9 July 2015 – Tax News

CHANGES TO THE TAX LEGISLATION OF CYPRUS

In an effort to accelerate growth and attract foreign investment on 9th of July 2015, the House of Representatives voted a number of amendments to the Income Tax Law, the Defence Tax Law, Capital Gains Tax Law as well as to the legislation regarding the transfer fees. The changes proposed are very positive for the international investors who do business through Cyprus and create a new dynamic for the island.

A. INCOME TAX LAW

1. Extension of Personal Income Tax Exemptions for Non-Cyprus Tax Resident Individuals Starting Employment in Cyprus

a. Exemption of 20% of the income from employment in Cyprus for the first three years of employment as applicable under the current Law (with a maximum exemption amount of €8,550 per year) is now extended to the first five years but the exemption will only be able to be claimed until the year 2020.

b. Exemption of 50% of the income from employment commenced in Cyprus after 1 January 2012 for individuals earning more than €100,000 per year, is 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 and also was not tax resident of Cyprus the previous tax year.

2. Introduction of Notional Interest Deduction (NID)

a. The main change in the Income Tax Law is the introduction of the Notional Interest Deduction (NID) on the company's equity. As from 1 January 2015, companies will be entitled to a notional interest payable deduction on the new capital introduced into the company. The NID can be set against any income generated by the company during the specific tax year.

b. The interest will be calculated on any new capital (share capital or share premium), meaning funds introduced into the share capital of the company after 1 January 2015 and which have actually been paid and used for the operations of the company.

c. The NID will equal the multiple of the "Reference interest rate" and the "new equity" as defined below:

d. "Reference interest rate" is defined as the 10 year government bond yield of the country in which the new equity is invested increased by 3% having however, as a lower limit the 10 year government bond yield of the Republic of Cyprus increased by 3%. The rate used will be the rate as at 31 December of the previous tax year, i.e. for the 2015 tax statements the 31 December 2014 rate will be used.

e. It is important to note that the NID granted on new equity cannot exceed 80% of the company's taxable profits. In addition the NID cannot create tax losses and it cannot be brought forward to be set off against future profits. Effectively, this means that the NID cannot create or increase a tax loss.

f. "New Equity" is defined as any equity introduced in the business on or after 1st January 2015 in the form of issued share capital and share premium (provided it is fully paid either in cash or in kind). New equity does not include amounts that have been capitalised and which are the result of a revaluation of movable or immovable property. Further there are several anti-abuse provisions in order to ensure that the NID is only calculated on New Equity introduce to the company after 1st of January 2015.

3. Increased Capital Allowances for Capital Expenditure

a. Under the current provisions of the law there is an increased capital expenditure allowance for new expenditure on plant and machinery and industrial buildings and hotels for the years 2012, 2013 and 2014.

b. The amended law will continue to offer increased capital allowances for the year 2015 and 2016. The rates for plant and machinery will be 20% instead of 10% and for machinery and industrial buildings will be 7% instead of 4%.

4. Exchange Differences

a. Exchange differences, either gains or losses, and irrespective of whether they are realized or unrealized will no longer be taxable/tax deductible.

b. This will apply irrespective of the purpose for which the funds in foreign currency were used except in the case of companies trading in foreign currencies and related products. Such companies will be able to irrevocably elect to be taxed on a realised basis and that any unrealised FX difference will be taxed in the year they become realised.

5. Group Loss Relief

a. Under the current provisions of the Law, group loss relief could be claimed for losses incurred by one Cyprus Company to another Cyprus company of the same group provided they are both Cyprus tax residents.

b. In an effort to align the Cypriot Tax Laws with related European Court of Justice’s decision, the Law is amended so that group loss relief is extended to include qualifying group subsidiary companies that are also tax residents in any EU member state. However, this will only apply provided the group subsidiary company has exhausted all the means available for using the available tax loss in its respective country of residence or in the country where its immediate holding company resides.

6. Limitation of loss carried forward on IP activities

a. The Cyprus IP tax Regime provides that 80% of royalty profit (royalty income less related expenses) will be regarded as deemed expense. Therefore only 20% of royalty profit will be taxed at 12.5% corporation tax setting the maximum effective tax rate to 2.5%. The law did not specify if the provision of 80% deemed deduction applied when a company had taxable losses. With the proposed law as of 1st of January 2015 only 20% of taxable losses will be carried forward.

B. DEFENCE TAX LAW

1. Introducing of "Non Domicile" Provisions for Individuals

a. The Cyprus Government's objective is to provide incentives to High Net Worth Individuals (HNWI) to relocate to Cyprus. By attracting such individuals Cyprus will be enhancing its position as an international business centre with significant positive effects on its economy.

b. Up to now, income of passive nature such as Dividends, Rents and Interest received by Cyprus tax resident individuals was heavily taxed under the Special Contribution for the Defence Law (SDC). This was of course a major disincentive for HNWI to become Cyprus tax residents since their worldwide passive income (and especially dividends) would suffer a heavy taxation in Cyprus.

c. The solution came through the introduction of the "Resident but not Domicile" tax status. Under the new law, tax resident individuals that are non-Cyprus domicile will be exempt completely from SDC irrespective of where the income is generated or remitted. Only domiciled Cyprus tax residents will be subject to Special Defence Contribution which includes the 17% SDC on dividends received and 30% on interest received as passive income.

d. So in order for the SDC to apply on a person he has to be more than 183 days in a calendar year in Cyprus and also have a Cyprus domicile.

e. The term "Domiciled in Cyprus" is defined as an individual who has a Domicile of Origin in Cyprus, if he has his regular place of abode in Cyprus as per the Wills and Succession Law except where :

1. An individual who has obtained and maintains a Domicile of Choice outside Cyprus in accordance with the Wills and Succession Law, provided that the individual was not a Cyprus tax resident for a period of 20 consecutive years preceding the tax year under examination.

2. An individual who has not been a Cyprus tax resident for a period of at least 20 consecutive years before the commencement of the law.

3. In addition, individuals who are considered as Cyprus tax residents as defined by the Income Tax Law for at least 17 years from the last 20 years before the year of assessment are considered as "Domiciled in Cyprus" for SDC purposes and will therefore be subject to the relevant taxation if and when this condition will be met.

C. CAPITAL GAINS TAX

1. Tax Incentives for Capital Gains Tax

a. In an effort to boost the suffering construction business the Government has introduced some tax incentives in relation to immovable property.

b. For Capital Gains Tax, the new law provides that Any property acquired during the period between the date the new Law comes into effect and 31 December 2016, will be exempted from capital gains tax from a subsequent disposal. However, the amendment of the Law does not include any property that will be acquired as a result of sale of property in settlement of a debt.

c. In addition, except in some specific circumstances, the land transfer fees will be reduced by 50% for the transfers that are taking place up until 31st December 2016.