

AMENDMENTS TO THE CYPRUS TAX LAW

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Moore Stephens (Limassol) Limited

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Introduction

On 9 July 2015, the House of Representatives enacted into laws a number of significant tax law proposals, in an effort to modernize the framework of the Cyprus tax system and improve Cyprus' competitiveness in attracting foreign investments. These laws have been published in the Cyprus Government Gazette on 16 July 2015 and are the followings:

1. Law amending the Income Tax Laws (A) – Introduction of notional interest deduction on equity.
2. Law amending the Income Tax Laws (B) – Taxation of widow's pension.
3. Law amending the Special Contribution for the Defence Laws (A) – Introduction of "domicile" concept.
4. Law amending the Special Contribution for the Defence Laws (B) – Interposition of company and taxation of dividends.
5. Law amending the Capital Gains Tax Laws – Exemption from Capital Gains Tax on immovable property acquired until 31 December 2016.
6. Law amending the Department of Lands and Surveys (Levy and Duties) Law.

1) Law amending the Income Tax Law (A) – Introduction of Notional Interest Deduction (NID) on equity

Company resident in Cyprus or company not resident in Cyprus which maintains a permanent establishment in Cyprus, is entitled to a NID on equity, which is effectively a tax allowable deduction against the taxable profits of the company.

The NID is calculated by multiplying the "**Reference Interest Rate**" with the "**New Equity**" held and used by the business in the carrying on of its activities.

For the purpose of the Law:

- "**Reference Interest Rate**" means the interest rate of the 10 year government bond yield of the country, in which the new equity is invested, plus a 3% premium, having as a minimum rate the 10 year Cyprus government bond yield as at 31 December of the tax year preceding the relevant tax year, plus a 3% premium.
- "**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, provided that these are fully paid. "New Equity" does not include amounts that have been capitalised as equity and which are the result of a revaluation of movable or immovable property.
It is provided that any new equity that has been introduced in a company on or after 1 January 2015 which directly or indirectly emanates from reserves existing as at 31 December 2014 but does not relate to the financing of new assets used in the business, is not deemed as new equity.

The NID granted on new equity cannot exceed 80% of the taxable profit before allowing the NID. It is provided that in the case of a loss such deduction is not granted. Effectively, this means that the NID cannot create or increase a tax loss.

Taxpayer can elect not to claim the NID or claim part of it. Such election can be made every tax year.

Any amount of NID which has been restricted due to the cap of 80% of taxable profit, or due to a taxpayer's election, is not available to be utilised by way of carry forward to future tax years.

Anti-abuse measures

The Law includes both specific and general anti-abuse measures:

- To avoid duplication of the NID, the deduction will be available only to one company in cases where the new equity of a company is derived directly or indirectly from the new equity of another.

- In the case where the new equity emanates directly or indirectly from loans on which interest expense deduction is claimed, the NID on the new equity is reduced by the amount of the interest expense deduction claimed.
- New equity may be contributed in cash or in assets in kind. In the case of assets in kind, the amount of new equity for the purposes of NID may not exceed the market value of the assets at the date of their introduction into the business, and their market value must be substantiated.
- Companies obtaining benefit from the reorganization provisions of the tax law, will have their new equity calculated as if the reorganization had not taken place.
- The Commissioner may not grant the NID, if in his judgement, actions or transactions have taken place without substantial economic or commercial purpose, or the new equity on which the NID is claimed emanates from equity that existed prior to 1 January 2015 and is presented as new equity through actions or transactions with related parties, with the aim of claiming NID.

Effective date

The above provisions are effective as from 1 January 2015.

Our comments

- ❖ Introduction of new equity is encouraged
- ❖ Boosting economic robustness of Cyprus companies through less reliance on debt financing whilst keeping their competitiveness
- ❖ Promoting the development of Cyprus economy

2) Law amending the Income Tax Law (B) – Taxation of widow's pension

In accordance with the previous tax law, income from widow's pension which exceeds the relevant amount of taxable income (€19,500) is subject to taxation at 20%. This income is not added to any other income (special mode of taxation).

Based on the current amendment, the taxpayer has the right to choose to be taxed either under the special mode of taxation as stated above or at normal rates. If the latter is chosen the pension is added to the individual's other income (including all allowable deductions).

Effective date

The above provisions are effective as from the tax year 2014.

Our comments

- ❖ The option to be taxed under general rules could potentially reduce the tax cost of individuals

3) Law amending the Special Contribution for the Defence (SDC) Laws (A) – Introduction of "domicile" concept

Prior to this amendment, Cyprus tax resident individuals earning Cyprus or foreign sourced income, in the form of dividends, rental income and 'passive' interest income, were subject to SDC at the following rates, irrespective of their domicile status:

- 17% on dividends
- 3% on rental income
- 30% on interest

With this amendment, individuals who are non-Cyprus domiciled are no longer subject to SDC.

(A) For the purpose of the SDC amended law, an individual has a “domicile in the Republic” if he/she has a **domicile of origin** in Cyprus based on the provisions of the Wills and Succession Law (WSL) (i.e. domicile of the father at the time of birth), except for:

- i. An individual who has acquired and maintains a domicile of choice outside Cyprus based on the provisions of WSL (i.e. factual concept – an individual permanently lives and intends to live in another country), provided that he/she has not been resident in Cyprus as defined in the Income Tax Law, for **any** period of at least 20 **consecutive** years **prior to the relevant tax year**, or
- ii. An individual who has not been resident in Cyprus as defined in the Income Tax Law, for **a** period of at least 20 **consecutive** years **immediately prior to the entry into force of the provisions of this Law**.

(B) Regardless of the **domicile of origin**, of part (A) above, any individual who is resident in Cyprus, as defined in the Income Tax Law, for at least 17 out of the last 20 years prior to the relevant tax year, will be deemed domiciled in Cyprus for the purpose of this Law.

Anti-abuse measures

The amended Law introduces anti-abuse measures which provide that, in the case where any person domiciled in Cyprus, transfers assets to a relative up to third degree kindred, who is not domiciled in Cyprus, and in the Commissioner’s judgement the main purpose of the transfer was to avoid paying SDC, the income arising from these assets is subject to SDC, which may be collected either from the person who transferred the assets, or from the person to whom the assets were transferred.

Effective date

The above provisions have come into effect on 16 July 2015, which is the date they were published in the Cyprus Government Gazette.

Our comments

- ❖ Cyprus tax resident individuals who are not domiciled in Cyprus are exempt from SDC on dividend, interest and rental income
- ❖ The holding of investments in dividend/interest earning assets e.g. shares, bonds by non-Cyprus domiciled individuals becomes more attractive
- ❖ Effort to attract expatriates and high net worth individuals to reside in Cyprus

4) Law amending the Special Contribution for the Defence (SDC) Laws (B) – Interposition of company and taxation of dividends

In accordance with the tax amendment point (3) above, only individuals who are **both** Cyprus tax residents **and** Cyprus domiciled will be subject to SDC.

In case where actual dividend is received by a company which is owned indirectly by Cyprus tax resident and domiciled individual(s), and the Commissioner considers that the interposition of this company as a shareholder of the company paying the dividend does not serve any substantial, commercial or economic purpose but is primarily intended to prevent, reduce or postpone the payment of SDC, the Commissioner may deem that:

- the dividend is paid directly to the Cyprus tax resident and domiciled individual(s) who directly/indirectly control the company receiving the dividend, and
- require the payment of the SDC on the dividend either from the company receiving the dividend or from the Cyprus tax resident individual(s) who directly/indirectly control the company.

Effective date

The above provisions have come into effect on 16 July 2015, which is the date they were published in the Cyprus Government Gazette.

Our comments

- ❖ The anti-avoidance measure has been introduced to guard against possible abuse of the deemed dividend distribution provisions by Cyprus resident and domiciled individuals
- ❖ It does not affect companies owned directly or indirectly by non-resident or non-domiciled shareholders

5) Law amending the Capital Gains Tax Laws – Exemption from Capital Gains Tax (CGT) on immovable property acquired until 31 December 2016

Gains from the disposal of immovable property consisting of land or land and buildings are exempt from CGT, provided that:

- It is acquired from the date the amended law comes into effect, i.e. 16 July 2015, until 31 December 2016.
- It is acquired through purchase or purchase agreement, and not through an exchange or donation, at market value from a non-related party.

This exemption does not apply to disposals of immovable property that has been acquired under foreclosure procedures based on the new foreclosure law.

Effective date

The above provisions have come into effect on 16 July 2015, which is the date they were published in the Cyprus Government Gazette.

Our comments

- ❖ This amendment aims to enhance the investment in the Cyprus real estate market
- ❖ It does not apply to the disposal of share in companies that own immovable property

6) Law amending the Department of Lands and Surveys (Levy and Duties) Law

Reduction in immovable property transfer fees & lease/sublease registration fees

As per the amended law, for any transfer of immovable property as well as the registration of any lease/sublease until 31 December 2016, a 50% reduction in immovable property transfer fees and lease/sublease registration fees is provided.

The 50% reduction in transfer fees will not apply in case the transfer involves immovable property acquired under the foreclosure procedures based on the new foreclosure law.

Abolition of levy refunds

The amended law has abolished the provisions by which the Commissioner refunded after 5 years from the day of transfer the amount of levy imposed and collected:

- On transfers of immovable property from a partnership to a company having as sole shareholders the partners of the assignor partnership.
- On transfers of immovable property to a (family) company by an individual shareholder of the company or his/her close relatives (i.e. spouse or relatives up to third degree kindred).

Abolition of special levies on transfers from a company to relatives of the shareholders

According to the amendment of the law, the special levies imposed on transfers of immovable property from a company to relatives of up to third degree of kindred of the shareholders are abolished and such transfers are now subject to the normal rates of levy on the values of the immovable property.

Effective date

The above provisions have come into effect on 16 July 2015, which is the date they were published in the Cyprus Government Gazette.

Our comments

- ❖ This amendment aims to enhance investment in the Cyprus real estate market
- ❖ It provides incentive for issuing title deeds
- ❖ The exemption on the transfer of property subject to VAT continues to apply and is not affected by the above exemption

Moore Stephens (Limassol) Limited

196, Arch. Makarios Ave., Ariel Corner,
1st floor, Office 102, 3030 Limassol, Cyprus
<http://limassol.moorestephens.com>

Contacts:

For additional information, please contact:

Christos Christodoulou
Tel: +357 25 820280
Email: c.christodoulou@moorestephens.com.cy

Lakis Savvides
Tel: +357 25 820280
Email: l.savvides@moorestephens.com.cy

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