

CYPRUS TAX LAW AMENDMENTS

On 16 July 2015, a number of tax law amendments were published in the Cyprus Official Government Gazette after being voted by the House of Parliament. These amendments are primarily aim to:

- Attract new equity capital and investments
- Strengthening the financial position of Cyprus companies and at the same time maintaining their competitiveness
- Give incentives to companies to relocate their business in Cyprus and create business substance
- Attract high net-worth individuals and entrepreneurs
- Modernizing the Cyprus tax system and making it more fair and competitive

There are also additional proposed amendments which are expected to be voted soon.

TAX LAW AMENDMENTS VOTED

CORPORATE TAX

1. Allowance for new equity / notional interest deduction

This law introduces a tax deduction in the form of notional interest which will be allowable to all companies irrespective of the nature and place of their activities (including permanent establishment of foreign companies).

The tax deduction will be calculated with the imposition of notional interest (reference interest rate) on **new equity** funds introduced into the business (Cyprus tax resident companies) on or after 1 January 2015, provided that the new equity funds will be used in conducting their business activities.

New equity includes share capital and share premium and does not include amounts that have been capitalized as revaluation reserves. Reserves existed at 31 December 2014 may be considered as new equity only if they are used for the financing of new assets of the company.

Reference interest rate is the yield on the ten year government bond of the country where the new equity is invested, plus 3%, on 31 December of the year preceding the tax year involved. The minimum rate being the yield on the ten year government bond of Cyprus plus 3%.

The notional interest to be deducted cannot exceed 80% of the taxable income of the company for the year, before the deduction of this notional interest.

The deductibility of the notional interest will be subject to the same rules as actual interest paid i.e. will be tax deductible only if it relates to assets used in the business.

Each year, a company may choose not to claim all or part of the available benefit.

Further to the above, by the application of this law amendment and depending on the level of capitalization of the company, the effective rate may be reduced up to 2,5% (with the current tax rate of 12,5%).

The law also includes a number of anti-abuse provisions of this deduction.

The effective date of this tax law amendment is the 1st January 2015.

SPECIAL DEFENCE CONTRIBUTION (SDC)

1. Introduction of the “Non – Domicile” principle

Before the introduction of this law amendment, defence tax was payable by Cyprus tax residents subject to any available exemptions on income derived from interest, rents and dividends.

According to the new tax law amendment, individuals who are not considered to be domiciled in Cyprus would be exempt from SDC on their income arising from interest, rents and dividends even though they are considered as Cyprus tax residents.

An individual can be considered as domiciled in Cyprus either by domicile of origin or by domicile of choice.

Individuals who have a domicile of origin in Cyprus are still considered not to be domiciled in Cyprus for SDC purposes in cases where:

- a. An individual who has a domicile of origin in Cyprus but he has obtained a domicile of choice in another country, provided that he was not Cyprus tax resident for at least 20 years before the tax year in which he becomes Cyprus tax resident.
- b. Any person who has not been tax resident of Cyprus for a period of at least 20 years before the law comes into effect.

Individuals who are domiciled by origin in other countries will not be subject to SDC in Cyprus even though they are Cyprus tax residents provided that they have not been Cyprus tax residents for at least 17 years out of the last 20 tax years. Such individuals will become domiciled in Cyprus and become liable to SDC from the 18th year onwards.

2. Dividends between resident companies

As from 16 July 2015, in cases where an actual dividend distributed to a company which is not owned directly or wholly by a resident individual or individuals i.e. it is held by another Cyprus tax resident company, the Tax Commissioner may challenge the interposition of the intermediary holding company as a shareholder of the company paying the dividend and consider its purpose as no commercial but was instead intended to avoid, reduce or delay the payment of SDC. In such cases the Tax Commissioner may demand the payment of the SDC on the dividends either from the company which received the dividend or from the individual or individuals who directly or indirectly control this company.

Prior to the above amendment dividend that is indirectly paid after four years from the end of the year in which the profits out of which the said dividend was paid, was subject to SDC and applied on dividends accruing as from 1 January 2012.

CAPITAL GAINS TAX

1. Capital gains tax exemption

According to this tax law amendment no capital gains tax will be imposed on gains arising from a subsequent sale of a property acquired between 16 July 2015 and 31 December 2016 by an independent party at market value.

Under the law, property is defined as land or land with building or buildings.

The exemption does not apply to immovable property that was acquired not by purchase or by purchase agreement but by a donation/gift or by way of an exchange.

The effective date of this tax law amendment is the 16th July 2015.

DEPARTMENT OF LANDS AND SURVEYS

1. Transfer fees exemption

A 50% exemption from transfer fees under the Land and Surveys (Fees) Law will apply to all transfer applications effected until 31/12/2016.

The effective date of this exemption is the 16th July 2015.

INCOME TAX

1. Widows pension

Income of an individual from widows' pension paid exceeding the amount of €19.500 is subject to tax at the rate of 20%. Such income is not added to any other income.

Any person who falls under the provisions of this section may for each year elect how to be taxed (either under this scheme or under regular income).

The above provision is effective from tax year 2014.

PROPOSED TAX LAW AMENDMENTS

1. Extension of available exemptions to individuals

- a. Extension from 3 to 5 years of the 20% exemption of the remuneration from any employment exercised in the Republic by an individual who was resident outside the Republic before the commencement of his employment. This exemption can be claimed until the year 2020 and the maximum amount to be claimed is €8.550 per annum.
- b. Extension from 5 to 10 years of the 50% exemption of the remuneration from any employment exercised in the Republic by an individual who was resident outside the Republic and commenced employment after 1 January 2012 and his/her remuneration in Cyprus exceeds €100.000 per annum.

2. Capital allowances on plant and machinery and buildings

This proposal provides an extension of the increased capital allowances on plant and machinery (20% instead of 10%) for the tax years 2015 and 2016.

In addition, for industrial and hotel buildings an increased capital allowance (7% instead of 4%) is granted for the tax years 2015 and 2016.

3. Tax neutrality of exchange differences

Foreign exchange differences (gains / losses), realized or unrealized will not be taxable / tax deductible irrespective of whether they are of trading or capital nature.

The above proposal does not apply to companies carrying out their business of trading in foreign currencies and related products. Such companies may irrevocably elect not to be taxed on unrealized gains or losses.

4. Dividend income

Under the current law, dividends received by a Cypriot tax resident company are unconditionally exempt from income tax.

As per the proposed tax law amendments and in order of the tax law to be harmonized with the EU Parent – Subsidiary Directive, dividends will no longer be exempted from income tax in the following cases:

- a) Where the dividends are treated by the subsidiary company as tax deductible expense.
- b) When there is an arrangement or a series of arrangements between the two companies which are considered as not genuine i.e. the arrangements are not put into place for valid commercial reasons.

5. Amendment to Intellectual Property Regime - limitation of losses carried forward

As per the existing provisions of IP Box regime, effected from 1/1/2012, 80% of the net profit generated from the exploitation of a qualifying as IP asset is exempt from taxation subject to certain conditions. However, no specific provisions were included in case the IP activities were loss making.

According to the proposed amendment, losses are restricted with the same way as profits i.e. at 80% and therefore only 20% of the resulting loss will be allowed.

6. Group loss relief

In order for the Cypriot tax laws to be harmonized with the European Court of Justice's relevant decisions, group loss relief provisions are extended to cases where the subsidiary (the surrendering company) is tax resident in an EU member state (currently group loss relief provision apply only between Cyprus companies). However these provisions can be applied provided that the subsidiary company has exhausted all the means of surrendering or carrying forward the losses in the member state of tax residence of the subsidiary or to any intermediary holding company.

7. Broadening the definition of the terms "Republic of Cyprus" and "permanent establishment"

Both definitions were broadened so that hydrocarbon activities in Cyprus exclusive economic zone are taxed.

8. Anti - abuse provisions for re-organizations

In cases where the Commissioner considers that the re-organization was made with the main purpose in avoiding, reducing or deferring the payment of taxes, may refuse to accept tax free re-organizations.

In addition, the Commissioner will have the right to impose conditions on the number of shares that will be issued for the re-organization purposes and the period for which such shares should be held. This period cannot exceed the three years.

9. Arm's length transactions (Article 33)

According to the proposed provisions, in cases the Commissioner increases the profits of a company by applying the provisions of Article 33 (related parties transactions), a corresponding deduction should be given to the other party incurring the expense or the loss, provided that both companies are Cyprus tax residents.

10. Capital gains from sale of shares in property companies

Under the current Law, capital gains tax applies to gains arising from the sale or disposition of immovable property situated in Cyprus and shares in companies represented by immovable property situated in Cyprus.

According to the proposed amendment:

- a. Gains arising from the sale of shares in companies which directly or indirectly participate in other companies which own immovable property situated in Cyprus will be subject to capital gains tax. In such cases the Law will apply only if the market value of the property is more than 50% of the value of the shares sold.
- b. Any gains arising from the trading of shares of companies which directly or indirectly own immovable property situated in Cyprus will be subject to capital gains tax. Under the current law such gains would be exempt from Income Tax since (sale of shares) and also would not fall under the provisions of capital gains tax.

In the case of sale of shares which directly or indirectly own property in Cyprus the gain to be taxed will be calculated on the market value of the immovable property.

CONTACT

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