Bills for prevention of tax abuse submitted to the Cyprus Parliament

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In brief

The Cypriot Ministry of Finance (MoF) submitted to Parliament two bills for amending the tax legislation, with the purpose of strengthening the Cyprus tax framework for the prevention of tax abuse, tax evasion and tax avoidance (the "bills").

The bills, which currently state that they are to be effective as from 1 July 2021, contain the following proposals:

- For payments to companies in jurisdictions in the EU 'blacklist' (i.e. companies in jurisdictions included in Annex I of the EU list of non-cooperative jurisdictions on tax matters), withholding taxes (WHTs) are introduced (or, in the case of royalties, expanded) as follows:
  - for payments of dividends, WHT at the rate of 17%
  - for payments of passive interest, WHT at the rate of 30%
  - for payments of royalties, WHT at the rate of 10%
- The corporate residency test (currently the 'management and control' test) is expanded with the introduction of a test based on incorporation in Cyprus, for companies that do not have a tax residency anywhere else in the world.

The bills now need to follow the legislative process and there could be changes before they are passed.

In detail

Overview of the proposed tax law amendments

The comments below are based on the bills in their current state.

1. WHTs for payments to companies in EU blacklisted jurisdictions

(i) Status of the recipient

For the proposed WHTs to be triggered the direct recipient of the dividends, interest and royalties should be a company in an EU blacklisted jurisdiction (the "recipient"); that is:

- a company tax resident in an EU blacklisted jurisdiction; or
- a company incorporated / registered in an EU blacklisted jurisdiction and which is not tax resident in a non EU blacklisted jurisdiction.

(ii) Dividends

A WHT at the rate of 17% is proposed for dividends paid by a Cyprus tax resident company to companies in EU blacklisted jurisdictions, where the direct recipient holds directly at least 50% of the capital, votes or entitlement to profit in the company paying the dividends.

The WHT does not apply in the case of dividend payments on shares listed on a recognised stock exchange.

The 50% holding threshold is met when the company receiving the dividend participates directly in the paying company either alone or jointly with associated companies which are also in an EU blacklisted jurisdiction and that also participate directly in the paying company.

(iii) Interest

A WHT at the rate of 30% is proposed for passive interest paid by a Cyprus tax resident company to companies in EU blacklisted jurisdictions.

The WHT does not apply in the case of passive interest payments on instruments listed on a recognised stock exchange.

Payments of passive interest by individuals are not within the scope of the proposals.

(iv) Royalties

A WHT at the rate of 10% is proposed for royalties paid by a Cyprus tax resident company to companies in EU blacklisted jurisdictions.

This is an expansion to the current WHT which is only applicable to certain royalty payments.

Payments of royalties by individuals are not within the scope of the proposals.

2. Additional corporate residency test

Currently companies that are managed and controlled from Cyprus are Cyprus tax residents, per the Income Tax Law. The proposals are not going to impact this rule and it will remain the case that such companies are Cyprus tax residents.

The proposals relate to companies which are incorporated / registered in Cyprus. Such companies will be considered as tax resident in Cyprus provided that they are not tax residents of any other jurisdiction.

The takeaway

These proposals are further clear indication of Cyprus' willingness to prevent tax abuse, tax evasion and tax avoidance. The Cyprus MoF notes that the bills are in line with recent EU Country-Specific Recommendations (CSRs) for Cyprus and the EU guidelines for defensive tax measures to be adopted by EU Member States towards EU blacklisted jurisdictions.

Currently the EU updates the EU blacklist up to two times per year. The bills do not indicate the effective date of application of Cyprus WHTs to jurisdictions added to each new version of the EU blacklist, or the effective date of disapplication of Cyprus WHTs to jurisdictions removed from each new version of the EU blacklist. It is expected that this and other matters (e.g. application of the Cyprus WHTs on a cash basis vs accruals basis, etc) will be clarified by the Cyprus authorities after voting of the bills.

Taxpayers should monitor for further developments on this matter so as to evaluate how this may affect their existing and new structures as well as their business.

Let's talk

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