

ESOPS AND THEIR TAXATION IN CYPRUS



ARTICLE BY

Stella Strati
Partner - Corporate Finance, Tax,
Private Client
stella.strati@pavlaw.com



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In an era where work-life balance is of increasing importance, the use of employee stock option plans (ESOPs) is a powerful tool to provide further benefits and incentives to employees and assist in attracting and retaining talent.

WHAT IS AN ESOP

An ESOP is a benefit plan offered by companies to their employees, providing them with the right to purchase company shares at a predetermined price, after a certain period, known as the vesting period. Usually the option provided under an ESOP may not be sold, transferred, pledged or otherwise encumbered or disposed and any shares issued under the ESOP are subject to similar restrictions. Moreover, ESOPs typically include provisions, that any rights granted to the employees thereunder are lost once the employment of the relevant employee is terminated.

ESOPs bring into line the interests of the employees with those of the company they work for, by making them partial owners, who benefit directly from the company's success and rising share value. They also help attract and retain talent; making a particular company more appealing to future employees and encouraging existing staff to remain with their employer, at the prospect of financial gain. As the value of stock options rises with the company's share price, employees are motivated to contribute to the company's success; hence ESOPs may enhance overall performance.

CYPRUS: ESOPS AND HOW TO TAX THEM

During the last few years Cyprus has been a favourite destination for the establishment, headquartering or relocation of start-ups, tech and software companies – industries in which the use of ESOP is widespread. Also, a number of individuals have chosen to relocate to Cyprus (especially post COVID19), to obtain the Cyprus tax resident but not domiciled (Non-Dom) status, and work from the island – enjoying a number of tax benefits, as well as the easy-going island life.

But how is an ESOP taxed in Cyprus under the applicable laws and regulations?

According to the Cyprus Income Tax Law:

“... a person who is resident in the Republic of Cyprus shall be charged with tax at the specified tax rates on income accruing or arising from sources both within and outside the Republic in respect of:

- Any profits or benefits from any business for whatever period;
- Any profits or other benefits from any office or employment, including the estimated annual value of any quarters or board or residence or of any other allowance granted in respect of office or employment, whether in money or otherwise, to the individual providing the salaried services or to any member of his family...”

The granting of stock option rights to employees of a company through an ESOP constitutes a benefit in kind and is subject to tax in Cyprus, provided that the employee is a Cyprus tax resident (either if such an individual is Cyprus domiciled or a Non-Dom). Taxable income for an employee is deemed to arise only upon the exercise of the stock option or when restrictions on sale are lifted.

The taxable income in such a case, is the difference between the average stock exchange value of the shares on the exercise date and the purchase price paid by the employee. In case the shares of the company are not listed on a stock exchange the fair value of the share is determined through a valuation, based on generally accepted share valuation methods.

Furthermore, once the employee exercises the option and obtains shares in the company, any dividends received by such individual will not be subject to any income tax in Cyprus. The dividends received by Cyprus domiciled tax residents will be subject to Special Defence Contribution (SDC), currently at the rate of 17%. Nevertheless, dividends received by Non-Doms are exempted from SDC. Therefore, any dividends received by a Cyprus tax resident who has the Non-Dom status, will be exempt from any taxation in Cyprus. However, such dividends shall be subject to National Health System contributions (GESY) currently at 2.65%

HOW WE CAN HELP

At Patrikios Legal, we can provide the necessary legal assistance in relation to the creation of an ESOP, under the applicable laws and regulations, according to the company's needs, aspirations and goals and taking into consideration the rights and interests of the employees. We can also assist with the administration and implementation of such ESOP and at the same time offer the necessary legal and tax advice and support.



Patrician Chambers
332 Agiou Andreou str.,3035 Limassol, Cyprus

P.O Box 54543, 3725 Limassol, Cyprus

T +357 25871599 | F +357 25344548
info@pavlaw.com

www.pavlaw.com

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