
Tax law amendments enhance Cyprus' corporate and personal tax competitiveness – Main amendments

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In brief

On July 16, 2015 a number of amendments to the Cyprus corporate and personal tax laws were published in the Cyprus Government Gazette. The main amendments introduced are:

- a tax allowable deduction on corporate equity by way of a notional interest deduction (NID)
- an exemption from taxation for personal investment income (dividends and interest) of non-domiciled individuals (non-doms)

The NID amendment aims to reduce corporate debt by increasing the attractiveness of equity from a tax perspective. The non-dom provisions aim to further encourage high net-worth individual investors to reside and invest in Cyprus.

The NID amendment takes effect as from January 1, 2015. The non-dom provisions take effect from July 16, 2015.

A number of other tax provisions were also published in the Gazette alongside these amendments. We will discuss these other amendments in a separate newsletter (issue N-4-2015).

In addition to the above a bill containing further tax amendments has been sent to Parliament for discussion and voting. We expect Parliament to consider these additional proposals in September, following the Summer recess. The main proposals include:

- neutral tax treatment for foreign currency exchange differences (forex) which do not relate to trading in forex
- extension of the arm's length principle to include arm's length downwards adjustments
- an extension of the period of the employment income exemption for expatriates earning over €100.000 from five to ten years

We set out in more detail below the above mentioned tax law amendments and proposals.

In detail

Enacted law amendments

Tax allowable deduction on corporate equity – Notional interest deduction (NID)

This amendment to the Income Tax Law aims to reduce corporate debt and encourage **new equity (share capital and share premium)** by introducing an annual tax allowable deduction - NID deduction - for corporate equity.

New equity introduced to a company as from January 1, 2015 in the form of paid-up share capital or share premium is eligible for the annual NID deduction.

New equity may be contributed in cash or in assets in kind. In the case of assets in kind the amount of new equity may not exceed the market value of the asset, which must be substantiated.

In a similar way that an interest expense on debt financing is generally calculated as an interest rate on loan principal, the annual NID deduction is calculated as an interest rate on the eligible share capital / premium.

The **NID interest rate** is the yield on 10 year government bonds (as at December 31 of the prior tax year) of the country where the funds are employed in the business of the company plus a 3% premium. This is subject to a minimum amount which is the yield of the 10 year Cyprus government bond (as at the same date) plus a 3% premium.

The NID is tax deductible in a similar manner as for actual interest expense. Accordingly, the NID deduction is tax deductible when new equity is used to finance most types of business assets.

The NID deduction cannot exceed 80% of the taxable profit (as calculated prior to the NID).

A taxpayer may elect not to claim part or all of the NID deduction available in any given tax year.

Any amount of NID deduction 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 or otherwise.

In order to tackle possible abuse of the NID the amendment introduces a **general anti-avoidance** provision for non-commercial transactions. The amendment also contains a number of **specific anti-avoidance** provisions which may restrict the NID, which, inter alia, include:

- New equity which emanates from reserves existing at December 31, 2014 is restricted unless the new equity is financing new business assets.
- New equity which emanates from share capital / premium existing at December 31, 2014 is restricted.
- New equity which emanates from revaluations of assets is excluded.
- Companies benefiting from the reorganisation provisions of the tax law will have their new equity calculated as if the

reorganisation had not taken place.

- To avoid duplication of the NID deduction, it will be available only to one company in cases where the new equity of a company is derived directly/indirectly from the new equity of another.
- A reduction in the NID deduction to the extent that another entity has claimed in Cyprus an interest deduction on funds if the new equity emanates directly or indirectly from such funds.

It is expected that the Cyprus tax authorities will issue a clarifying circular on the practical application of the NID.

The NID applies to Cyprus tax resident companies and to permanent establishments (PEs) in Cyprus of non-resident companies and is effective as from January 1, 2015.

PwC Observation

The aim of the amendment is to encourage new equity which in turn should increase the economic robustness of Cyprus companies through less reliance on debt financing whilst keeping their competitiveness.

Exemption from taxation for personal investment income (dividends and interest) of non-Cyprus domiciled individuals (non-doms)

Prior to this amendment Cyprus tax resident individuals earning **Cyprus or foreign sourced income** in the form of dividends or 'passive' interest were subject to Cyprus Special Defence Contribution (SDC), at the rate of 17% on dividends and 30% on interest,

irrespective of their domicile status.

With this amendment individuals who have non-dom status are no longer subject to SDC.

Coupled with the income tax exemptions existing for such income, this amendment means that non-doms are exempt from taxation in Cyprus on their dividends and 'passive' interest, irrespective of whether such incomes are earned in Cyprus or abroad.

Further for rental incomes, whether Cyprus or foreign sourced, Cyprus tax resident individuals who have non-dom status are now only subject to income tax on rental income.

For the purposes of the SDC Law an individual has his/her domicile in Cyprus if he/she is either:

- (a) an individual who has a domicile-of-origin in Cyprus, as defined in the Wills and Succession Law with the exception of:
 - (i) an individual who has acquired and maintains a domicile-of-choice outside Cyprus based on the provisions of the Wills and Succession Law and such individual was not a tax resident of Cyprus per the Income Tax Law (ITL) for any period of at least 20 consecutive years prior to the tax year of assessment; or
 - (ii) an individual who was not a resident of Cyprus per the ITL for a period of at least 20 consecutive years immediately before these amending provisions enter into force.

or,

- (b) irrespective of (a) above, an individual who is a resident of Cyprus per the ITL for a period of at least 17 years out of the last 20 years prior to the tax year of assessment.

Domicile-of-origin per the Wills and Succession Law is acquired at birth and as a rule is the same as the domicile of the father at the time of birth, and in exceptional cases of the mother. Referring to the exception in (a)(i) above, the Wills and Succession Law provides that a domicile-of-origin may be changed with a domicile-of-choice if in *actual fact* an individual 'permanently' establishes himself/herself in another country with the intention to permanently live and die there.

The amendment introduces anti-avoidance provisions which restrict its application in cases where domiciled individuals transfer assets to non-doms in order to take advantage of these provisions of the SDC law.

This amendment is effective as from July 16, 2015.

PwC Observation

In addition to the above mentioned exemptions on income, the Cyprus tax laws also provide for an unconditional exemption from tax for gains on disposals of shares/bonds issued by companies and other qualifying corporate titles (except in certain cases where the company holds immovable property in Cyprus).

Coupled with the above mentioned exemptions, this amendment to the SDC law makes Cyprus very tax efficient for the holding by non-doms of

investments in shares, bonds and other interest earning assets.

Amendments expected to be discussed and voted in September

Tax neutral treatment for foreign currency exchange differences (forex) which do not relate to trading in forex

Included within the bill are provisions for all forex to be tax neutral from a Cyprus income tax perspective (i.e. gains not taxable/losses not tax deductible) with the exception of forex arising from trading in forex, which remains taxable/deductible.

The definition of forex includes gains/losses on foreign currency rights or derivatives.

Regarding trading in forex, which remains subject to tax, this proposal introduces an option for taxpayers to make an irrevocable election whether to be taxed only upon realisation of forex rather than on an accruals/accounting basis.

This amendment is proposed to be effective as from January 1, 2015.

PwC Observation

Businesses with cross-border transactions usually incur forex. Forex is often difficult to predict, especially in the current global economic climate. The above proposal aims to simplify the income tax treatment of forex.

Extension of the arm's length principle to include arm's length downwards adjustments

The income tax law currently only provides for upwards adjustments to profits in cases

where taxable profits earned on related party transactions are below an arm's length (i.e. market value) amount. The bill proposes to amend the income tax law and introduce the possibility for a downwards adjustment in cases where expenses/losses incurred with related parties are not at arm's length.

Further, in cases where two related Cyprus taxpayers transact and the Cyprus tax authorities make an upwards arm's length adjustment to one of the taxpayers, it is proposed that there will be a corresponding downwards adjustment for the other taxpayer.

This amendment is proposed to be effective as from January 1, 2015.

PwC Observation

The above proposal aims to be fairer to businesses on their related party dealings.

Extension of the employment income exemption for expatriates earning over €100.000 from five to ten years

The income tax law currently provides for a 50% exemption from income tax for remuneration from **any employment exercised in Cyprus** by an individual who was not a resident of Cyprus before the commencement of the employment. The exemption applied for a period of 5 years, commencing in the year of taking up employment, provided that the annual remuneration exceeds €100.000.

The bill proposes that the period for which the exemption is available is increased from 5 years to 10 years.

It is also proposed that for employments commencing from January 1, 2015, there be an additional requirement that the individual was not tax resident in Cyprus for any three (or more) tax years in the five years immediately prior to the tax year of commencement of the employment, and was not a tax resident in the tax year immediately prior to the tax year of commencement of the employment.

The income tax law also currently provides for a 20% exemption from income tax for any remuneration from **any employment exercised in Cyprus** by an individual who was not a resident of Cyprus before the commencement of the employment, subject to a maximum exemption of €8.550. This 20% exemption applies for a period of three years commencing from the tax year following commencement of the employment. The bill proposes that for employments which commenced during or after 2012 the three year period is increased to five years and that the last year for which the 20% exemption will be available is 2020.

The bill additionally provides that those individuals eligible for the 50% exemption may not also claim the 20% exemption.

These amendments are proposed to be effective as from January 1, 2015.

PwC Observation

The maximum income tax rate on personal income in Cyprus is currently 35%. The above mentioned 50% exemption means that the effective income tax rate on eligible employment income for such highly paid individuals will range from around 8% to

below 17,5% depending upon personal circumstances. An extension of the exemption period would further enhance the attractiveness of this measure.

The takeaway

These enacted and proposed amendments aim to make the Cyprus tax system even fairer and even more competitive and should ultimately contribute positively to the local economy.

The enacted NID deduction together with the proposals for a neutral treatment of forex and extension of the arm's length principle should have a positive impact for business.

For individuals, the enacted and proposed amendments relate to the most common forms of personal income (i.e. employment income, dividend income and 'passive' interest income) and should encourage more high net-worth individual investors and high earning employees to reside, work and invest in Cyprus.

Let's talk

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

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