University of Cyprus
Economics Research Centre

Cyprus Tax Reform

Overview of the Final Report on the Cyprus Tax Reform Project

October 2025

Foreword

The project was commissioned by the *Ministry of Finance* to the *Economics Research Centre* (CypERC/KOE) of the *University of Cyprus*. CypERC is an independent centre of applied economic research that addresses economic policy issues of importance to Cyprus and the European Union. It collaborates with international academic and policy institutions as well EU think tanks. It combines the expertise of academic staff from the University of Cyprus, in-house specialists, and a broad network of partners and organizations both domestically and abroad. The project team included economists with expertise in public finance, competitiveness, environmental and labour economics, as well as econometricians, modelers, industry tax experts, and legal scholars. The team also included government experts form the Ministry of Finance and the Tax Department. Additional input was provided where necessary by international tax experts with extensive experience in legal tax matters to ensure the adoption of best practices. All participants contributed across various phases of the project.

Project Steering Committee

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George Panteli	Director General (in office until Oct 2024)	Ministry of Finance
Soteris Markides	Tax Commissioner	Ministry of Finance
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Comprehensive Tax Reform Project Description

Project Description

In today's rapidly evolving international and domestic environment, Cyprus recognized the need for a comprehensive and forward-looking tax reform - one that aligned with EU strategic priorities, addressed socio-economic challenges, and reinforced the country's long-term economic growth vision. The Comprehensive Tax Reform Project, commissioned by the Ministry of Finance to the Economic Research Centre (CypERC) of the University of Cyprus, was a two-year national initiative to modernize and strategically redesign Cyprus's tax system using evidence-based analysis from various models and indices developed for Cyprus. The project's overarching goal was to establish a tax framework that was simple, transparent, fair, and competitive, while ensuring fiscal neutrality, the long-term sustainability of public finances and promoting economic growth. Beyond revenue collection, the reform sought to align taxation with broader development objectives—particularly the green and digital transitions. The final output, presented in this report, delivers a comprehensive reform blueprint that balances efficiency, equity, competitiveness, and environmental sustainability. Through rigorous analysis, model estimates, international benchmarking, and inclusive consultation, the project created a modern tax framework that enhances growth, innovation, and resilience—strengthening Cyprus's capacity to meet future economic, social, and environmental challenges.

The proposed tax reform framework builds upon a set of **core principles** and **strategic objectives** designed to modernize and strengthen Cyprus's tax system (Figure 1). At its foundation, the reform aims to reduce administrative burdens, ensure a fairer distribution of the tax load, and maintain fiscal neutrality to preserve macroeconomic stability. Strategically, it envisions a simple, transparent, and socially just tax system that promotes growth, employment, innovation, and competitiveness while supporting the green and digital transitions.

Figure 1. Tax reform framework

Core Principles of the Reform

- Ensuring a fairer distribution of the tax burden.
- Preserving fiscal neutrality and maintaining macroeconomic stability.

Objectives of the Integrated Tax System

- Simple, transparent, efficient, and socially just.
- Promotes growth and employment.
- Encourages innovation, productivity, and competitiveness.
- Supports the green and digital transitions.
- Secures fiscal sustainability in the medium and long term.

Key Areas of Reform

1. Promoting Investment and Innovation
2. Shifting the Tax Burden: Gradually transferring part of the tax burden from labour to other bases
3. Green Taxation
4. Reducing Tax Evasion and the Shadow Economy
5. Ensuring Fiscal Neutrality
6. Designing a Fair and Effective Tax System

Scope of the Reform

- Personal Income Taxation (PIT)
- Corporate Income Taxation (CIT)
- Other direct taxes
- Simplification of the overall Tax system
- Legislation and Regulatory frameworks
- Alignment with Cyprus's commitments under the Recovery and Resilience Plan, the Vision 2035 strategy, and EU and international tax developments, with a focus on the green and digital transitions.

Methodology and Governance

The project employed economic modelling and econometric analysis tailored to the Cypriot economy, as well as other quantitative methods and tools using various datasets, to assess the impacts on households, firms, employment, competitiveness and economic growth. It was implemented by a multidisciplinary team of economists, tax experts, modelers, and legal specialists, supported by international collaborators.

The reform focuses on six key areas—ranging from promoting investment and innovation to shifting the tax burden from labour to other bases, introducing green taxation, curbing tax evasion, ensuring fiscal sustainability, and designing a fair and effective tax mix. This is the first comprehensive tax reform undertaken in over two decades (since 1/1/2003) marking a major step toward modernising Cyprus's tax system in response to evolving economic, social, and environmental challenges. It seeks to address structural trends such as support middle class income families with children, encourage female labour participation, the green and digital transitions, and the need to stimulate innovation and productivity growth in a small, open economy.

In designing the new framework, particular attention is given to the unique characteristics of the Cypriot economy—namely, that a large share of the population earns income below the tax-free threshold, that informal and undeclared economic activity remains significant, and the existence of deemed distribution and the 17% Special Defence Tax on dividends applies only to domestic residents. These realities shape the reform's emphasis on equity, broadening the tax base, and improving compliance through digitalisation and targeted enforcement. Overall, the reform's scope encompasses personal and corporate income taxation, other direct taxes, and complementary legislative and regulatory simplifications, all aligned with Cyprus's commitments and long-term fiscal sustainability objectives.[1]

The design and implementation of the reform were driven by a highly specialized **project team** composed of economists with expertise in public finance, labour markets, competitiveness, and environmental policy, alongside econometricians, modelers, and tax and legal experts. This multidisciplinary group operated under the coordination of CypERC, drawing on its extensive national and international network of collaborators to ensure analytical rigor and policy relevance. Equally important was the project's emphasis on **stakeholder engagement**. Through an Advisory Committee, the team delivered open presentations and maintained continuous dialogue meetings with key social and economic partners—including employers' associations, trade unions, professional bodies and various foreign policy organisations—to ensure that the proposed reforms were inclusive, balanced, and responsive to the real needs and expectations of Cypriot society and the business community.

Project Workflow, Milestones, and Deliverables

The project unfolded across 15 phases, combining technical analyses, multiple stakeholder dialogues, and empirical evaluations. Early phases involved macroeconomic and institutional analyses, international benchmarking (EU, OECD, World Bank), and diagnostic reviews identifying weaknesses related to complexity, equity, and compliance. The green taxation analysis included econometric assessments of environmental levies and compensatory mechanisms for vulnerable households.

Later phases focused on Personal Income Tax (PIT) and Corporate Income Tax (CIT). PIT reforms improved progressivity, introduced deductions for family and housing needs, and provided incentives for green investments. CIT reforms raised the corporate rate to 15%, replaced deemed distribution rules with a dividend withholding tax, and introduced anti–profit-shifting safeguards.

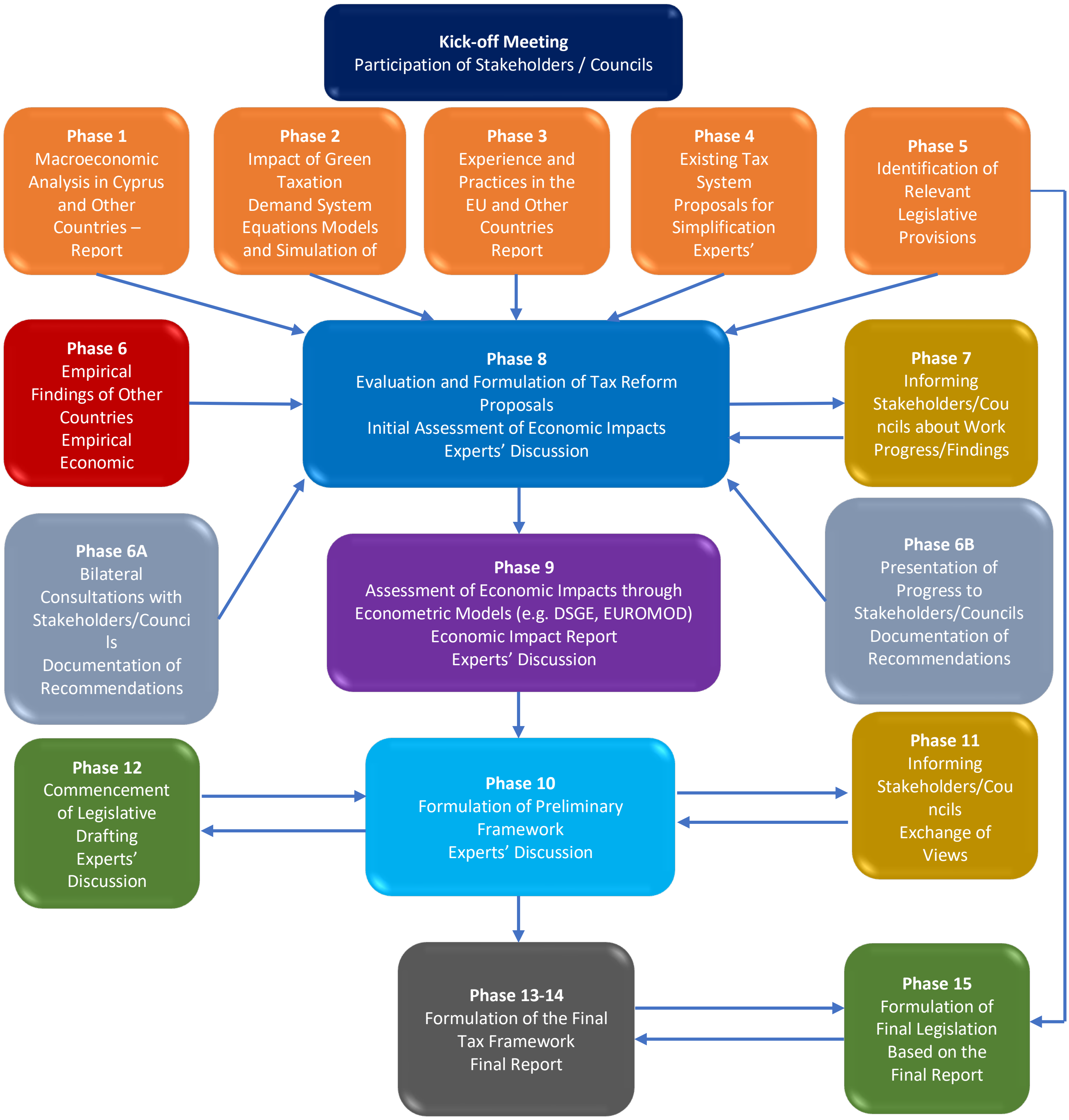
Advanced models such as EUROMOD, DSGE, macro-and-micro econometric models and profit optimization frameworks were used to evaluate fiscal, distributional, and competitiveness impacts. Continuous stakeholder engagement shaped proposals on tax thresholds, pension deductions, and digital economy taxation.

Figure 2 outlines the Phases of the Project. Phases 1–7 built the analytical foundation; Phases 8–12 focused on policy design and impact assessment; Phases 13–14 addressed the formulation of the Final

[1] Out of Scope (related areas may be indirectly considered): VAT, Social Insurance contributions, General Health System (GHS), Internal modernization of the Tax Department

Tax Framework; and Phase 15, drafting and legislative preparation, was carried out by the Tax Department.

Figure 2. Tax Reform Workflow Milestones



Executive Summary

Tax Reform

This overview provides a concise summary of the full Cyprus Tax Reform Report and should be read in conjunction with the complete document.

The Cyprus Tax Reform modernises the national tax framework for the first time in over two decades. It combines fiscal prudence with fairness, competitiveness, social and environmental responsibility. The package integrates reforms to **Personal Income Tax (PIT)** and **Corporate Income Tax (CIT)**. It broadens the tax base, reduces distortions on labour, and strengthens efforts to improve compliance through digitalisation.

Overall, the reform is fiscally neutral to mildly positive, producing a net **surplus of approximately €112 million**, while strengthening growth, transparency, and long-term fiscal sustainability.

Personal Income Tax (PIT) Reform

The Personal Income Tax (PIT) reform reduces the tax burden on the middle class income households and families, and promotes equity. The **tax-free threshold rises to €20,500**, with restructured brackets and a **top marginal rate of 35%**. New tax deductions for children, housing, and green investments enhance equity and encourage sustainable behaviour targeted mainly at middle-income households. The overall **fiscal cost is estimated at €151 million**.

Corporate Income Tax (CIT) Reform

The proposed Corporate Income Tax (CIT) reform balances fiscal needs with growth objectives. Raising the corporate tax rate to **15%** is projected to generate around **€240 million annually**, while preserving key incentives such as the **Notional Interest Deduction (NID)** and the **Intellectual Property (IP)** regime. Complementary measures such as the abolition of **deemed distributions**, a **5% withholding tax (WHT**) on actual dividends and the **Hidden Profit Distribution (HPD)** anti-avoidance regime, improve transparency and support sustainable investment. Overall, the package strengthens fiscal sustainability and competitiveness.

Tax Competitiveness

Cyprus remains among the most competitive tax jurisdictions. The **Mannheim Tax Index** shows that the proposed reforms—including the increase in the **Corporate Income Tax (CIT)** rate to 15%, the reduction of the **Special Defence Contribution (SDC)** to 5% Cyprus tax competitiveness is maintained if not improved. The **International Tax Competitiveness Index (ITCI)** confirms this strong performance, ranking Cyprus **3rd (OECD countries) and 2nd in Europe.** Overall, the reform maintains international attractiveness and investor confidence.

Overall Fiscal Impact

The **total fiscal cost** of the reform package is estimated at **€432 million**, primarily due to Personal Income Tax (PIT) adjustments and the reduction in the SDC rate. These costs are more than offset by **€544 million in additional revenues**, resulting in a **net fiscal surplus of approximately €112 million**. Key revenue sources include the Corporate Income Tax (CIT) rate increase (€240m), deemed profit distribution (€130m), second-round effects (€60m), and additional suggested policy measures such as the immovable property tax (€54m), company levy (€50m), and non-domiciled fee (€10m). Dynamic modelling using the **Dynamic Stochastic General Equilibrium (DSGE)** model confirms that even under conservative assumptions, the fiscal balance returns to baseline within a few years, supported by growth in consumption, investment, and employment.

Conclusion

The Cyprus Tax Reform establishes a balanced, growth-oriented, and sustainable fiscal framework. It **improves fairness** through the **Personal Income Tax (PIT)** reform and **maintains competitiveness** through modernised **Corporate Income Tax (CIT)** provisions. With a projected **net fiscal surplus**, strong **international competitiveness**, and a commitment to reducing the shadow economy through digital compliance tools, the reform positions Cyprus as a **transparent, resilient, and forward-looking European economy**.

Table of Contents

Cyprus Tax Reform: Overview of Project's Results

Introduction

This Overview synthesizes the **principal findings of the Cyprus Tax Reform Project**, prepared for the **Ministry of Finance of the Republic of Cyprus**.[2] It summarizes the analysis and policy recommendations derived from a data-driven evaluation of Cyprus's tax system, emphasizing reforms that promote **fairness**, **fiscal sustainability**, and **international competitiveness**. It integrates the core components of the reform—**Personal Income Tax (PIT)**, **Corporate Income Tax (CIT)** and the overall **Fiscal Impact Assessment**—into a coherent framework aimed at modernizing the national tax structure while preserving macroeconomic stability.

The Overview is organized into sections as follows:

Section 2 outlines the **Personal Income Tax (PIT)** reform's rationale, design, distributional effects, and fiscal cost. It highlights measures to reduce the tax burden especially for middle class households, support families, and incentivize homeownership and green investments.

Section 3 presents the **Corporate Income Tax (CIT)** reform, covering the rate increase to 15%, the introduction of **Hidden Profit Distribution (HPD)** and **closed-company** rules, and the retention of key incentives such as the **Notional Interest Deduction (NID)** and **Intellectual Property (IP)** regimes. Dynamic modelling confirms that these reforms strengthen fiscal capacity while preserving competitiveness.

Section 4 benchmarks Cyprus internationally using the **Mannheim Tax Index (MTI)** and the **International Tax Competitiveness Index (ITCI)**. Results show that Cyprus maintains its strong global standing, improving its shareholder-level competitiveness despite a higher corporate rate.

Section 5 consolidates fiscal **impact assessment**, incorporating second-round effects and validation through the **Dynamic Stochastic General Equilibrium (DSGE)** model. The analysis indicates that the reform remains fiscally neutral to mildly positive, yielding a projected surplus. It also addresses the **shadow economy**, emphasizing the importance of digital monitoring, compliance incentives, and coordinated enforcement to reduce tax evasion and broaden the revenue base.

The Overview concludes with a concise summary of the key findings and policy insights.

[2] It offers a concise overview of the comprehensive Cyprus Tax Reform Report and should be read in conjunction with the full document.

Personal Income tax (PIT) Reform

This section provides a concise outline of the proposed personal income tax reform, offering a high-level view of its rationale, objectives, and key components. In response to evolving economic conditions and the need for a more equitable and efficient tax system, the reform aims to modernize the current framework while ensuring fiscal sustainability.

Specifically, the Personal Income Tax (PIT) reform addresses three core objectives: First, it promotes economic activity and encourages labour force participation, fosters equality of individuals, ensures balanced tax rates between individuals and corporations, and provides tax incentives for targeted investments like home ownership, rental properties, and green initiatives. These align with the principles of fairness and equity of the tax system and help address global challenges of sustainability, green transition and household homeownership. Second, it fosters social equity by reducing income inequality, indirectly addressing the demographic challenges through tax deductions for middle-income households with dependent children and university students. Third, it maintains a simple tax system based on individual taxation.

Main Objectives of the Reform

The proposed reform follows by a set of strategic objectives aiming to improve the fairness, functionality, and social responsiveness of the personal income tax system. These objectives include:

- **Reducing the overall tax burden** on individuals and households.
- **Supporting the middle class** through targeted tax relief measures, including:
  - Deductions based on family composition, such as children and university students.
  - Incentives for the acquisition of a first home.
  - Tax benefits for green upgrades to residential properties.
- **Alleviating the housing crisis** and promoting home ownership among households.
- **Encouraging the servicing of housing loans** and improving rental income reporting, thereby reducing tax evasion.
- **Encouraging employment**, with a particular focus on:
  - Increasing female participation in the labour force.
- **Addressing demographic challenges**, including the issue of declining birth rates and aging population.
- **Promoting the green transition** of households through fiscal incentives.
- **Retaining human capital** by improving the existing tax framework to make Cyprus more attractive for skilled professionals and reduce the outflow of talent abroad.

To effectively translate these objectives into policy, the Personal Income Tax (PIT) reform package is organized around four strategic axes. These pillars reflect best practices from personal income tax systems across the European Union and are informed by insights gathered through more than 40 bilateral consultations with organizations and stakeholders. Each axis addresses a core dimension of the reform:

- **Adjustment of Personal Income Tax Brackets and Rates**: Modernizing the tax structure to reflect current income distributions, reduce tax burden, and enhance equity.
- **Tax Relief for Middle-Income Households and Encouragement of Labour Force Participation**: Targeted deductions for families with children, incentives to encourage female labour force participation, and measures to ease the financial burden on working households.
- **Promotion of First-time Homeownership and Housing Loan Repayment**: Introduction of mortgage interest allowances and other incentives to support access to housing, reduce long-term housing insecurity and encourage homeownership.

- **Encouragement of the Green Transition for Households**: Fiscal incentives aimed at supporting energy-efficient upgrades and environmentally sustainable practices in residential living.

Proposals for Personal Income Tax Reform

Building on the objectives outlined above, the reform introduces a series of targeted reforms designed to reshape the personal income tax system. These proposals aim to deliver tangible benefits to households, enhance transparency, and align fiscal policy with broader social and economic goals. The four proposals being put forward for the reform of personal income taxation are as follows:

1. **Revised Tax Brackets and Tax Rates**: An increase of €1,000 in the tax-free income threshold, raising it to €20,500. A restructuring of the income tax brackets, including a shift of the top tax rate of 35% to apply only to taxable income exceeding €80,000. The proposed tax schedule is presented in Table 1 below:

Table 1. Revised Tax Brackets and Tax Rates

Taxable Income (€)	Tax Rate
0 – 20,500	0%
20,501 – 30,000	20%
30,001 – 40,000	25%
40,001 – 80,000	30%
80,001 and above	35%

2. **Income Tax Deductions for Children and University Students**: Households with a total gross income of up to **€80,000** will be eligible for the following **tax deductions**:
   - **€1,000 per spouse/cohabitant**[3] for each dependent child (up to 19 years of age for females, and 20 years of age for males).
   - **€1,000 per spouse/cohabitant** for each university student (up to 23 years of age for females, and 24 years of age for males).
3. **Tax Deduction for first time Housing Loan or Rent Payments**: Households with a total gross income of up to €80,000 will be eligible for a tax deduction of up to €1,500 per spouse/cohabitant for either of the following:
   - **Annual instalments of a serviced (performing) loan** used for the purchase of the household's first home, or
   - **Rental payments** for the household's primary residence.
4. **Tax Deduction for Green Household Upgrades**: Households with a total gross income of up to €80,000 will be eligible for a tax deduction of up to €1,000 in the year they undertake green upgrades to their primary residence. Eligible upgrades may include:
   - Installation of photovoltaic systems,
   - Purchase of electric vehicles (EVs),
   - Other environmentally sustainable improvements.

   The deduction may be applied in the year of the upgrade, with a potential eligibility horizon of up to five years, depending on the nature and timing of the investment.

Adjustments to personal income tax brackets and rates are introduced to better reflect current income distributions. These changes aim to enhance progressivity, provide greater support to middle-income earners, and ensure a more balanced contribution across income levels.

[3] As defined by the Marriage Law of 2003 (No. 104(I)/2003) and the Civil Union (Partnership) Law of 2015 (No. 184(I)/2015).

In alignment with these structural reforms, reform 2 introduces targeted deductions to support families with dependent children and university students, promoting educational access while easing the tax burden on working households and encourage female labour participation. Reform 3 focuses on housing affordability by offering deductions for mortgage or rental payments related to a household's first home, helping to strengthen housing stability. Reform 4 encourages environmentally responsible choices by providing tax relief for green household upgrades, contributing to the broader transition toward a low-carbon economy.

Fiscal Impact Assessment of the Proposed PIT Reform

This section presents the estimated fiscal impact of each proposed reform, both individually and in combination. The assessment has been conducted using **EUROMOD**, based on the **European Union Statistics on Income and Living Conditions (EU-SILC)** dataset, which provides harmonized microdata on income, poverty, and living conditions across EU member states as well as other econometric models at the Centre. To address limitations inherent in EU-SILC, the analysis also draws on complementary data sources and official statistics, including the **Household Budget Survey (HBS)**, the **Household Finance and Consumption Survey (HFCS)**. Moreover, econometric model estimates using the **administrative data** provided by the Tax Department complement the empirical findings.

The combined effect of the four proposed personal income tax (PIT) reforms results in an estimated **reduction of fiscal revenues by €151 million**. The fiscal impact of each measure is summarized as follows:

- **PIT Reform 1**: Adjustment of tax brackets and rates, including an increase in the tax-free threshold to €20,500 and shifting the top rate of 35% to income above €80,000 results in a **€66 million** revenue loss.
- **PIT Reform 2**: Deductions of €1,000 per child and per university student for households with income up to €80,000 lead to a **€26 million** reduction.
    - An alternative scenario with higher income caps (100,000 for families with 4 or more dependent children/university students maintaining the €80,000 cap for the rest) based on the number of children increases the cost to **€28 million**.
    - An alternative scenario with higher income caps (€100,000 for families with 3 or 4 dependent children/university students and €160,000 for families with 5 or more dependent children/university students maintaining the €80,000 cap for the rest) based on the number of children increases the cost to **€29 million**.
    - A more generous version with €2,000 tax deductions per child/university student, raises the cost to **€44 million**.
- **PIT Reform 3**: Deductions of up to €1,500 per spouse for mortgage or rent payments on a first home result in a **€30 million** revenue loss.
- **PIT Reform 4**: Deductions of up to €1,000 for green household upgrades (e.g., photovoltaics, EVs) yield a **€29 million** reduction.

Lone-parent households are treated in the most favourable scenario (i.e. as a household with two parents), receiving double the deduction amount (i.e., **€2,000 per child/university student** and the income cap is set at **€40,000**. The fiscal cost of all measures discussed is presented in Table 2 below.

Table 2. Fiscal Impact of the Proposed Reform and Alternative Child/Student Deductions.

	Reform scenario	**Fiscal cost (€ million)**
1	Increase of tax-free limit to €20,500, rounded tax brackets and transfer of the maximum tax rate of 35% to taxable income greater than €80,000:[1,2] 0 – 20,500: 0% 20,501 – 30,000: 20% 30,001 – 40,000: 25% 40,001 – 80,000: 30% 80,000+: 35%	66
2	Tax deduction of €1,000 per child (with ages up to 19 for females and 20 for males), and €1,000 per university student (aged 19-23 for females and 20-24 for males) (€2,000 for lone parents) to each spouse of households with **gross income up to €80,000** (€40,000 for lone parents)	26
3	Tax deductions for the instalments of a serviced loan for the purchase (or rent) of the household's first home up to €1,500 to each spouse with **gross income up to €80,000**	30
4	Tax deduction for green household upgrades up to €1,000 in the year of the upgrade, e.g., up to 5 years with **gross income up to €80,000**	29
	Reform package 1 + 2 + 3 + 4	**151**
2a	As in 2 with different household income caps: For families with up to 2 children/university students gross income cap €80,000 (€40,000 for lone parents), for 3 or 4 children/university students cap is €100,000 (€50,000 for lone parents) and for 5+ children/ university students cap is €160,000 (€80,000 for lone parents).[3]	29
	Reform package 1 + 2a + 3 + 4	**154**
2b	As in 2 with different household income caps: For families with up to 3 children/ university students gross income cap €80,000 (€40,000 for lone parents), for 4+ children/ university students cap is €100,000 (€50,000 for lone parents).[3]	28
	Reform package 1 + 2b + 3 + 4	**153**
2c	Tax allowance of €2,000 per child (with ages up to 19 for females and 20 for males), and €2,000 per university student (aged 19-23 for females and 20-24 for males) to each spouse of households (€4,000 for lone parents) with **gross income up to €80,000** (€40,000 for lone parents).	44
	Reform package 1 + 2c + 3 + 4	**169**

Notes:
1. If in reform (1) the upper tax bracket threshold is kept at €60,000 (instead of €80,000) the fiscal cost drops to €56 million.
2. Increasing the tax-free threshold by €5,000 to €24,500 and retaining the remaining tax bracket thresholds as in reform (1) yields a fiscal cost of €187 million.
3. Estimates of Reform 2a and 2b are based on limited official data availability for families of 4+ children.

Combined Scenarios

The following scenarios present the cumulative fiscal impact of the proposed personal income tax reform measures when implemented together, offering insight into the overall budgetary implications under different policy configurations.

- **Proposed Reforms summarized in** Table 2 (rows 1-4): €151 million total cost.
- Alternative package with adjusted income caps (€100,000 for families with 4 or more dependent children/university students--€50,000 for lone parents with double the amount of the deduction--maintaining the €80,000 cap for the rest----€40,000 for lone parents with double the amount of the deduction): €153 million.
- Alternative package with adjusted income caps (€100,000 for families with 3 or 4 dependent children/university students--€50,000 for lone parents with double the amount of the deduction--and €160,000 for families with 5 or more dependent children/university students--€80,000 for

lone parents with double the amount of the deduction--maintaining the €80,000 cap for the rest--€40,000 for lone parents with double the amount of the deduction): €154 million.

- Alternative package with increased child/student deductions (€2,000 instead of €1,000—€4,000 for lone parents): €169 million.

Impact on Typical Household Types

This section illustrates how the proposed personal income tax reform measures affect selected household profiles, highlighting the distributional impact across different family compositions and income levels.

Figure 1 illustrates the reduction in personal income tax liabilities for three representative middle-class households under the proposed reform package. **Panel A** shows households with **two earners** (combined gross annual income of €56,184), while **Panel B** presents households with **a single earner** (gross annual income of €28,356). Under the current tax system, these households face tax liabilities of **€2,150** and **€1,222**, respectively, regardless of the number of dependent children. With the proposed reform, and assuming full eligibility for the proposed tax deductions, the tax liabilities for two-earner households decrease to **€422**, **€222**, and **€22** for households with no, one, and two dependent children, respectively. For single-earner households, the corresponding tax liabilities fall to **€796**, **€596**, and **€396**.

Figure 1. Impact of proposed reform on 6 different middle-income households

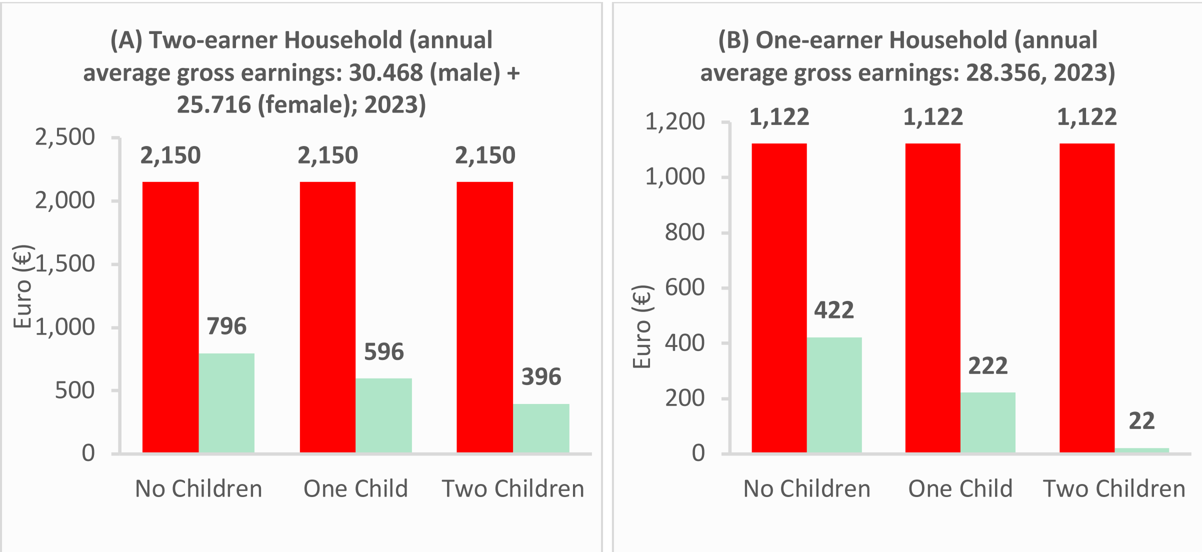
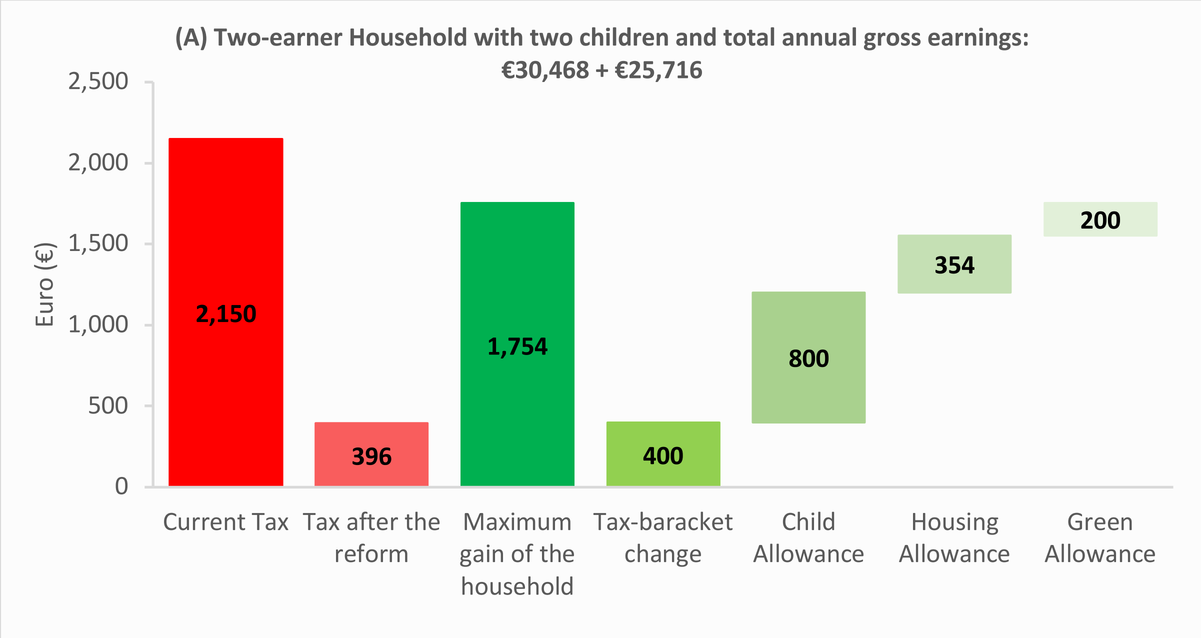


Figure 2 provides a detailed breakdown of how a **typical household**, comprising **two adults and two children** with a **combined gross annual income of €56,184** (€30,468 + €25,716), is affected by **each individual reform measure**. The analysis covers the impact of: (1) revised tax brackets, (2) deductions for two dependent children (or university students), (3) housing-related deductions for first-home purchase or rent, and (4) green household upgrades deduction. It is worth noting that comparing the single earner with one child household vis-à-vis the lone parent single child household, under the proposed PIT reforms the lone parent household with one child will pay no personal income taxes (compared to the one-earner household shown in Panel B).

Figure 2. Impact of each measure (1-2-3-4) on a typical household with two dependent children



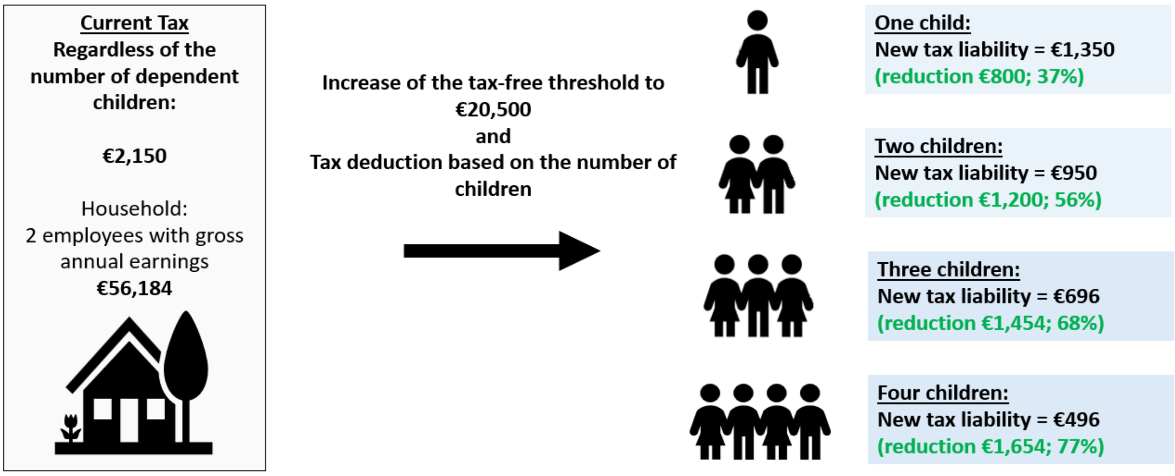
For the typical household in Figure 2, under the current tax system, the household's total tax liability is €2,150. Under the proposed reform the tax liability falls to €396—resulting in a total reduction of €1,754, or 81.6%. This reduction is attributed to the following components:

- €400 from the increased tax-free threshold (Reform 1).
- €800 from child-related deductions (Reform 2), i.e., €200 per child for each parent.
- €354 from housing-related deductions (Reform 3), with €300 attributed to Employee 1 and €54 to Employee 2.
- €200 from green upgrade deductions (Reform 4), fully sourced from Employee 1.

Note that Employee 2 does not fully utilize the available allowances, benefiting only partially from the housing and green deductions (€54 out of a possible €500).

For typical middle-class households with different number of children the proposed PIT reforms yield significant tax deductions. In this scenario, the household does not benefit from deductions related to first-time home purchase or green investments, focusing instead on child-related tax deductions and the increase in the tax allowance. For the same household analysed previously, with an annual income of €56,184, the PIT under the existing system amounts to €2,150. Under the proposed, the PIT decreases according to the number of children as follows: €1,350 for one child, €950 for two children, €696 for three children, and €496 for four children (see Figure 3).

Figure 3. The Effect of Increased Tax-Free Thresholds and Child Dependents on Household Tax Liability Reduction



Conclusion

The proposed personal income tax reform represents a pivotal step toward modernizing Cyprus's fiscal framework in response to evolving socioeconomic challenges. By recalibrating tax brackets, introducing targeted deductions, and incentivizing socially beneficial behaviours such as homeownership and green investments, the reform seeks to enhance equity, efficiency, and economic resilience. The measures outlined address socioeconomic challenges such as housing, demographics, environmental sustainability, and labour market participation—particularly among women.

At the heart of the PIT are four targeted reforms designed to deliver tangible benefits to households and improve the overall functionality of the tax system:

- **Adjustment of Tax Brackets and Rates**: Raising the tax-free threshold and shifting the top tax rate to higher income levels to reduce tax burden and enhance equity.
- **Income-Based Deductions for Children and University Students**: Providing relief to families through deductions based on the number of dependents and university students.
- **Tax Deduction for Housing Loan or Rent Payments**: Supporting homeownership and housing stability through targeted deductions for first-home purchases or rental expenses.
- **Tax Deduction for Green Household Upgrades**: Encouraging environmentally sustainable choices with fiscal incentives for energy-efficient improvements.

Looking ahead, the successful implementation of these reforms will depend on careful policy design, robust administrative capacity, and ongoing stakeholder engagement. While the estimated fiscal cost of €151 million underscores the need for careful budgetary planning, the potential long-term gains, in terms of improved living standards, and strengthened public trust, are substantial. As Cyprus navigates its path toward a more inclusive and future-ready tax system, these proposals offer a solid foundation for meaningful change, grounded in evidence-based economic policy analysis.

Corporate Income Tax (CIT) Reform

This section outlines a **comprehensive modernization of Cyprus's corporate tax framework**, shaped by the February 2025 Presidential Palace presentation**,** stakeholder feedback**, and a** review of all relevant CIT circulars. The reform package is structured into three parts: **(i) recommended reforms**—including raising the CIT rate to 15%, abolishing deemed distribution provisions with a 5% withholding tax on actual dividends, introducing hidden profit distribution (HPD) rules, targeted "green & tech" incentives, and clarifications to residency and closed-company rules; **(ii) provisions to remain unchanged**—such as group relief, NID, IP, tonnage tax, and subsidiary interest; and **(iii) deferred measures** to be revisited once the system stabilizes. Using the **Dynamic Profit Maximization Model as well as supplementary estimates** the analysis estimates that increasing the CIT rate from 12.5% to 15% would raise approximately **€240 million annually**, confirming that the reforms strengthen fiscal capacity while balancing fairness and clarity.

Summary of Corporate Income Tax Reform Proposals

The Cyprus tax system was completely reformed in 2002 as part of the accession of Cyprus to the EU. Since then, a number of amendments have been made over the years, responding to the Cyprus Financial Crisis in 2013 and also aligning the system with EU Directives as these were being issued.

The existing tax system has served the country and its economy well and has helped create a dynamic ecosystem, including, but not limited to, the expansion of the ICT sector.

Having considered best practices internationally, including reviewing tax systems or specific tax provisions of other EU and non-EU Member States; and having obtained verbal and written feedback from over 40 stakeholders in Cyprus; and after having reviewed the independent expert's report on Aggressive Tax Planning (ATP) practices (including a face to face meeting with the independent expert to discuss the findings); Therefore:

- The basis of taxation for Cyprus tax residents should continue as a Hybrid one with Cyprus tax residents being taxed on a worldwide income basis with a number of exemptions being allowed;
- Cyprus tax residency for companies should remain around the Management and Control Principle – taking into consideration the independent expert's recommendations to provide clear guidance in the law;
- The deductibility of expenses should continue to be that of partial deduction; (Tax deductible if matched to taxable income, non tax deductible if matched to exempt income and apportioned if expenses cannot be matched according to a fair methodology)

At the same time, as the Cyprus economy developed and evolved since the introduction of the current tax laws back in January 2003 (and any amendments to them), **some of its features may have created unintended and at the time unforeseen inequalities** and other issues not intended and not foreseen at the time of passing the relevant laws.

In addition to the current thinking internationally and within the EU, provisions which may have been acceptable in 2002, may now raise ATP concerns and or be considered as Harmful Tax Practices. These need to be urgently addressed. Furthermore, through practical application of the tax laws in the past 20 years there may be issues which need clarification or that need to be modernised.

Following the presentation at the Presidential Palace (in February 2025) and taking into account the stakeholder suggestions to the extent possible, the fiscal and economic impact of the reforms, this section summarizes the proposed tax changes, organized into three sections/parts. The first outlines the **proposed reforms**; the second includes proposals recommended remaining **unchanged**; and the third lists proposals to be **reconsidered or implemented at a later stage**, once the tax system has stabilized. In addition, all the tax circulars related to Cyprus CIT have been reviewed.

Recommended Reforms

Key proposals include:[4]

- Increasing the corporate tax rate from 12.5% to 15% (effective 1 January 2026).
- Abolishing the Deemed Distribution Provisions (including the 4-year rule) from 2026, replacing them with a 5% withholding tax on actual dividends to Cyprus tax resident and domiciled individuals, with transitional rules to safeguard revenues.
- Introducing Hidden Profit Distribution (HPD) provisions, inspired by the Estonian model, to discourage disguised distributions and encourage formal dividend payments, with HPDs taxed at a higher rate (proposed 17%).
- Aligning salaries of "closed companies" with Social Insurance benchmarks to protect revenues and prevent under-reporting.
- Strengthening the interpretation of "management and control exercised in the Republic" for corporate tax residency purposes.
- Introducing "green and tech" incentives, including super deductions for investments in sustainability, digital transformation, and upskilling.
- Expanding tax residency rules for individuals by adding a "centre of business interests" test, alongside the existing 183-day and 60-day tests.
- Retaining the non-domicile regime but extending its period subject to an annual fee.
- Considering a modest extension of the loss carry forward period (from five to seven years).
- Deferring capital gains tax amendments to later phases, but flagging possible changes (e.g. updated exemptions, revised immovable property definitions).
- Reviewing the taxation of trusts, including discretionary trusts, with a temporary tax regime at the trustee level and final adjustment at distribution.
- Providing favourable stock option taxation initially for startups, with safeguards to avoid abuse.
- Imposing stamp duty limited to real estate, financial, and insurance sectors.
- Reviewing taxation of ex gratia employment termination payments, with a possible flat 20% rate.
- Introducing rules for taxation of cryptocurrencies, NFTs, mining, staking, and airdrops, differentiating between capital and income tax treatment.
- Simplifying treatment of interest and rental income and clarifying rules for funds and NAV taxation.
- Allowing certain incentives for listings on the Cyprus Stock Exchange, while avoiding state aid issues.

Provisions to Remain Unchanged

The reform does not alter:

- Deductibility of Interest on 100% subsidiaries.
- Group relief provisions.

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[4] International Tax experts Lubbers, Boer & Douma B.V. (The Hague, the Netherlands) have analysed most of the Proposed Reforms on compliance with: EU Fundamental Freedoms, EU State Aid law, and EU Directives. They have also addressed EU Policy Developments, EU Code of Conduct on business taxation (the "**Code**"), Tax Treaties, and OECD Policy Developments, where appropriate. Additionally, some other reforms, such as export promotion incentives, were examined but not recommended by the tax experts due to potential conflicts with state aid rules. The analysis and recommendations of the International Tax experts are available in the Appendix of the complete report.

- Notional interest deduction (NID) and intellectual property (IP) deductions.
- The tonnage tax regime.

Deferred Measures

To be reassessed after stabilization of the new tax system, CypERC suggests:

- Possible pooling of foreign tax relief to enhance competitiveness.
- Clarification that secondary adjustments will generally not apply, except for undervalue transactions with shareholders already covered under HPD rules.

To estimate the economic impact of CIT reforms on Cyprus, the study applies the Dynamic Profit Maximization Model as its primary methodology. The next section employs this model and estimates the domestic economic impact of the main CIT reforms.

Assessing the Domestic Economic Impact of the Main CIT Reforms

This section evaluates the economic effects of changes in the CIT structure in Cyprus, focusing on both the revenue implications and the efficiency losses arising from tax-induced distortions. The analysis examines the potential fiscal and behavioural impact of increasing the CIT rate from 12.5% to 15%—as proposed under the reform. It quantifies the expected revenue gains.

To estimate these effects within the Cypriot context, the study applies a Dynamic Profit Maximization Model as its primary methodological framework. This model enables the simultaneous determination of output supply and factor demand, capturing substitution effects between labour and capital and accounting for both short-run and long-run behavioural responses. It allows for a dynamic and realistic assessment of how firms adjust production decisions, employment levels, and capital accumulation in response to changes in corporate taxation, providing an integrated perspective on fiscal and efficiency outcomes.

This methodological approach is particularly valuable for tax policy evaluation, as it models firms' optimizing behaviour under changing fiscal conditions. By estimating the price elasticities of production inputs, the model simulates how changes in tax rates affect production quantities and revenues across different sectors of the economy.

Impact on Revenues

Post-reform tax revenues are estimated by applying the CIT rates to simulated output levels. According to the Dynamic Profit Maximization Model analysis, increasing the CIT rate from 12.5% to 15% is expected to generate approximately €200 million in additional public revenue (based on 2023 data) (Table 3).

In addition, the CypERC performed supplementary calculations using the average tax revenue from legal entities over the period 2019–2024, which amounts to approximately €1,350 million. Assuming that business behaviour remains unchanged following the increase in the CIT rate, total revenues are projected to reach around €1,620 million, representing an increase of approximately €270 million.

As a result, the expected revenue gain is estimated to fall between these two projections and is conservatively placed at around €240 million.

Table 3. Summary of Results from Proposed Corporate Tax Reform: Tax Revenues

	CIT Rate (%)	% Change in Revenues relatively to the current tax system (τ=12.5%)	Corporate tax Revenues (€ million)
Current tax system	12.5	-	1593
Tax Reform	15	12.54	+200

Note: The Dynamic Profit Maximization Model estimates a €200 million revenue gain from increasing the CIT rate from 12.5% to 15%, assuming 2023 economic conditions. The estimates on revenue gains at the corporate level do not account for the SDC on dividends.

Conclusion

The February 2025 presentation at the Presidential Palace, followed by extensive consultations, has shaped a **comprehensive corporate income tax (CIT) reform package** structured into three elements: **(i) recommended reforms, (ii) provisions to remain unchanged, and (iii) measures to be reconsidered once the system stabilizes**. Together, these measures seek to balance fiscal sustainability, tax competitiveness, and fairness**.**

The proposed reforms include an **increase in the CIT rate from 12.5% to 15%**, the **abolition of the deemed distribution provisions**, the **introduction of hidden profit distribution (HPD) rules**, and a range of **targeted incentives and clarifications** to modernize the system. Key provisions such as **group relief, notional interest deduction (NID), intellectual property (IP) deductions, and the tonnage tax regime** remain unchanged. **Deferred measures** will allow for further refinement once stability is secured.

Economic analysis using the **Dynamic Profit Maximization Model** highlights that firms' adjustments in output, labour, and capital demand are manageable, ensuring that the reform delivers fiscal gains. The estimates based on the two methodologies described in the previous section show that **raising the corporate tax rate to 15% will generate approximately €240 million in additional public revenue**.

In sum, the reform package seeks to strike a careful balance**:** modernizing the tax framework, strengthening revenues, and preserving Cyprus's appeal as an investment hub. While the results are encouraging, the long-term success of the reform will depend on consistent implementation and the careful phasing-in of deferred measures**.**

The next section focuses on international tax competitiveness and summarizes forward-looking effective tax measures by expanding the Mannheim Tax Index and the International Tax Competitiveness Index (ITCI**)**, to benchmark Cyprus against other jurisdictions.

Tax Competitiveness

This section summarizes the impact of current and proposed corporate tax reforms Cyprus's international tax competitiveness. The latter is assessed using two well-established and complementary methodologies, which have been adapted by the CypERC to capture the specific features of the Cypriot tax system: the **Mannheim Tax Index** and the International Tax Competitiveness Index (ITCI).

The **Mannheim analysis** shows that the proposed reforms—**raising the CIT to 15%**, **reducing the SDC for domiciled investors to 5%**, and **accelerating depreciation**—significantly improve Cyprus's shareholder-level standing, moving from **8th to 2nd place for domiciled investors**, while **non-doms remain in 2nd place**.

At the same time, the extended **ITCI ranks Cyprus 3rd among OECD countries and 2nd in Europe** under the current system. The reforms **slightly improve the score** while keeping Cyprus firmly in those positions, with **loss carry forward extensions and higher income thresholds** delivering marginal further gains.

Taken together, the two analyses confirm that the reforms **strengthen rather than weaken Cyprus's international standing**, consolidating its position just behind **Estonia and Latvia** and aligning it with **European best practices**.

Mannheim Tax Index

The first approach extends the Mannheim Tax Index that was developed by the University of Mannheim and the Centre for European Economic Research (ZEW), two leading institutions in European tax policy analysis and widely recognized by the European Commission (EC) as a key reference tool for informing EU-level tax policy and reform discussions. Tax competitiveness is evaluated among 35 countries (the EU-27 and eight non-EU countries), estimations were based on a system of equations used in the *Mannheim Tax Index* (Spengel et al., 2024). The methodology is based on the model developed by Devereux & Griffith (1998, 2003), focusing on the estimation of effective tax rates. Understanding the distinction between nominal and effective corporate tax rates is essential for accurately assessing tax burdens. The nominal tax rate represents the statutory corporate rate and does not account for deductions, exemptions, depreciation rules, or other tax incentives, it offers only a general indication of a country's tax policy. In contrast, the effective tax rate considers both statutory rates and relevant tax provisions, such as deductions and depreciation allowances. It measures the impact of taxation on the present value of an investment and provides a more realistic basis for cross-country comparisons of tax competitiveness.

The findings indicate that, under the main proposed tax reforms — namely (1) increasing the corporate income tax rate from 12.5% to 15%, and (2) reducing the Special Defence Contribution (SDC) on dividends for domiciled tax residents from 17% to 5%, while maintaining the 0% rate for non-domiciled individuals — Cyprus's tax competitiveness improves substantially for domiciled investors, while retaining its strong position for non-domiciled investors.

Specifically, as summarized in Table 4 Cyprus advances from 8th to **2nd place** among 35 countries for **domiciled** investors, surpassing key jurisdictions such as Luxembourg, Estonia, and the UK, and ranking just behind Malta (1st). For **non-domiciled** investors, Cyprus retains its already strong **2nd place** position, just after Malta. When these changes are combined with additional incentives, such as accelerated depreciation for assets supporting the green and digital transition (e.g., reducing machinery depreciation to five years), Cyprus maintains its 2nd place ranking for both investor types.

Table 4. Summary of Results from Proposed Corporate Tax Reform: Competitiveness

	CIT Rate (%)	SDC Rate on Dividends	Position (Ranking) – Dom Investors	Position (Ranking) – Non-Dom Investors
Current tax system	12.5	17% (dom), 0% (non-dom)	8th	2nd
Tax Reform	15	5% (dom), 0% (non-dom)	2nd	2nd

Note: Rankings reflect Cyprus's relative position among the EU-27 and eight non-EU countries—UK, North Macedonia, Norway, Switzerland, Turkey, Canada, Japan, and the USA. It is based on the Effective Average Tax Rate (EATR), using data from the Mannheim Tax Index and authors calculations.

These results demonstrate how well-calibrated tax reforms can significantly improve returns for resident shareholders, even alongside a higher corporate tax rate. The sharp reduction in the SDC for domiciled individuals meaningfully boosts after-tax dividend income, enhancing Cyprus's appeal to local investors. At the same time, the reform package preserves Cyprus's competitiveness at the corporate level through measures like accelerated depreciation. With the new tax regime, rivalled only by Malta at the shareholder-level, Cyprus will solidify its position as one of the most attractive and competitive jurisdictions for both domestic and international capital.

Similar results regarding Cyprus's international tax competitiveness, are obtained using the International Tax Competitiveness Index (ITCI) presented in the next section.

International Tax Competitiveness Index (ITCI)

This section investigates how the Cyprus's international tax competitiveness is affected by the proposed tax reforms via the lenses of extending the ITCI developed by the Tax Foundation, as a need to provide a comparative tool to evaluate the tax systems of the OECD countries with respect to their competitiveness and neutrality. Extending the Tax Foundation's GitHub repository for the ITCI [5], which allows the integration of additional countries, the CypERC has included Cyprus in the ITCI map for the first time. This is important for the government and tax policymakers since it provides a useful tool to assess the relative competitiveness of the existing Cyprus's tax system at the international level as well as how this is affected by potential reform scenarios. The extended ITCI analysis complements the rest of the models and tools developed by the Economics Research Centre to evaluate the impact of tax reforms.

Given the existing tax system, Cyprus ranks third with overall score 90.9 in ITCI, below Estonia and Latvia that rank first and second with overall scores 100 and 92.3, respectively. Also, Cyprus ranks above New Zealand and Switzerland (with overall scores 84.6 and 84.1, respectively). The detailed ranking of the countries based on the overall score and each category is presented in Table 5. Focusing on the alternative tax categories to get an insight of the overall ranking but also the relative sub-categorical ranking, Cyprus now ranks third (with score 84.1) in Corporate Income Taxation, eleventh (with score 80.3) in Individual/Personal Income Taxation, twelfth (with score 77.8) in Consumption Taxes, seventh (with score 75.7) in Property Taxes, and eighth (with score 85) in Cross-Border/International Tax Rules. Comparing our results with the European version of the *Index*, Cyprus is in the second place with overall score 91.1 in the European Tax Policy Scorecard – ETPS (Bray and Mengden, 2025), below Estonia (overall score 100) and above Switzerland (overall score 90.9). It is important to note that the ETPS—which uses the same tax categories and methodology as the ITCI — focuses only on 32 European countries and restricts the tax policy variables from 42 to 39.

[5] https://github.com/TaxFoundation/international-tax-competitiveness-index/tree/master

This work by using the ITCI as a tool to study the ranking of Cyprus's tax international tax competitiveness under some key reforms demonstrates that the *combination* of (i) increasing the top marginal corporate tax rate from 12.5% to 15% and (ii) decreasing the top marginal dividends tax rate from 17% to 5%, raises Cyprus's overall score in the ITCI from 90.9 to 91.2 (0.33% improvement) but keeps it in the third place in the relative rankings with its existing tax system—including all other reforms and scenarios further improves the position of Cyprus bringing it closer to second place. Regarding the effects on rankings per tax category, the proposed key reforms lower Cyprus's Corporate Taxes Rank from the third to the fifth place (due to the increase of the top marginal corporate tax rate from 12.5% to 15%), whereas they elevate Cyprus's Individual Taxes Rank from the eleventh to the sixth place (due to the reduction of the top marginal dividends tax rate from 17% to 5%). Moreover, the combination of the above two key reforms with (iii) an increase of the loss carryforward from 5 to 10 years, and (iv) an increase of the top income tax rate threshold from 2.1 (€60,000/€28,356) to 2.8 (€80,000/€28,356) has no further influence on the previous results (Table 6).

Table 5. International Tax Competitiveness Index Rankings (2024)

Country	Overall Rank	Overall Score	Corporate Tax Rank	Individual Taxes Rank	Consumption Taxes Rank	Property Taxes Rank	Cross-Border Tax Rules Rank
Estonia	1	100	2	2	19	1	10
Latvia	2	92.3	1	3	22	5	7
Cyprus	3	90.9	3	11	12	7	8
New Zealand	4	84.6	31	6	2	9	18
Switzerland	5	84.1	11	8	4	37	1
Lithuania	6	79.6	4	10	28	8	17
Luxembourg	7	79.1	23	24	6	15	5
Czech Rep.	8	77.6	9	4	33	6	12
Hungary	9	77.3	5	5	37	24	4
Slovak Rep.	10	76.8	16	1	29	2	27
Israel	11	76.6	12	30	10	11	11
Turkey	12	75.2	22	7	17	23	6
Sweden	13	73.3	7	19	24	10	13
Australia	14	72.8	33	16	9	4	34
Netherlands	15	68.6	24	31	18	22	3
Austria	16	68.3	20	26	16	16	16
Germany	17	67.2	32	36	14	12	9
Canada	18	67.1	27	32	8	26	20
US	19	67	21	18	3	29	36
Norway	20	66.2	14	29	26	17	15
Costa Rica	21	65.5	36	33	7	13	30
Slovenia	22	65.3	10	13	31	25	21
Mexico	23	65.3	28	20	13	3	37
Finland	24	65.3	8	28	25	20	22
Korea	25	63.6	26	39	1	32	32
Japan	26	61.4	35	35	5	27	29
Belgium	27	61.3	18	14	27	30	25
Greece	28	61	19	9	35	28	23
Denmark	29	60.3	15	37	21	18	33
Chile	30	58.6	37	25	11	14	39
UK	31	58.2	29	22	34	35	2
Poland	32	57.5	13	12	38	31	24
Ireland	33	57.1	6	38	36	19	35
Spain	34	56.5	30	23	20	38	19
Iceland	35	56.1	17	21	30	34	28
Portugal	36	54	38	27	23	21	31
France	37	50.4	34	34	32	33	14
Italy	38	47.6	25	17	39	39	26
Colombia	39	46.1	39	15	15	36	38

Table 6. 2024 International Tax Competitiveness Index Rankings (2024) after the Application of the Proposed Key Reforms in Cyprus's Tax System

(changing (i) the Top Marginal Corporate Tax Rate from 12.5% to 15%, (ii) the Top Marginal Dividends Tax Rate from 17% to 5%, (iii) the Loss Carryforward from 5 to 10 years, and (iv) the Top Income Tax Rate Threshold from 2.1 (€60,000/€28,356) to 2.8 (€80,000/€28,356) – Corporate + Individual Tax Reform Combined Effect)

Country	Overall Rank	Overall Score	Corporate Tax Rank	Individual Taxes Rank	Consumption Taxes Rank	Property Taxes Rank	Cross-Border Tax Rules Rank
Estonia	1	100	2	2	19	1	10
Latvia	2	92.3	1	3	22	5	7
Cyprus	3	*91.2* ↑	*5* ↓	*6* ↑	12	7	8
New Zealand	4	84.6	31	7	2	9	18
Switzerland	5	84.2	11	9	4	37	1
Lithuania	6	79.7	3	11	28	8	17
Luxembourg	7	79.1	23	24	6	15	5
Czech Rep.	8	77.7	9	4	33	6	12
Hungary	9	77.5	4	5	37	24	4
Slovak Rep.	10	76.9	16	1	29	2	27
Israel	11	76.8	12	30	10	11	11
Turkey	12	75.2	22	8	17	23	6
Sweden	13	73.5	7	19	24	10	13
Australia	14	72.8	33	16	9	4	34
Netherlands	15	68.7	24	31	18	22	3
Austria	16	68.4	20	26	16	16	16
Canada	17	67.2	27	32	8	26	20
Germany	18	67.2	32	36	14	12	9
US	19	67	21	18	3	29	36
Norway	20	66.4	14	29	26	17	15
Costa Rica	21	65.5	36	33	7	13	30
Finland	22	65.4	8	28	25	20	22
Slovenia	23	65.4	10	13	31	25	21
Mexico	24	65.3	28	21	13	3	37
Korea	25	63.8	26	39	1	32	32
Japan	26	61.5	35	35	5	27	29
Belgium	27	61.4	18	14	27	30	25
Greece	28	61.1	19	10	35	28	23
Denmark	29	60.5	15	37	21	18	33
Chile	30	58.7	37	25	11	14	39
UK	31	58.4	29	20	34	35	2
Poland	32	57.6	13	12	38	31	24
Ireland	33	57.5	6	38	36	19	35
Spain	34	56.6	30	23	20	38	19
Iceland	35	56.3	17	22	30	34	28
Portugal	36	54	38	27	23	21	31
France	37	50.5	34	34	32	33	14
Italy	38	47.7	25	17	39	39	26
Colombia	39	46.1	39	15	15	36	38

Further, implementing a comparison of the ITCI results with the European version of the Index, shows that Cyprus is in the second place with overall score 92.6 in the European Tax Policy Scorecard (ETPS), below Estonia with overall score 100 and above Switzerland with overall score 92. It is important to note that the ETPS—which uses the same tax categories and methodology as the ITCI —focuses only on 32 European countries and restricts the tax policy variables from 42 to 39. Our extended ITCI enlarges the scope of European ranking for these 42 variables and evaluates the impact of the tax reforms for the European OECD countries in the ETPS and the rest of the non-European OECD countries.

Overall, the main results of the extended ITCI analysis, using the proposed key reforms for Cyprus, show that the *combination* of (i) increasing the top marginal corporate tax rate from 12.5% to 15%, (ii) decreasing the top marginal dividends tax rate from 17% to 5%, (iii) increasing the loss carry forward from 5 to 10 years, and (iv) increasing the top income tax rate threshold from 2.1 (€60,000/€28,356) to 2.8 (€80,000/€28,356) raises Cyprus's overall score in the ITCI from 90.9 to 91.2, that is an improvement of about 0.33%, but keeps it in the third place in the relative rankings with its existing tax system.

Conclusion

The combined assessment of Cyprus's tax system through the **Mannheim Tax Index** and the **International Tax Competitiveness Index (ITCI)** confirms that the country holds a **top-tier position both in Europe and among OECD countries**. According to the Mannheim results, the increase in the corporate income tax (CIT) rate from **12.5% to 15%** modestly reduces Cyprus's standing at the **corporate level**, yet this is more than compensated at the **shareholder level**. With the reduction of the **Special Defence Contribution (SDC)** and the adoption of **accelerated depreciation rules**, Cyprus climbs from **8th to 2nd place for domiciled investors** and continues to hold **2nd place for non-domiciled investors**, underscoring the attractiveness of the reformed system.

The extended ITCI analysis reinforces this conclusion. Under the existing regime, Cyprus ranks **3rd among OECD countries** and **2nd in Europe**, trailing only Estonia and Latvia. With the reforms, Cyprus retains these positions while recording **slight score gains**, as improvements in the **individual tax category** offset the higher CIT rate. Further adjustments, such as extending the **loss carry forward period** or raising **income tax thresholds**, add marginal benefits without shifting the overall ranking.

Overall, the evidence demonstrates that **Cyprus's tax framework remains robust and reform-resilient**. The key policy priority moving forward will be to safeguard stability, ensure transparent implementation, and adapt selectively to international standards. This approach will allow Cyprus to stay aligned with European best practices while reinforcing its reputation as a reliable and competitive investment destination.

Fiscal Impact of the Tax Reform

The fiscal impact of the proposed tax reform represents a key dimension of its overall evaluation, determining both its short-term budgetary effects and long-term fiscal sustainability. This analysis quantifies the expected revenue gains and costs associated with the main reform components, drawing on administrative data and policy simulations. It provides an assessment of how adjustments to Personal Income Tax (PIT) and Corporate Income Tax (CIT), changes in the Special Defence Contribution (SDC), and new fiscal instruments affect Cyprus's public finances and fiscal position.

Quantitative Assessment of the Reform's Fiscal Impact

This section presents the estimated budgetary effects of the reform's main components. The analysis quantifies both the costs and revenues associated with the reform, summarised in Table 7

Table 7. Fiscal estimates are based on average government revenues and expenditures over 2019–2024, a period considered representative of normal economic conditions, as recent years have shown unusually high revenue performance.

Overall, the **Fiscal total cost** of the proposed changes is estimated to reach €432 million. Changes to Personal Income Tax (PIT) and the reduction of the Special Defence Contribution (SDC) rate to 5% account for most of the revenue losses, as their associated costs are **€151 million** and **€217 million** respectively. Moreover, Digital and Green Corporate Tax Allowances are estimated to reduce revenues by **€17 million,** and the abolition of SDC on Rents and restrictions on Stamp Duty further reduce revenues by €**29 million and €8 million,** respectively.

On the **revenue side**, it is estimated that the Corporate Income Tax (CIT) rate increases from 12,5% to 15% will lead to revenues close to **€240 million**. Specifically, as detailed in Chapter 3, the CypERC employed a dynamic profit-maximization model to assess the real economic impact of raising the CIT rate from 12.5% to 15%. The model's results indicate a substantial increase in tax revenues—around €200 million per year—accompanied by relatively modest welfare losses. Complementary calculations by the CypERC, based on the average tax revenues from legal entities during 2019–2024 (approximately €1,350 million), suggest that—assuming no behavioural changes—total revenues could reach about €1,620 million, an increase of roughly €270 million. However, the expected revenue gain is conservatively estimated at around €240 million, the average of the two methodologies.

Table 7. Fiscal Position of Tax Reform

	CypERC Reform Team Proposals	
		Fiscal Cost (€ million)
1	Personal Income Tax reforms	151
2	Special Defence Contribution reduction to 5%	217
3	Legal Entities – Additional Changes*	64
4	**Total Fiscal Cost from CypERC Tax Reform Proposals (1+2+3)**	**432**
		Fiscal Revenues (€ million)
5	Corporate Income Tax rate increase (to 15%)	240
6	Second-round effects**	60
7	Revenues from deemed profit distribution for 2024–2025***	130
8	Immovable Property Tax (on values above €3 million)	54
9	Company Levy (for companies that pay €0 or less than €800 of corporate income tax)	50
10	Fee for the extension of the non-dom regime (€100k per year)	10
11	**Total Fiscal Revenues from CypERC Tax Reform Proposals (5+6+7+8+9+10)**	**544**

Fiscal Position 1: Total Revenues (11) – Total Expenditures (4)		**112**
12	**Additional Fiscal Revenues from Tax Reform Measures:** (a) Taxation of cryptocurrencies, gratuity payments & "Golden Hellos" (b) Tax compliance measures & reduction of the shadow economy (c) Legal entities (adjustment of wages)	
Final Fiscal Position		**Surplus exceeding €112 million**

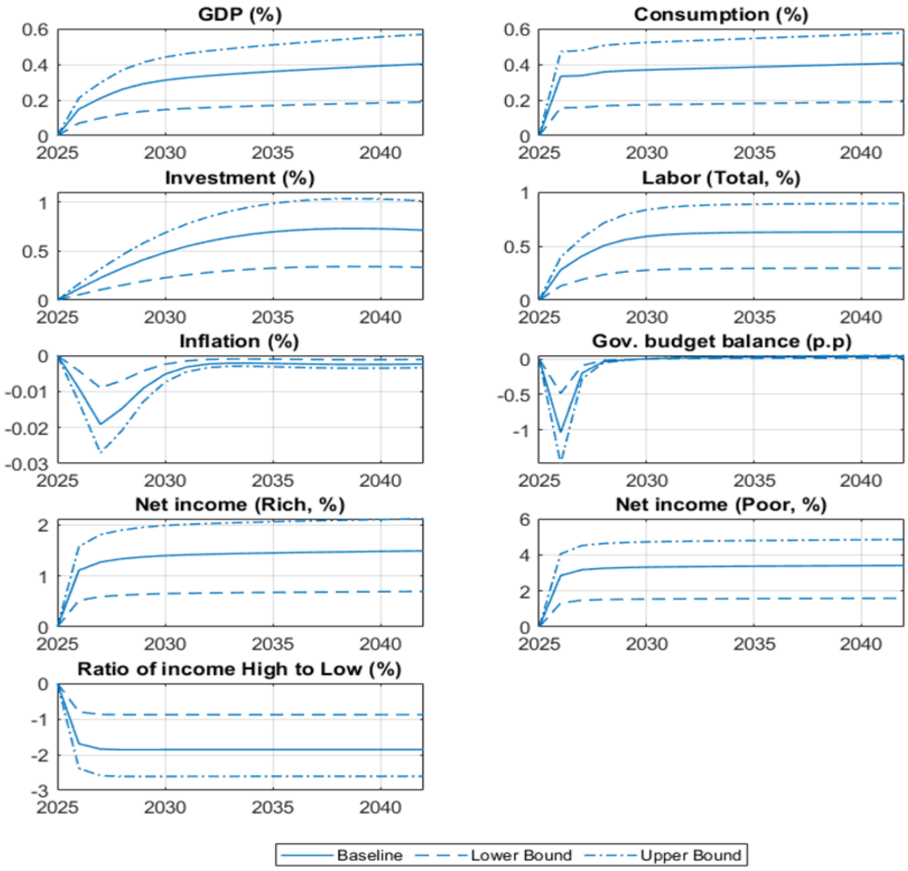
* Legal Entities – Additional charges on fiscal cost include, among others, measure like Abolishing Special Defence Contribution on rents and Digital & Green Allowances.

** The econometric model developed by CypERC for the Cypriot economy was used to estimate secondary fiscal revenues arising from higher consumption, investment, and employment due to lower labour taxation. These secondary effects include additional revenues from income tax, VAT, and other indirect taxes, estimated at a total of €60 million.

Furthermore, alleviation of the reform's fiscal cost is expected from additional revenues arising from Second-Round effects. In a very conservative scenario—assuming that no other fiscal revenues arise apart from those generated by the increase in the CIT rate—a revenue–expenditure gap of approximately €202 million (or 0.06% of GDP) is projected. However, this deficit is expected to be smaller once second-round effects are taken into account; that is, the increase in consumption and investment will generate additional revenue through higher VAT, income tax, and other tax receipts. Specifically, given a fiscal multiplier estimated at around 0.65 and an elasticity of total tax revenues with respect to GDP approximately equal to 1, it is estimated that an **additional €225 million in tax revenues** will be generated. Assuming these gains materialize over a period of three to four years, they translate into **annual revenues of approximately €56–75 million**.

The above results were further validated using the **Dynamic Stochastic General Equilibrium (DSGE) model developed by CypERC for the Cypriot economy**. This model allows for the simulation of tax reductions on labour income while accounting for the resulting effects on other macroeconomic variables such as **consumption**, **investment**, and **labour-related** tax revenues. The effects of the increased fiscal stimulus on other macroeconomic indicators are illustrated below (Figure 4). Specifically, a **1% GDP increase in the fiscal deficit** (approximately €333 million) has positive effects on **consumption, investment, employment**, and overall **GDP.** Notably, the initially observed deficit is eliminated within four years without the need for additional fiscal measures (Figure 4, graph: Government budget balance). In other words, even if the fiscal cost associated with the reform were to reach 1% of GDP (assuming no additional borrowing) and no additional revenue measures were introduced, the DSGE model simulations indicate that the fiscal balance would return to its baseline within four years. The findings confirm the previous estimate of **annual second-round effects in the range of €50–80 million**.

Figure 4: Impulse Responses of Key Variables from DSGE model on the Cypriot Economy



Moreover, when revenues from Deemed Profit Distribution for 2024–2025 are taken into account, the overall fiscal cost of the reform is reduced by approximately **€130 million**. In addition, the implementation of suggested policy measures can further offset the reform's cost, generating an estimated **€114 million** in additional revenues. Suggested policies include an Immovable Property tax[6] on properties valued above €3 million, a Levy on companies paying corporate income tax less than €800 and a Fee on non-Domiciled individuals. These proposals are formulated on the basis of the recommended reforms presented in Chapter 3 (of the full Cyprus Tax Reform Report), as well as on estimates derived using Cyprus's statistical data.

Immovable Property. According to Land Registry data, the total value of immovable property in Cyprus is estimated at €171.4 billion, owned by around 664,000 entities, of which 636,000 are individuals holding property worth €126 billion. Based on CypERC estimates, an introductory rate of 0.15%, on properties valued above €3 million expected to yield revenues to around **€54 million**. per year. An alternative option to apply the levy exclusively to idle immovable property above a certain valuation

[6] Property taxation is widely regarded as a relatively efficient and less distortionary form of taxation, capable of generating substantial revenue, particularly from middle- and upper-income households (see Chapter 6 of the full Cyprus Tax Reform Report for an extensive review). Unlike many other taxes, recurrent property taxes primarily target accumulated wealth rather than influencing future economic behaviour, which helps promote equitable outcomes and reduces distortions in economic decision-making. By discouraging land hoarding, property taxes also encourage more productive and efficient land use. Evidence from international experience highlights that well-designed property taxation can serve as a stable revenue source while minimizing negative economic distortions and fostering more effective land allocation.

was also considered; however, the absence of both an official definition of idle immovable property and reliable data, precludes an accurate fiscal estimate.

Fee on Legal Entities. According to Tax Department statistics, 88,980 legal entities filed a tax statement in 2021 with their reported taxable income corresponding to €1.14 billion in corporate income tax. Out of these 88,980 entities, only around 31,000 entities reported at least one euro of taxable income. Additional analysis shows that just 280 entities account for 50% of total taxable income and that 30% of total taxable income comes from less than 30 entities. Therefore, CypERC proposes a small yearly fee of €800 on companies that pay €0 or less than €800 of corporate income tax which is expected to bring in revenues close to **€50 million**. [7] Alternatively, the fee could be enacted on entities paying less than €800 of corporate income tax but with gross revenues and/or total assets above €1 million. In this case, revenues are estimated to be reduced and not exceed €8 million.

Fee on non-Domiciled individuals. Throughout the period 2017-2022, there have been 7,785 non-domiciled individuals regularly filing tax statements in Cyprus. CypERC has explored multiple alternative approaches regarding a fee implementation on such individuals, including a yearly €25,000 fee, a progressive fee based on reported dividend amounts, as well as a €100,000 fee upon the renewal of the non-dom regime, if the individual wishes to do so. Individuals with more than €2 million in dividends are expected to choose the latter approach, which is the preferred one, while the rest are assumed to select the 5% tax regime. Moreover, it should be noted that fee revenues will accumulate yearly and offset the revenue loss coming from changes in Special Defence Contribution rates. Overall, utilizing all three of the mentioned approaches, implementing a fee on non-domiciled individuals is expected to generate between €145-€200 million upon the expiration of the existing regime currently in effect for these individuals.

Given that the design of the preferred suggestion entails that the fee will be imposed at the regime's expiration, that is after 17 years since its initiation, data suggests that for the first 7 years around 200 individuals will benefit from this extension option. As a result, without taking into consideration new flows of non-doms, it is estimated that fiscal authorities will receive additional yearly revenues, close to €4-€5 million for the first year, which will be expanding cumulatively per year (e.g., reach €8-€10 million the second year, €12-€15 million the third year, etc.) as more non-domiciled individuals reach the end of their arrangement and assuming they opt to renew their non-dom status. For the purposes of fiscal impact estimation, a conservative **€10 million** annual figure is included.

Fiscal Impact Summary

The fiscal impact analysis estimates total revenues from the reform at **€544 million**, against a total cost of **€432 million**, resulting in a **net fiscal surplus of approximately €112 million (Fiscal Position 1)**. Policymakers are encouraged to prioritise the introduction of an immovable property tax, initially limited to idle land, alongside the implementation of the fee on non-domiciled individuals wishing to extend their regime. Additional revenue-raising measures could be introduced at later stages, depending on developments in public finances and the overall performance of the reformed tax system.

It should be noted that these estimates do not account for potential additional revenue gains arising from the implementation of Global Tax Pillar II, improved tax compliance and a reduction in the shadow economy, nominal GDP growth, and other proposed measures whose fiscal impact could not be quantified due to data limitations, such as a potential tax on cryptocurrencies. Taking these factors into consideration, the **final fiscal position is expected to exceed the €112 million surplus** currently estimated, further reinforcing the reform's positive contribution to fiscal sustainability.

[7] In the case of companies paying more than €0 but less than €800 of corporate income tax, the tax paid is subtracted from the fee, so that the fee and the corporate income tax paid add up to €800.

Fiscal Outlook and Sustainability Assessment

Looking beyond the quantitative assessment, CypERC expects that the implementation of the tax reform will **not endanger fiscal sustainability**. The reform balances short-term fiscal adjustments with long-term revenue stability, supported by structural measures that enhance compliance and broaden the tax base. The overall fiscal stance remains sound for the following reasons:

1. **Macroeconomic resilience.** Even if the fiscal cost associated with the reform were to reach 1% of GDP and no additional revenue measures were introduced, the DSGE model simulations indicate that the fiscal balance would return to its baseline within four years (Figure 4). However, this result should be interpreted with caution since it is derived based on the assumptions that the deficit would not be financed through increased borrowing and on today's tax system parameters before the reforms.

2. **Structural revenue gains.** Additional fiscal space is expected to emerge over the medium term through higher **tax compliance**, a gradual **reduction in shadow economy activity**, **expenditure consolidation**, and **nominal GDP growth**. Collectively, these are projected to offset the reform's initial cost and reinforce its long-term sustainability.

Overall, these findings indicate that the proposed tax reform preserves fiscal stability while supporting the transition toward a more efficient, equitable, and growth-oriented tax system. The next section focuses on the implications of the shadow economy, outlining potential measures to enhance tax compliance and tools that can support effective monitoring and enforcement.

Tax Compliance and the Shadow Economy

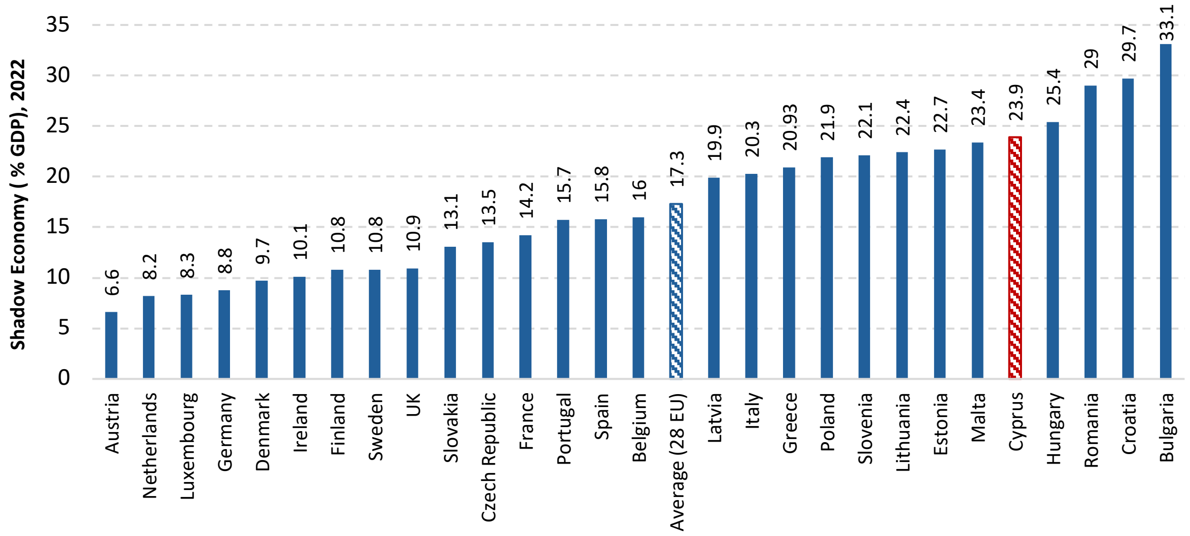
Estimating the size of the shadow economy is essential for understanding the extent of tax non-compliance and the challenges it poses to fiscal policy design. The shadow economy is generally defined as the economic activities that are hidden from public authorities either because of intentional avoidance of paying taxes or because these activities are illegal. According to CypERC's and KIOS's Online VAT Fiscalization Project (2025)[8] several empirical studies have examined the issue using both micro-level survey data and macroeconomic indicators. Although the specific estimates vary depending on the methodology applied, the results consistently reveal a substantial share of undeclared economic activity in the economy. The consolidated findings of the Fiscalization Project indicate the presence of a shadow economy in Cyprus, implying the occurrence of tax evasion, with the estimates for Cyprus varying between 20% - 30% of GDP depending on the adopted empirical methodology

Based on the most recently available data from the European Parliament study on the Taxation of the Informal Economy in the EU[9], Figure 5 presents the size of the shadow economy (as a % of GDP) across 28 EU countries and the UK, in 2022. The estimates range from 6.6% of GDP in Austria to 33.1% in Bulgaria. Cyprus is among the countries with the highest sizes of shadow economy with an estimate of 23.9% which is well above the 28-EU-Countries average (17.3%).

[8] Economics Research Center (CypERC) and KIOS Research and Innovation Center of Excellence, University of Cyprus, March 2025, Online VAT Fiscalization Project, Feasibility Study.

[9] Schneider, F., and Asllani, A., 2022, Taxation of the Informal Economy in the EU, Publication for the Economic and Monetary Affairs Subcommittee on tax matters (FISC), Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, Luxembourg.

Figure 5. Size of the Shadow Economy of the 27 EU-Countries + UK (in % of GDP), 2022



Source: Taxation of the Informal Economy in the EU, European Parliament.

A recent study by Achim et al. (2024)[10] supports these findings. Covering 26 EU countries from 2001 to 2021, it estimates that in 2021, Cyprus's shadow economy accounted for approximately 22% of GDP, with figures ranging from 8.1% in Luxembourg to 47.4% in Bulgaria.

Overall, and despite methodological variation, all studies confirm the significant size of the informal sector and persistent tax underreporting. These findings highlight the need for continued efforts to strengthen tax administration, improve monitoring tools, and design incentives that encourage formal economic participation. The next section focuses on measures to reduce tax avoidance and strengthen compliance through improved monitoring mechanisms.

Measures to reduce tax avoidance or compliance measures

Effective tax policy requires not only fair rates but also a framework that encourages voluntary compliance and minimizes opportunities for avoidance. The following measures outline both general and targeted initiatives designed to reduce tax avoidance, strengthen compliance, and limit the scope of the shadow economy in Cyprus.

1. **Simplified and Transparent Tax System**
   A simplified tax system reduces administrative complexity, and enhances transparency, making compliance easier for both individuals and businesses. It therefore lowers compliance costs and limits opportunities for avoidance through legal loopholes or interpretive ambiguity.

2. **Reduction of the Overall Tax Burden**
   Lowering the tax burden on labour and small businesses, incentivises voluntary compliance and encourages participation in the formal economy, thereby reducing incentives for underreporting income.

3. **Gradual Introduction of Universal Tax Filing**
   The gradual expansion of tax filing obligations to all taxpayers promotes transparency, broadens the tax base, and ensures that all income sources—particularly from self-employment and property—are properly declared.

[10] Achim, M.V., Postea, M.M. and Noja, G.G., 2024. New estimate of shadow economy based on the total energy consumption. Evidence from the European Union countries. Energy Economics, 130, p.107335.

4. **Expansion of Credit Card Usage and Limitation of Cash Transactions**
   Promoting electronic payments and restricting cash use increase transaction traceability, facilitate real-time reporting, and reduce opportunities for concealment of income.

5. **Strengthening of Tax Audits and Penalty Frameworks**
   Expanding audit coverage, supported by risk-based selection and data analytics, combined with a review of penalty levels, increases deterrence against non-compliance while ensuring proportional and fair enforcement.

6. **Combating Undeclared (Informal) Employment**
   Enhanced coordination between tax and labour authorities, combined with digital cross-checking of employment data, aims to reduce undeclared work and expand social contribution revenues.

Further, the proposed tax reform introduces a comprehensive set of legal, administrative, and digital measures aimed at reducing tax avoidance and strengthening compliance. Key measures include:

7. **Hidden Profit Distributions (HPD) Regime** (Section 3, recommended proposal 2.2)
   Treating shareholder benefits (such as personal expenses, non-commercial loans, and transactions at undervalue) as deemed dividends—taxed at a higher withholding rate—closes a key channel for undeclared income extraction. Clear and objective HPD rules encourage compliant behaviour and reinforce equity between different taxpayer categories.

8. **Introduction of Market Wages** (Section 3, recommended proposal 3)
   The reform introduces deemed market-rate salaries for director-shareholders will be initially explicitly linked to the Social Insurance Authority's published insurable earnings for self-employed occupational categories. Salaries cannot fall below those in effect on 31.12.2024, thereby protecting current tax revenues while requiring upward adjustment for under-declared remuneration. Over time, the minimum remuneration mechanism may be revisited and strengthened in line with EU best practices, such as the Netherlands' "customary wage" rule, which sets minimum director salaries based on comparable employment, internal pay scales, or a statutory threshold.

9. **Strengthening of Corporate and Individual Tax Residency Rules** (Section 3, recommended proposals 4 & 6)
   Tightening the interpretation of "management and control exercised in the Republic" and introducing an additional "centre of business interests" test curb artificial residency shifts by both companies and individuals. These reforms ensure that taxation aligns with genuine economic activity and substance in Cyprus.

10. **Capital Gains: Redefinition of "Cyprus Immovable-Property-Rich" Shares** (Section 3, recommended proposal 9(d))
    Extending capital gains taxation to include disposals of shares deriving over 50% of their value from Cypriot real estate closes avoidance channels involving holding-company structures and treaty shopping, ensuring taxation reflects underlying economic substance.

11. **Trusts: Temporary Taxation and Final Assessment at Distribution** (Section 3, recommended proposal 10)
    Introducing temporary taxation at the time of income receipt, with final reconciliation upon distribution, increases transparency and prevents timing arbitrage or residency-based avoidance.

12. **Stock Options: Anti-Abuse Safeguards** (Section 3, recommended proposal 11)
    Setting limits on the proportion of remuneration paid through stock options and establishing objective approval criteria prevent salary substitution with preferentially taxed equity instruments, while maintaining support for startups and innovation.

13. **Cryptocurrency Framework with Ring-Fencing** (Section 3, recommended proposal 14)
    Applying clear taxation rules for crypto transactions—including ring-fencing of trading losses, taxation of short-term trades as income, and regulation of mining/staking—enhances auditability and prevents misclassification and timing manipulation in a high-risk sector.

14. **Interest and Rental Income Simplification** (Section 3, recommended proposal 15)
    Applying a single, consistent regime for rental income and clarifying the distinction between active (corporate) and passive (individual) interest income reduce arbitrage opportunities and strengthen enforcement clarity.

15. **Funds: Uniform Mode of Taxation** (Section 3, recommended proposal 16)
    Applying a single, non-optional taxation method across fund structures and investor types eliminates selective treatment, ensuring consistency and equal treatment of resident and non-resident investors.

Monitoring Tools and Digital Infrastructure

For a successful reform, the deployment of **modern digital tools** and **data-driven monitoring systems** by the Tax Department is essential. These include **real-time VAT monitoring**, **AI-based anomaly detection**, and **big data analytics** to enhance risk assessment, identify evasion patterns, and improve audit efficiency. When combined with staff training and inter-agency data sharing, such innovations can significantly strengthen the capacity of tax authorities to promote compliance, transparency, and fiscal accountability across all sectors of the economy.

According to **CypERC's and KIOS's Online VAT Fiscalization Project (2025)**, improving VAT compliance requires a holistic approach—one that addresses administrative efficiency, system complexity, compliance costs, and penalty enforcement, while ensuring that tax data is collected in real or near real time. As emphasized by the EU Tax Committee, real-time reporting is a cornerstone in combating VAT fraud, necessitating the establishment of a robust technological and regulatory infrastructure in Cyprus.

To achieve these objectives, the CypERC–KIOS technical proposal recommends the following key measures:

- **Full digitalization of VAT registration**, with the issuance of a digital signature and certificate to all taxable persons.
- **Mandatory electronic invoicing (e-Invoicing)** for all taxable persons in both B2B and B2C transactions, enabling real-time or periodic cross-matching of purchaser and seller data.
- **Integration of electronic cash registers (ECRs) and POS systems** with digital signature devices and EFT payment systems, ensuring encrypted, tamper-proof, and authenticated data transmission directly to the Tax Department.
- **Compliance with EU e-invoicing standards** (PEPPOL BIS 3.0) and the **eIDAS Regulation** to guarantee authentication, integrity, and interoperability.
- **Incorporation of AI-driven risk assessment tools** and **scenario analysis** to detect irregularities, identify underreporting, and strengthen fraud prevention.

Additionally, the framework promotes a **centralized e-invoicing platform** for real-time reporting and cross-checking of sales and expense data between businesses and suppliers. This system would enable the Tax Department to conduct **remote electronic audits**, significantly reducing administrative burdens for both taxpayers and authorities.

A comparable example is found in **Greece's "myDATA" (My Digital Accounting and Tax Application)** system, developed by the Independent Authority for Public Revenue (AADE). The platform modernizes tax reporting by requiring businesses to electronically transmit income and expense data - either in real time or periodically - through certified invoicing software, ERP systems, or directly via the online portal. It automatically generates digital accounting books that reconcile transactions between suppliers and customers, thereby enhancing transparency and curbing tax evasion. Since its gradual introduction in 2020, myDATA has simplified tax procedures, improved traceability, and significantly strengthened compliance.

This integrated digital infrastructure—combining electronic invoicing, fiscal memory units, secure data connectivity, and AI analytics—is designed to enhance the efficiency of tax collection, reduce VAT fraud, and strengthen compliance across all sectors of the economy. It also positions Cyprus to meet the EU requirement for mandatory e-invoicing by 2028, ensuring full interoperability with European standards and alignment with best practices in digital fiscal governance.

Conclusion

The comprehensive fiscal assessment demonstrates that the proposed tax reform is **fiscally neutral to mildly positive** and consistent with **long-term fiscal sustainability**. Despite an initial estimated cost of **€432 million**, the reform's financing mix—driven by higher corporate income tax revenues, second-round growth effects, and targeted new policy measures—more than compensates for these costs, resulting in a **net fiscal surplus of approximately €112 million** under conservative assumptions.

Dynamic model simulations confirm that even under adverse scenarios, the **fiscal balance returns to its baseline within a few years**, supported by positive effects on consumption, investment, and employment. Over the medium term, structural gains from **higher compliance, reduced informality, and digital monitoring tools** are expected to expand fiscal space further.

Overall, the tax reform provides a **balanced and forward-looking fiscal framework**—one that preserves macroeconomic stability, promotes equity, and equips Cyprus with a more transparent and sustainable tax system.

Overall conclusion

This Overview presents a summary of the implications and main findings of the Cyprus Tax Reform. The reform delivers a comprehensive, fiscally balanced, and forward-looking restructuring of the national tax system - a data-driven blueprint for modernising Cyprus's fiscal framework while safeguarding stability and competitiveness.

The **Personal Income Tax (PIT)** reforms reduce the tax burden of households and families and address challenges which include housing, demographics, female labour employment and green sustainability. The tax-free threshold rises to €20,500, brackets are rebalanced with a top marginal rate of 35%, and targeted deductions for children, first-home housing costs, and green household upgrades are introduced. The gross fiscal cost of these measures is estimated at €151 million, focused on middle-income households. Distributional analysis confirms meaningful gains in disposable income for representative dual-earner and single-earner families, while the schedule remains progressive.

Corporate measures re-anchor revenues without undermining the investment climate. Raising the Corporate Income Tax (CIT) rate from 12.5% to 15% is projected to yield €240 million annually, with core pro-investment provisions—Notional Interest Deduction, the Intellectual Property regime, and the tonnage tax—retained. Transparency and anti-avoidance are strengthened by abolishing deemed distributions, applying a 5% withholding tax on actual dividends to domiciled individuals, introducing Hidden Profit Distribution (HPD) rules, and clarifying residency and "closed-company" remuneration. Together these steps broaden the base, reduce arbitrage, and channel payouts into clearer, compliant forms.

International benchmarking shows Cyprus remains a front-runner. On the Mannheim Tax Index the reform advances Cyprus from 8th to 2nd for resident investors and preserves 2nd for non-residents (EU-27 plus eight non-EU comparators). The International Tax Competitiveness Index places Cyprus 3rd among OECD countries and 2nd in Europe; reform scenarios maintain these standings, indicating that the package raises steady revenues while sustaining attractiveness.

The overall **fiscal impact** is favourable even under conservative assumptions. Total costs amount to €432 million—primarily from PIT changes and the lower SDC rate—while additional revenues of €544 million produce a net surplus of roughly €112 million. Key pillars are the CIT rate increase (€240m), deemed profit distribution (€130m), second-round effects (€60m), and suggested policy measures: an immovable property tax on values above €3 million (€54m), a company levy (€50m), and a non-dom extension fee (€10m). Dynamic Stochastic General Equilibrium simulations indicate that even if a temporary deficit were to emerge, the budget would return to baseline within four years, supported by stronger consumption, investment, and employment. The compliance agenda—real-time VAT reporting, e-invoicing, and risk-based audit selection—targets a sizeable shadow economy and is expected to widen the base over time.

Successful delivery depends on phased sequencing, administrative readiness, and sustained investment in digital infrastructure, with priorities including clear operational guidance on Hidden Profit Distribution (HPD) and closed-company rules, transitional arrangements for dividend taxation, and the staged rollout of VAT digitalisation. Additional gains are expected from stronger compliance, gradual reductions in the shadow economy, nominal GDP growth, and prospective measures not yet fully quantified. Overall, the Cyprus Tax Reform broadens the base, reduces distortions on labour, and reinforces efforts to improve compliance through digitalisation, while maintaining top-tier international rankings and achieving a fiscally neutral to mildly positive position.