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Recent amendments to the Cyprus Tax System

A number of significant amending bills to the tax laws of the Cypriot Tax system have been voted by the House of Representatives on 9 July 2015 which were published in the Official Gazette of the Republic on 16 July 2015. Furthermore, additional changes are expected to be reviewed and voted by the House of Representatives after the summer vacation in September.

The changes introduced give incentives for new equity capital and promote economic activities but at the same time sustaining the tax revenues. In addition, the changes are aimed at harmonizing Cyprus Tax Laws with the new provisions of the EU Parent-Subsidiary Directive.

At this stage the draft laws have still to be considered and voted on by the government, and there may be significant amendments during the course of the legislative process.

The content of this article is intended to provide a general guide to the most important changes. Specialist advice should be sought about your specific circumstances.

[I] Notional interest deduction of equity

As from 1 January 2015, the Government has introduced the Notional Interest Deduction (NID) regime on equity.

Companies and permanent establishments of foreign companies are entitled to NID on new equity capital. The NID will equal the multiple of "reference interest rate" and the "new equity".

The definitions of the aforementioned terms under Cyprus law are:

- **"Reference interest rate"** : The interest rate of the 10 year government bond of the country in which the new equity is invested, plus 3%, having as a lower limit the 10 year government bond yield of the Republic of Cyprus plus 3%. The bond yield is the one applicable as of 31 December of the tax year preceding the relevant tax year.
- **New equity"**: Any equity introduced in the business after 1 January 2015 in the form of both share capital and share premium, provided it is fully paid and used for the operations of the company. New equity does not include amounts that have been capitalized and which are the results of a revaluation of movable or immovable property.

In cases where the New Equity is contributed in the form of asset in kind, the amount of equity used for the purposes of calculating NID will be limited to the market value of the assets as at the date of their contribution into the business.

The NID will be limited to 80% of the taxable profit before deducting the NID, and no NID will be allowed in the event of losses.

In addition, there are several anti-abuse measures in order to:

- Ensure that the NID is calculated only on New Equity as defined above.
- Challenge arrangements that directly or indirectly aim at re-characterize "old equity" into "New equity" or arrangements which aim at claiming NID without any

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effective economic or commercial reasons.

- Restrict NID in cases where another company (Cyprus tax resident or not) has claimed a NID or an interest expense deduction on the same equity.
- The NID is considered as interest expense and therefore subject to the same limitations as interest (i.e. when New Equity is invested in non-business assets).

The introduction of the NID is intended to level the tax treatment between equity and debt finance, as both will be eligible for tax deductions.

[II] Introduction of non-domiciled regime

The Special Defense Contribution (SDC) Law is amended so that an individual will be subject to SDC only if he or she is a tax resident and domiciled in Cyprus.

Therefore, following the introduction of “non-domicile” rule, Cyprus tax residents who are not domiciled in Cyprus will effectively not be subject to SDC in Cyprus on any dividends, interest and rental income.

An individual is considered to be domiciled in Cyprus if he or she has a domicile of origin unless an individual has:

- Obtained and maintained domicile of choice outside Cyprus, given that such an individual has not been a tax resident of Cyprus for a period of 20 consecutive years preceding the tax year, or
- Not been a tax resident of Cyprus for a period of 20 consecutive years prior to the introduction of the law.

An individual who has been a tax resident of Cyprus for at least 17 years out of the last 20 years preceding the tax year will be considered to be domiciled in Cyprus.

It is expected that the non-domiciled rules will further encourage the relocation of high-net-worth individuals to become tax residents in Cyprus.

The above rules are effective as of 16 July 2015 which is the date they were published in the Official Gazette of the Republic.

[III] Capital Gains Tax (CGT) Law changes

Currently, CGT is imposed only on gains derived from the disposal of immovable property situated in Cyprus as well as the disposal of shares held in companies which own immovable property in Cyprus.

Any property acquired from the date the amending law comes into force (16 July 2015) until 31 December 2016, will be exempted from capital gains tax from a future disposal.

Reduction of transfer fees on real estate transactions

Transfer fees are reduced by 50% for transfers of immovable property until 31 December 2016.

Other Proposed Amendments

Below are several additional changes that are expected to be voted in September. These amendments will be enacted into law once they are published in the Official Gazette of the Republic.

A. Tax neutrality of foreign exchange gains and losses

Foreign exchange differences, either gains or losses, irrespective of whether they are realized or unrealized will be disregarded for tax purposes. These new provisions do not apply to gains or losses arising from trading in foreign currencies or foreign currency derivatives. Companies trading in foreign currencies or foreign currency derivatives may elect to be taxed on the basis of realised profits or losses and any unrealized foreign exchange differences will be treated as taxable in the year they are realized.

B. Limitation of losses carried forward on Intellectual Property (IP) activities

Cyprus's IP regime, which was introduced in 2012, allows for an 80% deemed deduction from the net profit generated by the use or disposal of qualifying IP assets. The law did not specify if the provision of the 80% deemed deduction applied when a company had taxable losses. With the proposed amendment only 20% of the resulting taxable loss will be carried forward.

This provision will be effective as of 1 January 2015.



C. Group loss relief - Alignment with European Court of Justice (ECJ)

Under the current provisions of Cyprus law, the group relief provisions are applicable only between Cyprus Tax Resident Companies. From now on, group relief will be available between companies resident in Cyprus and companies resident in other EU member states.

This will however only apply provided the surrendering company has exhausted all possibilities of surrendering the available tax losses in its respective country of residence or in the country where its immediate holding company resides.

The above amended group loss relief provisions will be effective as of 1 January 2015.

D. Extension of accelerated capital allowances

The accelerated depreciation provisions on plant and machinery (20% as opposed to 10%) and industrial and hotel buildings (7% as opposed to 4%) will be extended until 31 December 2016.

E. Extension of income tax exemption for new individual taxpayers

As of 1 January 2012 individuals taking up residence and employment in Cyprus with income from employment of more than €100,000 per annum are entitled to a 50% deduction from personal income tax for the first five years of employment. This period will be extended from five years to ten years.

This plan is available to individuals who were not Cyprus tax residents for any three out of the last five years prior to the commencement of their employment in Cyprus.

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