

Tax law amendments aiming at enhancing Cyprus' tax competitiveness – Other amendments

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In brief

Further to our newsletter N-4-2015, the House of Representatives has voted on 10 December 2015 on additional proposals aiming at enhancing the competitiveness of the Cypriot economy and also the modernization of the Cyprus tax framework. The main amendments which were voted are analysed in our Newsletter N-9-2015, December 14, 2015. The remaining amendments which are analysed in this Newsletter include:

Income Tax Law

- extension of the definition of the term «Republic» and «Permanent Establishment» so that any business activities relating to Cyprus' natural resources carried out within Cyprus's exclusive economic zone and continental shelf are subject to income tax
- taxation of income which arises from the provision of services regarding activities relating to Cyprus' natural resources carried out within Cyprus by foreign tax residents by applying a 5% withholding tax rate
- taxation of income of local authorities from rents
- clarification that 80% of losses resulting on royalties or from the sale of intellectual property, is not deductible for tax purposes
- extension of the accelerated tax depreciation available on industrial buildings and hotels (7%) and plant & machinery (20%) until the end of 2016
- the modernisation of the tax framework regarding group relief provisions
- the deduction of contributions to Pension Schemes, or Medical Schemes, provided that the schemes are approved by the Commissioner
- imposition of restrictions on company reorganisations
- the introduction of a fee via a decree for the issuance of tax rulings
- extension of the list of companies included in Appendix I

Capital Gains Tax Law

- extension of the definition of the term «Property» to include companies which directly or indirectly hold shares in a company(ies) which owns/own immovable property in Cyprus
- extension of the definition of the term «Gains» so that profits which relate to property in accordance with the provisions of the Capital Gains Tax Law and which are exempt from income tax are subject to capital gains tax
- determination of the base cost in cases of plot separation
- rebasing of cost for capital gains purposes in cases of prior disposal
- application of arm's length principles on disposals between related parties

Assessment and Collection of Taxes Law

- clarification on refund of provisional tax

The amendments aim to harmonise the tax framework with European directives, to make it even more fair, simple and more competitive, and is expected that they will positively contribute to the local economy.

***In detail
Legislations which
have been voted***

Income Tax Law

***Definition of the term
«Republic»***

The definition is extended to include explicitly amongst others the exclusive economic zone (EEZ) of Cyprus and its continental shelf and any constructions or plants located in these zones.

The amendment is effective from 1 January 2015.

***Definition of the term
«Permanent
Establishment»***

The definition is extended to include activities relating to the extraction, exploration and use of Cyprus' continental shelf, of the subsoil or the natural resources, and also the construction and exploitation of pipelines and other constructions in the bottom of the sea of Cyprus. The profits from such activities will be subject to taxation at the rate of 12,5%.

The amendment will be effective from 1 January 2015.

PwC Observation

By extending the definition it is clarified that any business activities relating to Cyprus' natural resources carried out within the above zones will be subject to income tax.

***Taxation of income
originating from the
provision of services
regarding activities
relating to natural
resources***

Income earned by persons who are not Cyprus tax residents and do not have a permanent

establishment in Cyprus, from services which are carried out in Cyprus in relation to the extraction, exploration or use of the continental shelf, as well as the establishment and use of pipelines and other installations on the ground, on the seabed and on the surface of the sea, is subject to taxation at the rate of five per cent (5%) which is withheld in the case of direct or indirect payment by a Cyprus tax resident.

The amendment will be effective from 1 January 2016.

PwC Observation

The amendment specifies the tax rate of any business activity carried out by persons which are not Cyprus tax residents and do not have a permanent establishment in Cyprus in relation to natural resources within Cyprus.

***Income of local
authorities subject to
taxation***

In accordance with the respective amendment, the income of local authorities from the leasing of property is subject to income tax.

The above amendment is effective from 1 January 2015.

PwC Observation

Following the amendment, the local authorities will be subject to taxation on business income and income from the leasing of immovable property.

***Intellectual Property (IP)
Regime***

Currently only 20% of profits from leasing or sale of intellectual property owned by Cyprus tax resident companies (after the deduction of expenses) are subject to income tax.

With this proposal, it is clarified that in the case of a loss (after the deduction of expenses), 80% of this loss will not be tax deductible.

When the company claims notional interest deduction (NID) on new capital introduced based on the new enacted article 9B or claims a deemed deduction based on the revised article 33 (related party transactions), both these deductions will be considered as an expense and consequently 80% will be non-deductible.

The above amendments will be effective from 1 January 2012.

PwC Observation

The IP regime is becoming more attractive since NID and other deemed deductions can be included in the calculation of the taxable profit/loss.

***Extension of the
accelerated tax
depreciation available on
industrial buildings,
hotels and plant &
machinery acquired until
the end of 2016***

Plant and machinery purchased in 2012-2014 benefited from 20% per annum tax depreciation. Industrial buildings and hotels purchased in 2012-2014 benefited from 7% per annum tax depreciation.

The amendment extends the period for which accelerated depreciation is available to purchases made in 2015-2016.

The above amendments are effective from 1 January 2015.

PwC Observation

The amendment is aimed to encourage business investment in qualifying fixed assets.

Group relief provisions

In order to harmonise and align the tax framework with European Court of Justice decisions, a Cyprus tax resident company can include in the calculation of its taxable profits, tax losses (as computed under Cyprus tax law) of a company which is a tax resident of another EU country as long as both companies are part of the same group according to Cyprus group relief provisions.

As per the amendment, the surrendering EU company must first exhaust all possibilities available to utilise the losses in its country of residence or in the country of any intermediary EU holding company.

In addition, in order to establish whether two Cyprus tax resident companies are part of the same tax group, the interposition of a non-Cyprus tax resident company will **not** affect the eligibility for group relief as long as the interposed non-Cyprus tax resident company is tax resident:

- (a) in a EU country or
- (b) in any other country with which Cyprus has signed a Double Tax Treaty or an Exchange of Information Agreement

The amendment is effective from 1 January 2015.

PwC Observation

The above amendment will increase the scope for application of group relief in Cyprus.

Deduction for premiums or contributions to insurance companies for Pension Schemes, or Medical Schemes

In accordance with the current legislation, a deduction from a person's taxable income for premiums or other contributions to insurance companies for Pension Schemes, or Medical Schemes, is granted provided that the Schemes have been approved in accordance with Regulations.

Based on the amendment, a deduction will be granted provided that the Schemes are approved by the Commissioner of Taxation.

The above-mentioned amendment is effective from 1 January 2015.

PwC Observation

Following the amendment, more clarity is expected in relation to approved schemes.

Imposition of restrictions on company reorganisations

In accordance with the amendment, the Commissioner of Taxation has the right to deny the exemption of profits generated as a result of reorganisations if he considers that the main reason or one of the main reasons of such reorganisation is the avoidance, reduction or suspension of the payment of tax and has the right to request for any documentation he deems necessary for the establishment of the aim of the reorganisation.

Such decision may be subject to objection and appeal in accordance with the Assessment and Collection of Taxes Law.

In the case where such exemption is granted, the Commissioner of Taxation may set terms:

- (a) in relation to the number of shares to be issued within the scope of the reorganisation and
- (b) the period for which the shares issued within the scope of the reorganisation are required to be kept by the receiver (the period of the restriction cannot exceed three years).

The shares of companies listed on a recognised stock exchange as well as the transfer of shares due to hereditary succession are excluded from the period of mandatory possession.

In the case where the above two terms are not met, the tax which was originally not imposed is considered as immediately due.

The above amendments will be effective from 1 January 2016.

PwC Observation

The potential abuse of the provisions of the law is addressed.

Issuance of tax rulings

In accordance with the amendment, the Cabinet of Ministers is entitled to impose a fee for the issuance of a tax ruling by way of a relative decree.

PwC Observation

It is expected that this measure will expedite the issuance of rulings by the Tax Authorities.

Extension of the list of companies included in Appendix I

The list is extended to include the below companies for which the European Council Directives apply:

- Poland

Companies which have been established as per Polish law as "spolka komandytowo-

акcyjna” (The above amendment is effective from 1 January 2016)

- Bulgaria

Companies which have been established as per Bulgarian Law, as “събирателното дружество”, “командитното дружество”, “дружеството с ограничена отговорност”, “акционерното дружество”, “командитното дружество с акции”, “неперсонифицирано дружество”, “кооперации”, “кооперативни съюзи” “държавни предприятия” and are of a commercial nature. (The above amendment is effective from 1 January 2007)

- Romania

Companies which have been established as per Romanian Law as “societăți pe acțiuni”, “societăți în comandită pe acțiuni”, “societăți cu răspundere limitată”, societate în comandita simpla”, “societate în nume colectiv”. (The above amendment is effective from 1 January 2016)

PwC Observation

Inter alia this amendment means that participation in these companies qualifies for the “titles” exemption, i.e. there will be no tax in Cyprus upon disposal (unless the companies hold Cyprus located immovable property).

Capital Gains Tax Law

Extension of definition of “property” so that companies which are direct or indirect shareholders of company/ies owning Cyprus immovable property are subject to tax

The definition of the term is extended to include shares in companies which are direct or indirect shareholders in companies that own Cyprus immovable property and at least fifty percent (50%) of the market value of the shares in question derive their value from the market value of the Cyprus immovable property.

In computing the above percentage any balance sheet liabilities of the company owning the Cyprus immovable property are not taken into account.

The above amendment will be effective from the date of its publication in the Cyprus Government Gazette.

PwC Observation

Any gains accrued from the disposal of shares in companies that indirectly own Cyprus immovable property, by holding shares in companies that either directly or indirectly hold the immovable property in question, are now taxed in Cyprus.

Extension of definition of “gain” so that trading profit derived from property that is exempt from Income Tax is now subject to Capital Gains Tax

Gain from disposal of immovable property, falling within the definition of property of the Capital Gains Tax Law, which is exempt under the Income Tax Law will now be subject to capital gains tax.

The above amendment will be effective from the date of its publication in the Cyprus Government Gazette.

PwC Observation

Provident funds or other persons that are exempt from income tax on trading profits which are derived from property which falls within the ambit of the Capital Gain Tax Law, will now be subject to capital gains tax on such disposals.

Plots separation

Based on current law, in the case of immovable property acquired prior to 1.1.80, which was separated into plots without new titles being issued, and one of the plots is then sold, the value of the sold plot as at 1.1.80 will be deemed to be the market value allocable to the plot just prior to the separation of the immovable property, i.e. no capital gains tax is levied on the increase in value from the date of acquisition of the immovable property until the separation into individual plots.

Based on the amendment, the issuance or not of new titles following the separation into individual plots does not affect the above.

The amendment will be effective from the date of its publication in the Official Gazette of the Republic.

PwC Observation

The current incentive provided to immovable property owners for plots separation is further enhanced by this removal of the issuance of title deeds condition.

Accordingly, irrespective of whether or not title deeds are issued, taxpayers who satisfy the other conditions may benefit.

Adjustment of tax cost for capital gains tax purposes due to a previous disposal

Based on the amendment, in cases of disposal of:

- (a) immovable property that was directly or indirectly property of a company or companies during a previous share disposal, or,
- (b) shares of a company that directly or indirectly owns shares in another company/ies

where in such disposals tax was imposed and paid, the value of the immovable property which is deducted is equal to the sale value that was used for the purposes of computing the gain in the previous disposal of the immovable property in question.

The amendment will be effective from the date of its publication in the Official Gazette of the Republic.

PwC Observation

The above amendment ensures that double taxation is avoided in respect to profits that arise from a direct or indirect disposal of immovable property situated in Cyprus.

Arm's length conditions in respect of disposals involving related parties

In case of disposals between related parties, when an amount is reported as sale value that is lower than the market value of the property, the sale value will be deemed to be the market value of the property on the disposal date as set by the Commissioner.

The amendment will be effective from the date of its publication in the Official Gazette of the Republic.

PwC Observation

Modernisation of the legislation in respect of related party transactions.

Assessment and Collection of Taxes Law

Refund on overpayment of provisional tax

Clarification in respect of the refund mechanism on overpayment of provisional tax.

The above applies from 1 January 2015 onwards.

PwC Observation

Clarity in respect of the refund mechanism on overpayment of provisional tax is provided.

The takeaway

The law amendments that were voted aim to make the Cyprus tax framework even fairer and even more competitive and should ultimately contribute positively to the economy.

Let's talk

For an in-depth discussion of how these proposals might affect you or your business, please contact:

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