance tax rulings from the Cyprus tax authorities. Such rulings are issued on the application by or on behalf of a taxpayer on actual or proposed transactions, relating to tax years for which the due date for filing a tax return has not yet passed. Requests for rulings must be in writing and must comprise of the information required by the relevant circulars of the tax department. Rulings will be binding only with regard to the taxpayers specifically mentioned in the ruling request, and provided that the circumstances described therein continue to be applicable and that there is no subsequent modification in the tax legislation that renders the ruling inapplicable.

The tax department will express an opinion on the applicable tax treatment of the proposed transaction or scenario presented to it and will not be responsible for verifying the facts and circumstances described in the application. In case of any subsequent discrepancy between the scenario presented and the actual transaction, the tax authorities can either decline to apply the tax ruling or inform the tax rulings division of the actual facts, for the purposes of confirming or altering the initial ruling.

In any case, there is not a requirement or obligation for a taxpayer to obtain a tax ruling for the purposes of acquiring a local business or entering into a particular transaction.

X YEAR IN REVIEW

One of the most important developments on the tax field in Cyprus during the last 12 months was the implementation of exit taxation rules, as well as provisions with respect to hybrid mismatch rules in accordance with the ATAD. This confirms Cyprus' commitment to follow the BEPS recommendations and remain BEPS and OECD compliant.

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One of the current 'hot topics' in Cyprus is the existence of substance or real presence for entities. In the second part of 2018, the Central Bank of Cyprus issued two circulars setting out the definition of shell companies or entities. Although these circulars aimed at providing guidance to Cyprus banking institutions for the purposes of deciding on whether to engage in or maintain business relationships with legal entities, it can be considered as an important development because it provides a more practical overview of the substance requirements in Cyprus.

A recent trend is the relocation of the headquarters of international groups (especially enterprises dealing with IP) in Cyprus, the creation of substance and the establishment of real presence on the island, for the purposes of becoming Cyprus tax residents and obtain the advantages of the Cyprus tax system.

The covid-19 pandemic also resulted in specific legislative developments. More specifically, an implementing directive was issued by the Cyprus Tax Commissioner in October 2020 stipulating that the determination of the tax residency of individuals, the place of effective management in relation to corporate residency and the existence of PEs will not be affected by the temporary nature of the extraordinary circumstances related to the coronavirus outbreak; and, therefore, whereabouts and actions affected by the pandemic should be ignored by tax authorities and must not trigger a corporate tax residency scrutiny or change.

XI OUTLOOK AND CONCLUSIONS

There are a number of anticipated changes on the tax legislation.

More specifically, it is anticipated that the taxation of funds will be amended for the purposes of providing incentives to investors.

Moreover, because the commitment of Cyprus to follow the BEPS recommendations and remain OECD compliant continues to be evident, it is expected that further amendments are introduced in the domestic legislation for the purposes of achieving this. We also anticipate additional detailed transfer pricing rules, including the requirement of performing transfer pricing studies in more areas and not just intra-group financing transactions.

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Appendix 1

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Stella Strati is a partner with the corporate finance, tax and private client department of Patrikios Pavlou & Associates LLC. She is also the general manager of Pagecorp Group, an administrative service provider authorised by the Cyprus Securities and Exchange Commission to provide corporate services. She has extensive experience in corporate and commercial law, mergers and acquisitions, restructurings, tax law and banking and finance transactions, across a wide range of industries. She advises important local and international companies and financial organisations, as well as leading international banking institutions on all aspects of financial and commercial cross-border transactions and security matters. Stella has assisted some of the largest developers in Cyprus on landmark projects and she is also advising private clients on estate planning, asset protection and on Cyprus International Trusts. Stella is a member of the Cyprus Bar Association, STEP and IBA, and she regularly attends conferences and seminars as a speaker and panellist, and she contributes to numerous publications. She is also certified with the Advanced Diploma in International Taxation (ADIT) and is an International Tax Affiliate of the Chartered Institute of Taxation (CIOT), Stella is recommended by *The Legal 500* as a leading individual, a great partner and a tax expert.

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