

Cyprus Tax

New legislation for encouraging economic activity and attracting foreign direct investment

On 16 July 2015 the House of Representatives of Cyprus approved a number of changes to tax legislation aimed at encouraging economic activity and attracting foreign direct investment. The changes purport to encourage international investors (high net worth individual investors, groups and high earning employees) to enhance corporate substance and improve the tax efficiency of their international operations by working and residing in Cyprus.

Amendments to tax legislation stipulated below and marked with an asterisk (*) signify that they have not been passed yet, nevertheless, are expected to be approved and passed by the House of Representatives in September 2015.

1. Notional interest deduction (“NID”) on equity Companies will be entitled to a NID on ‘New Equity’ contributed and paid to Cypriot companies from 2015 onwards.

“New Equity” means any equity, introduced in the business on or after 1 January 2015 in the form of issued share capital and share premium. It does not include amounts that have been capitalized and which are the result of a revaluation of movable or immovable property.

The NID will be calculated based on the ‘New Equity’ and a ‘Reference Interest Rate’. The Reference Interest Rate will be based on the 10 year government bond yield of the Country in which the new equity is invested in, plus 3% (a minimum rate applies).

The NID granted in any tax year cannot exceed 80% of the taxable income. In the event of losses, the NID will not be available. Effectively, this means the NID cannot create taxable losses to be carried forward.

The legislation includes specific anti abuse provisions and is effective from 1 January 2015.

2*. Foreign exchange gains or losses are tax neutral as of 1 January 2015

Foreign exchange (forex) gains or losses will no longer affect the tax computation irrespective of the assets or liabilities creating these forex results or whether these are realized or unrealized. Simply put, any forex gains will not be taxable and any forex losses will not be deductible.

An exception to this applies to companies specifically trading in FX currencies, FX currency options and derivatives

3*. Implementation of the amendments made to the EU parent subsidiary directive

In order for the Cypriot Income Tax law to be harmonized with the amended EU Parent-Subsidiary Directive, the previously unconditional exemption of dividend income from corporate income tax on dividends received by a Cyprus company will not be available as of 1 January 2016 if the relevant dividend received by a Cyprus tax resident company is allowed as a tax deduction in the jurisdiction of the foreign paying company.

The restriction of this exemption will also apply in the case that an arrangement has been put in place to take advantage of this exemption without real economic substance. The dividend income which falls within the above criteria and hence does not enjoy the Income Tax exemption will be treated as trading income and will be subject to 12.5% income tax in Cyprus. It will not be subject to special defence contribution (SDC).

4*. The right for **arm's length adjustments** granted to the Commissioner of Inland Revenue for imposition of deemed income is now extended so now if the counterparty is another Cypriot entity, the equal and opposite expense is granted in that respect as an adjustment. This allows in essence transfer pricing downward adjustments subject to conditions. It will become effective as of 1 January 2015.

5*. The scope of application of the **group relief loss provisions** has now been amended to allow for surrendering of losses by EU member state companies to its Cyprus group companies, subject to conditions. This amendment to the legislation brings it in line with the court decisions of the ECJ on this matter. It is effective as from 1 January 2015.

6*. Reserving tax neutrality of reorganizations for bona fide transactions General anti-abuse provisions are now introduced in relation to company reorganizations.

In case the authorities consider that a reorganization is not carried out for valid commercial reasons which reflect economic reality, but instead, they are of the opinion that the main reason is to avoid, reduce or defer tax, then they have the statutory right to refuse granting the exemptions.

Furthermore, in order for the tax authorities to safeguard the bona fide nature of the reorganization, they may impose conditions in relation to the number of shares to be issued by the receiving company as well as request that the shares issued in the course of reorganization be kept by the receiving company for a maximum period of 3 years. It will become effective as of 1 January 2015.

7*. Limitation of losses carried forward on IP activities

According to the IP box regime introduced in 2012, an 80% deemed deduction is available on the net profit generated from the business use or disposal of a qualifying IP asset.

However, the law did not explicitly include a corresponding limitation in case the IP activities were loss making for tax purposes.

From now on, this provision is fine-tuned to state that only 20% of the resulting loss will be allowed, a provision that will be effective as of 1 January 2015.

Amendments for Individuals

1*. The **personal tax exemption** for high earners which is already available (since 1 January 2012) is now granted for 10 years instead of 5 years.

Individuals taking up tax residency in Cyprus and earning over €100.000 annually employment income, enjoy 50% exemption from personal income tax. Certain conditions apply to be eligible for this exemption.

The 50% exemption will not be available to individuals that were Cyprus tax residents for a period of 3 out of 5 years preceding the year of employment.

Further, the exemption will not be available to individuals that were Cyprus tax residents in the year preceding the year of commencing their employment.

The income tax law also provides for a 20% exemption for remuneration from employment in Cyprus subject to a maximum exemption of €8.500. This exemption applies for a period of 3 years starting from the tax year following the commencement of employment. For employments which commenced during or after 2012, the 3 year period is extended to 5 years and the last year for which it will be available is 2020. The bill provides those eligible for the 50% exemption cannot claim the 20% exemption.

This amendment to the legislation is expected to encourage the relocation to Cyprus of senior management to enhance business substance of Cyprus operations. It will become effective as of 1 January 2015.

2. Payment of **special contribution for defence (SCD)** on Income for **non-domiciled individuals** is abolished.

Defence tax is payable on dividends, interest and rental income.

Individuals who are considered to be “non-domiciled” in Cyprus (subject to criteria defined in the legislation), would be exempt from payment of SCD tax on dividends, interest and rental income (whether actual or deemed), regardless of whether such income is derived from sources within Cyprus and regardless of whether such income is remitted to a bank account or economically used in Cyprus, even if they are tax residents of Cyprus. Several anti-abuse provisions are also included in the legislation to eliminate cases of tax avoidance.

The term “domiciled in Cyprus” is defined in the law as an individual who has a domicile of origin in accordance with the Wills and Succession Law.

An individual can be considered as domiciled in Cyprus either (i) by domicile of origin or (ii) by domicile of choice, as defined by the Wills and Succession Law of Cyprus.

An individual who has domicile of origin in Cyprus can still be considered not to be “domiciled” in Cyprus for this purpose under certain conditions.

Notwithstanding the above, an individual who has been a tax resident of Cyprus for at least 17 out of the last 20 years prior to the tax year will be deemed to be “domiciled in Cyprus” and as such be subject to SDC regardless of his/her domicile of origin.

The rules regarding non-domiciled individuals are effective starting as of 16 July 2015, and are expected to encourage the relocation to Cyprus of high net worth individuals.

General Tax Amendments

1*. Broadening of the **definition of ‘Republic of Cyprus’** in the Income Tax legislation to include all activities carried out within the Exclusive Economic Zone (“EEZ”) of Cyprus.

2*. **Extending the accelerated annual capital allowances** for fixed asset expenditure (plant and machinery 20% and industrial and hotel buildings 7%) which have already been in place for tax years 2012-2014, are now extended to years 2015 and 2016.

3*. **Anti-avoidance provisions for postponement of deemed dividend distribution arising** from artificial structures (arrangements with no real trading or economic substance).

4*. Giving the statutory right to the tax authorities to impose an **administrative fee for the issuance of tax rulings**.

5*. **Local authorities will no longer be exempted from taxation of rental income**, as it creates an unfair advantage against other entities which are operating in the same industry

Changes Related to Immovable Property

1. Capital gains tax

- (a) Capital gains from sale of shares in property companies

Currently, Capital Gains Tax is charged on disposal of immovable property located in Cyprus or on disposal of shares of companies, which own immovable property located in Cyprus. Under the proposed legislation, gains from the sale of shares in companies which indirectly own immovable property in Cyprus by holding shares in a company, which own immovable property located in Cyprus will also be subject to capital gains tax. This will apply only in case the value of the immovable property represents more than 50% of the value of the company whose shares are sold.

- (b) Exemption from capital gains tax related to properties acquired until 31 December 2016. With this proposed amendment any gains on disposal of properties acquired between the date on which the provision comes in to effect and 31 December 2016, will be completely exempt from capital gains tax.

2*. Immovable property tax law

- (a) Abolition of the immovable property levy payable to municipalities.

The municipality and community levy payable to the municipalities will be abolished.

- (b) Immovable property tax law. A new Immovable property tax law will be introduced which provides for the imposition of tax based on a single tax rate of 1‰ on the value of the property based on the latest general valuation by the Department of Lands and Surveys (currently that of 31 December 2013).

3. Land registry fees

- (a) For transfers of immovable property to be effected until 31 December 2016 the transfer fees will be reduced by 50%
- (b) No land transfer fees will be paid on transfer of immovable property from parents to children

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