

Setting up your Business in Cyprus

Issues to consider

Cyprus has succeeded in differentiating itself from other financial centers. Cyprus accession to the EU on 1 May 2004 has helped to establish the country as the ideal gateway for EU inbound and outbound investments.

The Cyprus attractive corporate tax rate, which remains one of the lowest across EU, and the country's double tax treaties, (65 to date with more to come), have made the island one the most progressive and efficient business centres in Europe.

However, there are a number of issues which you must consider when you are looking to set up your business in Cyprus

This document takes you through some of the common questions we come across and gives you practical information about the issues you need to consider.

What type of Business Structure should we use?

There are advantages and disadvantages to all of them, and there is no one correct answer, it's all dependent on your specific business circumstances and needs. A brief overview of the main structures is below:

Establishment (a branch of your overseas business)

- Not a separate legal entity but an extension of the overseas parent company
- No limited liability or ring-fencing of the Cyprus operations
- If have a permanent establishment in Cyprus then profits from this PE are liable to Cyprus Corporation tax
- The permanent establishment (Branch) in Cyprus has to submit audited financial statements and tax returns to Cyprus Tax Authorities and Registrar of Companies on annual basis

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Limited Company:

- Provides limited liability and ring-fencing to Cyprus operations
- Gives a perception of a local business, with longevity
- Corporation tax to be paid on company profits
- All Cyprus Companies irrespective of revenue or profit, have to submit audited financial statements and tax returns to Cyprus Tax Authorities and Registrar of Companies on annual basis.

Limited Liability Partnership:

- Members (partners) have limited liability
- Profits are allocated to members who then pay Income Tax on these profits personally
- The tax residence of the member, and where the profits in the LLP originated will determine in what jurisdiction and how these profits are taxed.

How much Corporation Tax will the business pay?

Current Corporation Tax rates in Cyprus is 12,5%

All Cyprus tax resident companies are liable to 12.5% corporation tax on their profits.

Tax Deductions include:

- 100% of the expenditure incurred wholly and exclusively for the purposes of production of income
- 100% of the donations and Subscriptions to approved charity organisations
- 100% Employee Contribution to social insurance and approved funds on employees' salaries.
- Employer's Contributions to Medical Fund limited to 1% of employees' remuneration
- Employer's Contributions to Provident/Pension fund for employees limited to 10% of employees' remuneration.
- Entertainment expenses for business purposes are restricted to 1% of gross income or maximum amount of €17.086
- Up to €700, €1.100 or €1.200 per square meter (depending on the size of the building) of any expenditure incurred for the maintenance of a building in respect of which there is a Preservation Order.

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- 80% of the profit from disposal of intellectual property and net royalty income (under certain conditions)
- From 1 January 2012, 100% of interest expenses incurred for the acquisition of the share capital of a subsidiary company when the participation in the subsidiary is 100%, directly or indirectly, and provided that the subsidiary does not own any assets that are not used in the business.
- 100% of Interest Incurred for the acquisition of a fixed asset used in the business.
- The notional interest deduction (NID) deduction cannot exceed 80% of the taxable profit derived from assets financed by new equity. Equity introduced to a company as from 1 January 2015 (new equity) in the form of paid-up share capital or share premium is eligible for an annual NID. The annual NID is calculated as an interest rate on the new equity. The relevant interest rate is the yield on 10-year government bonds (as at December 31 of the prior tax year) of the country where the funds are employed in the business of the company plus a 3% premium (subject to a minimum amount which is the yield on the 10-year Cyprus government bond as at the same date plus a 3% premium). Certain anti avoidance provisions apply.
- Up to 20% of expenditure on film infrastructure and technological equipment (subject to conditions)

Tax Exemptions include:

- 100% of the interest Income not arising from or not closely connected to the ordinary activities of the company
- 100% of the dividend Income
- 100% of the profits from disposal of securities.
- 100% of the profits of a permanent establishments abroad
- 100% of rent of preserved building
- 100% of gains relating to foreign exchange differences (forex) with the exception of forex arising from trading in foreign currencies and related derivatives.
- Up to 50% of income of company which operates in Cyprus in the audio-visual industry (under conditions)

Non – Deductible Expenses:

- 100% of a private motor vehicle expenses
- 100% of the immovable property tax and professional tax
- 100% of professional tax
- 100% of expenses not supported by invoices or receipts
- 100% of wages and salaries related to services offered within the tax year on which contributions to Social Insurance, Redundancy Fund, Human Resource Development Fund, Social Cohesion Fund, Pension Fund and Provident Fund have not been paid in the year in which they were due.

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Tax Inducement:

The tax loss incurred during a tax year and which cannot be set off against other income, is carried forward subject to conditions and set off against the profits of the next five years. The current year loss of one company can be set off against the profit of another, subject to conditions, provided the companies are Cyprus tax resident companies of a group.

Group is defined as:

- One Cyprus tax resident company holding directly or indirectly at least 75% of the voting shares of another Cyprus tax resident company
- Both of the companies are at least 75% (voting shares) held, directly or indirectly, by a third company

As from 1 January 2015 interposition of a non- Cyprus tax resident company(ies) will not affect the eligibility for group relief as long as such company(ies) is tax resident of either an EU country or in a country with which Cyprus has a double tax treaty or an exchange of information agreement (bilateral or multilateral).

A partnership or a sole trader transferring a business into a company can carry forward tax losses into the company for future utilisation.

Losses from a permanent establishment abroad can be set off with profits of the company in Cyprus. Subsequent profits of an exempt permanent establishment abroad are taxable up to the amount of losses allowed.

NOTE: Any tax suffered abroad on income subject to income tax will be credited against any income tax payable on such income irrespective of the existence of any double tax treaty.

In addition as from 1 January 2015 a Cyprus tax resident company may also claim the tax losses of a group company which is tax resident in another EU country, provided such EU company firstly exhausts all possibilities available to utilise its losses in its country of residence or in the country of any intermediary EU holding company

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What if we use Cyprus to set up our holding company?

The Cyprus' favorable tax legislation means that it is a very attractive place to set up a holding company.

Dividend income payable to a Cyprus holding company from its subsidiary or associate company is exempt from corporation tax. It is also exempt from defense fund. This exemption does not apply if:

- More than 50% of the paying company's activities result directly or indirectly in investment income and
- The foreign tax imposed is substantially lower than the tax burden in Cyprus (<6,25%).

Sale of shares held by a Cyprus holding company in its associates or subsidiaries is free of any corporation tax unless it owns immovable property in Cyprus.

Any dividend payable from a Cyprus holding company is treated as follows:

- If shareholders are not tax residents or non-Domiciled in Cyprus, then dividend is paid free from any withholding tax or defense contribution.
- If shareholders are tax residents or Domicile in Cyprus then the company is obliged to withhold 17% defense contribution
- If the shareholder is a resident corporation any dividend payable from the holding company is free from corporation tax and defense contribution.

What if we make cross-border transactions between group companies?

Cyprus follows internationally recognised Transfer Pricing (TP) rules where cross-border trading and financial transactions between affiliated entities have to be conducted on an arm's length basis. The price and terms should be the same as if the transactions had been between completely independent parties.

Typical transactions between affiliated entities that are covered by TP regulations are:

- Sale and purchase of goods
- Provision of management services
- Property rental charges
- Transfer of intangible assets e.g. trademarks, patents
- Sharing of knowledge, expertise, business contacts etc.
- Provision of financial support e.g. inter-group loans and charging a "market" interest on loans

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A business will need to prepare a Transfer Pricing Report proving the arm's length basis of transactions. The report will include a functional and risk analysis, analysis of the adopted pricing model and benchmarking of the arm's length basis.

SME's are generally exempt from Cyprus's transfer pricing regime, so only "large" entities need to undertake detailed TP analysis. A "large entity" for TP purposes is one with > 250 employees, or < 250 employees but Revenues > €40M and Gross Assets > €20M.

However even if an entity is exempt from the [Country's] transfer pricing regime it may fall under the scrutiny of the other international tax jurisdictions where it transacts. There may also be other tax regulations which ensure transactions are undertaken at a commercial value.

What Employment Taxes and Social Security will need to be paid?

If an individual is resident in Cyprus then is subject to Cyprus tax laws. An individual is resident in Cyprus when he is physically present in Cyprus more than 183 days within a calendar year.

As from 1 January 2017 an individual can be a tax resident of the Republic even if he/she spends less than or equal to 183 days in the Republic provided that he/she satisfies all of the following conditions within the same tax year (1 January – 31 December):

- does not spend more than 183 days in any other country;
- is not a tax resident of any other country;
- spends at least 60 days in the Republic;
- maintains a permanent home in the Republic that is either owned or rented;
- carries on a business in the Republic, is employed in the Republic or holds an office in a person who is a tax resident of the Republic at any time during the tax year.

When a person is a Cyprus tax resident, tax is imposed on his income accruing or arising from sources both within and outside the Republic in relation to:

- Profits or other benefits from trading activity
- Profits or other benefits from any office or employment
- Dividends and interest
- Pensions
- Rent, royalties premiums or other profit arising from property.

We would advise any new entrant to Cyprus or person who spends time working in Cyprus to take professional advice to determine whether they are Cyprus tax resident.

Current Personal Income Tax rates in Cyprus are:

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Band of income (€)	Tax rate (%)
0 – 19,500	0
19,501 – 28,000	20
28,001 – 36,300	25
36,301 – 60,000	30
Over 60,001	35

Employers and employees also have to pay Cyprus social security, which is called Social Insurance:

Current Social Insurance rates are:

	Maximum Level of Annual Income (€)	Rate (%)
Employer	54.396	8,3%
Employee	54.396	8,3%

NB: (rates are for the tax year to 31/12/2018)

It is the employers' legal responsibility to pay over employee's tax and social security deductions and his contributions to the Cyprus Authorities. These are paid by the employer monthly not later than the end of the month following the month to which the contributions refer.

Other Employer's Contributions:

	%
Social Cohesion Fund	2
Reduncancy Fund	1.2*
Industrial Training Fund	0.5*
Annual Leave Fund	8*

*Restricted to the maximum level of Annual Income as per above.

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What is Value Added Tax (VAT) and should the business be registered?

VAT is a "goods and services tax" on supplies made, the standard rate of which is 19%.

There are three types of supply

- Taxable – must charge VAT on supplies, can reclaim input VAT
- Exempt – cannot charge VAT nor reclaim input VAT
- Outside the scope – not in the Cyprus VAT system

The supply of most types of goods and services in Cyprus would be classed as Taxable supplies. However when these supplies are made to companies which are outside of Cyprus advice needs to be sought as to what rate of VAT, if any, to use.

Rates:

Standard rate	19%
Reduced rate	9%
Reduced rate	5%
Zero rate	0%

Reduced rate 9% applies to:

- Restaurants and catering services
- Accommodation in hotels and tourist lodgements
- Transportation of passengers

Reduced rate 5% applies to:

- The supply of foodstuff
- The supply of pharmaceutical products and vaccines
- Books, newspapers and magazines
- Entry fees of museums, theatres, circus and other entertainment events.
- Renovation and repair of private households after three years of first residence.
- Acquisition and construction of residence.

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Zero Rated applies to:

- The exportation of goods
- Supply, modification, repair, maintenance, chartering and hiring of sea-going vessels and aircrafts as well as the supply of services of sea-going vessels and aircrafts.

Exemptions

Exempted Supplies include:

- Rental of immovable property under certain circumstances.
- Financial services (with some exceptions)
- Hospital and medical caring services
- Postal services
- Insurance services
- Disposal of immovable property where application for building permission has been submitted prior to 1 May 2004.
- Educational services at all levels of education under certain conditions

Who is obliged to register

Every individual or company is obliged to register if:

- a) at the end of any month, the value of taxable supplies recorded in the last 12 months exceeds €15.600 or
- b) at any point in time the value of taxable supplies are expected to exceed €15.600 in the next 30 days
- c) provides services to a VAT registered person within European Union with nil registration threshold
- d) offers distant sales with registration threshold of €35.000
- e) is involved in the acquisition of goods from other EU member states and relates to persons who offer exempt supplies of goods and services or are non-profitable organisations with registration threshold of €10.250
- f) offers zero rated supplies of goods or services
- g) acquires a company on a going concern basis.

Vat returns and payment of VAT

Any registered person has to submit to the VAT Commissioner a VAT return within 40 days from the end of any tax period and pay the VAT due.

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Administration of intra-community trading and intra-community services

Businesses that undertake intra-community trading, i.e. acquisitions and sales of goods and supply of services from/to EU member states need to complete the following forms:

Intra – Community Acquisitions:

- Intrastat – Arrivals of Goods
- Inclusion in the VAT return (on a total basis)

Intra – Community Services

- Intrastat – Departures of goods
- Recapitulative statement of supplies of goods and services (VIES form)
- Inclusion in the VAT return on a total basis.

When and how are they submitted?

INTRASTAT forms are submitted to the VAT authorities within 10 days from the end of the related month, in electronic form only.

If a Cyprus entity sells goods or provides services to its non EU parent then there is no VAT chargeable on this overseas supply, however on the basis that the supply would be VAT'able if made in the Cyprus then the entity will be able to reclaim all its input VAT.

Can we provide Share option plans to our staff?

Share Option plans are not extensively offered, in way of attracting, motivating and retaining key staff, because such share option plans are considered, under Cyprus Tax legislation, as benefits in kind and are taxable.

How else can we compensate our employees?

Cyprus has a very comprehensive range of compensation and benefit options available for companies to offer their employees.

Pensions, private medical insurance, life and disability cover, provident funds are now commonplace benefits provided by many Cyprus businesses to their workforce.

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