

Cyprus defensive measures on payments to low-tax/ blacklisted jurisdictions *January 2026***Introduction**

The Cyprus Parliament recently passed amendments to the Cyprus tax legislation, introducing new defensive measures and enhancing existing ones in respect to payments of dividends, interest and royalties to companies in low-tax and/ or in EU-blacklisted jurisdictions.

The amendments were introduced to fulfil certain obligations undertaken under the EU Recovery and Resilience Plan, according to which Cyprus had committed to introduce withholding taxes on outbound payments of dividends, interest and royalties to low-tax jurisdictions. In relation to payments of interest and royalties, Cyprus has exercised the alternative option of non-deductibility for tax purposes.

These defensive measures need to be carefully assessed, in order to understand the potential impact and implications on cross-border structures and arrangements, and to proactively plan for needed mitigating steps, including restructuring where appropriate.

Summary

With effect from **1 January 2026**, the following provisions will apply:

- Payments of **dividends** by Cypriot tax resident companies to **associated** entities in **low-tax jurisdictions** will be subject to **withholding tax at 5% (as from 1st January 2026; previously the rate was 17%)**.
- Payments of **interest** and **royalties** by Cypriot tax resident companies to **associated** entities in **low-tax jurisdictions** will **not be deductible** for corporate tax purposes at the level of the Cypriot paying companies, irrespective of whether these expenses were incurred wholly and exclusively for the generation of taxable income.

These new defensive measures are in addition to the existing withholding tax provisions relating to payments of dividends, interest and royalties made to entities in [EU 'blacklisted' jurisdictions](#) (17% on dividends and interest, 10% on royalties), in place since 31 December 2022. It is worth noting that the existing provisions for blacklisted jurisdictions were also amended and broadened, with effect from **16 April 2025**, in an ongoing effort to further align Cyprus with OECD and EU standards and display its commitment to combat aggressive tax planning.

Further, a general anti-abuse rule (GAAR) has been introduced in the legal framework, to counter arrangements lacking commercial substance and whose main purpose is to obtain a tax advantage. The GAAR aims to capture cases of artificial interposition of non-EU entities that are not themselves in blacklisted jurisdictions or LTJs. In such cases, and unless the taxpayer can demonstrate (and retain supporting documentation for 6 years) that the recipient company has sufficient substance, the relevant arrangements will be disregarded, and the defensive measures will apply.

Table

The defensive measures are summarized in the table below:

Payment type	Jurisdiction	Defensive measures	Effective as from
Dividends	Low-tax	5% withholding tax	1 January 2026
	Blacklisted	17% withholding tax	Already in force
Interest	Low-tax	Non-deductibility	1 January 2026
	Blacklisted	17% withholding tax	Already in force
Royalties	Low-tax	Non-deductibility	1 January 2026
	Blacklisted	17% withholding tax	Already in force

New Important Definitions

The following new terms have been introduced in the tax law:

- A **low-tax jurisdiction** ("LTJ") is defined as a non-EU jurisdiction with a corporate tax rate lower than 50% of the Cypriot corporate tax rate
- A **non-low tax jurisdiction** ("non-LTJ") is a jurisdiction that does not fall within the aforementioned definition of an LTJ.
- A **non-cooperative jurisdiction** ("NCJ") is defined as a jurisdiction included in the latest published and valid edition of the EU list of non-cooperative countries for tax purposes (the EU "blacklist") at the time of the transaction, and in the latest published edition of the previous calendar year.
- An **associated entity** in an LTJ or an NCJ is defined as one having a direct or indirect relationship with the Cypriot paying company of at least 50% (shares, or voting rights, or right to profits), either alone or together with other associated persons.

Details of Defensive Measures

INCOME TAX LAW

The amendments to the Cyprus Income Tax (CIT) Law provide for the following:

Interest

Interest expenses (accrued or paid) by Cypriot tax resident companies to associated entities tax resident in an **LTJ** or incorporated/ registered in an LTJ and not tax residents in a non-LTJ, will not be allowed as tax deductible for corporation tax purposes.

The above does NOT apply to interest accrued/ paid to a company that is listed in any recognized stock exchange.

Royalties

Royalty expenses (accrued or paid) by Cypriot tax resident companies to associated entities tax resident in an **LTJ**, or incorporated/ registered in an LTJ and not tax residents in a non-LTJ, will not be allowed as tax deductible for corporation tax purposes.

In addition, a 10% withholding tax (WHT) will apply on the gross amount of royalties paid to non-Cypriot entities that are tax resident in an **NCJ**, or incorporated/ registered in an NCJ and not tax resident in another jurisdiction which is not an NCJ. The WHT will NOT apply in case where the payer is an individual, or where such payments have already been subject to WHT under a pre-existing WHT provision (Article 21 of the CIT Law).

SPECIAL DEFENCE CONTRIBUTION

The amendments to the Special Defence Contribution (SDC) Law provide for the following:

Dividends

Special Defence Contribution (SDC) will be withheld on dividends paid to associated entities tax resident in an **LTJ or an NCJ**, or incorporated/ registered in an LTJ/ NCJ and not tax resident in a non-LTJ/ non-NCJ. As from 1st January 2026 the withholding rate is 5% for payments to LTJs and 17% for payments to NCJs (prior to that, the rate was 17% for both).

SDC will also be withheld in case of distribution of assets in the context of a share capital reduction, to the extent that the value of the distributed assets exceeds the amount of the share capital actually paid by such shareholder.

An exemption applies for dividends paid to companies whose shares are listed in any recognised stock exchange.

Interest

SDC at 17% will be withheld on interest paid or accrued to associated entities tax resident in an **NCJ**, or incorporated/ registered in an NCJ and not tax resident in a non-NCJ.

An exemption applies for interest paid to companies whose shares are listed in any recognised stock exchange.

PAYMENTS TO PERMANENT ESTABLISHMENTS (common provisions)

The aforementioned defensive measures also apply in case of payments to a Permanent Establishment (PE) of a non-Cypriot resident entity, where the PE is in an LTJ or an NCJ.

The above does not apply if the non-Cypriot company (that has the PE) is itself tax resident in a jurisdiction which is neither an LTJ nor an NCJ, and the payments made to the PE:

- are subject to tax and are not exempt in the jurisdiction in which the relevant company is tax resident, **or**
- are subject to tax at the minimum corporate tax rate of 15%, based on the legislation adopting the EU directive on minimum tax ("Pillar Two" Directive), or the OECD's Global Anti-Base Erosion (GloBE) rules.

Anti-Abuse Provisions

As part of the defensive measures, a general anti-abuse rule has been introduced in the tax legislation, allowing tax authorities to disregard arrangements that lack commercial reasoning and do not reflect

economic reality, and whose main purpose (or one of the main purposes) is to obtain a tax advantage by circumventing the defensive measures.

The main aim is to combat the interposition of related companies that are not themselves tax resident in an NCJ, but which lack sufficient commercial substance and justifications for being interposed between the Cypriot company and an associated entity in an NCJ.

In this respect, two decrees have been published by the Council of Ministers (one relating to the CIT Law provisions and another regarding the SDC Law provisions), providing clarifications regarding the application of the general anti-abuse rule.

Specifically, in case of payments of dividends/ interest/ royalties by a Cyprus company to an associated entity in a **non-NCJ** jurisdiction, for which no tax is withheld (as required by the defensive measures), the Cypriot paying company is obliged to check and retain for at least six years, supporting documentation that the recipient company satisfies **at least five of the following six substance requirements**:

- 1. Decision making:** At least one board member has the necessary qualifications and authority to make decisions regarding the company's activities, assets or rights that generate the company's income, **and** is actively and independently exercising his/ her duties.
- 2. Local presence of decisions-makers:** At least one of the decision-making Board members resides in the jurisdiction where the company is tax resident (or within a daily commute distance).
- 3. Office space:** The company has office premises at its disposal in the jurisdiction of its tax residence, from where the directors and employees exercise their duties.
- 4. Board meetings:** The majority of the Board meetings are held in the jurisdiction where the company is tax resident.
- 5. Operational expenses:** The operational expenses (including directors' remuneration and staff costs) that are paid within the company's jurisdiction of tax residence for the tax year in which the transactions took place, are proportional to the company's activities.
- 6. Beneficial ownership:** The group of companies in which the recipient company is part of is not structured in such a way that the company's sole function is to receive the income from the Cypriot company and then transfer all (or almost all) of it to another associated company soon afterwards, so that it realises only an insignificant amount of taxable profit, thus enabling the flow of funds to the beneficial owner.

If the recipient company fails to meet two or more of the aforementioned six requirements, the relevant arrangements shall be disregarded and the defensive measures will apply, unless the Cypriot income-paying company demonstrates that the arrangements were put in place for valid commercial reasons reflecting economic reality, or that obtaining a tax advantage was not the primary purpose of the arrangements.

*NOTE: The current decrees address the application of the anti-abuse rules for payments to associated entities in **non-NCJs**. It would be reasonable to expect that updated decrees will be issued closer to the end of 2025, to also address cases of payments to associated entities in **non-LTJs**.*

Administrative enforcement and penalties

The tax authorities reserve the right to request, via written notification, from the Cypriot paying company to provide via electronic or other means, a detailed statement including full data of the relevant arrangements, and/or submission of information and documentation to support that the recipient company satisfies at least five out of the six substance requirements.

Failure to disclose the required documentation within 60 days from receipt of the written notification will result in the imposition of administrative penalties as follows:

- €2,000 if disclosure is made within 61 to 90 days
- €4,000 if disclosure is made within 91 to 120 days
- €10,000 if disclosure is made after 120 days, or not at all

Confirmation of compliance

The Decrees specify that Cypriot paying companies with an obligation to retain supporting documentation regarding substance requirements (as described above) will need to certify, via their annual income tax return or via any other means the Commissioner determines, that they have complied with the documentation requirements for the relevant tax year.

Exceptions to the documentation requirements

The documentation requirements do not apply if the recipient company is:

- Tax resident of Cyprus, or
- Tax resident in another EU Member State or in the European Economic Area
- Part of a multinational group and subject to a minimum corporate tax rate of 15%, based on the legislation adopting the EU directive on minimum tax ("Pillar Two" Directive), or the OECD's Global Anti-Base Erosion (GloBE) rules
- A member of a consolidated group for accounting purposes that does not have a presence in an NCJ, either through a company or through a permanent establishment.

Renegotiation of Double Tax Treaties

In cases where Cyprus has Double Tax Treaties in force with jurisdictions classified as LTJs or NCJs, and such treaties do not grant taxing rights to Cyprus on payments of dividends (to LTJs and NCJs), or interest and royalties (to LTJs), the law provides that Cyprus will inform the other contracting state within three years to initiate a treaty renegotiation process.

NOTES

The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained. Totalserve Management Ltd will be glad to assist you in this respect. Do not hesitate to contact us.