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

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In brief

Further to our newsletter N-3-2015, following a meeting held on 10 December 2015, the House of Representatives voted additional proposals which amend the tax framework in relation to individuals and companies. The main amendments introduced are:

- neutral tax treatment for foreign currency exchange differences (forex) which do not relate to trading in forex, aiming towards the complete simplification of the tax treatment.
- the recognition of expense in a company through a compensatory adjustment, in cases where in transactions between Cyprus related parties the Cyprus tax authorities increase the profits of the other related party. The amendment aims to be fairer to businesses in their related party transactions.
- an extension of the period of the 50% employment income exemption for expatriates earning over €100.000 from five to ten years enhancing the attractiveness of the existing provision.
- the harmonization of the tax framework with the European Directive 2011/96/EU (Parent-Subsidiary Directive), including two amending directives subsequently issued, in relation to the common tax regime which applies for parent and subsidiary companies of different member states which relates to the introduction of anti-hybrid and general anti-avoidance provisions with regards to the distribution of profits from a subsidiary company to its parent company within the EU.

It is expected that the above amendments will be published in the Official Gazette within the following few days completing in this manner the legislative procedure. With the exemption of the application of the provision in relation to the harmonization with the European Directive 2011/96/EU, which will be effective as from 1 January 2016, the remaining provisions will be effective from 1 January 2015.

A number of other tax provisions have also been voted alongside these amendments. We will discuss these other amendments in a separate newsletter (issue N-10-2015).

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

In detail

Enacted law amendments

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 gains/losses arising from trading in forex, which remain 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 will 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

The income tax law currently only provides for upwards adjustments to profits in cases where taxable profits earned on related party transactions are below arm's length amount.

The amendment to the income tax law introduces the possibility, in cases where two related Cyprus tax resident persons transact and the Cyprus tax authorities make an upwards arm's length adjustment to one of the taxpayers, of effecting a corresponding downwards adjustment for the other taxpayer. The corresponding provisions of the legislation will be applicable on the deductibility of such downward adjustments.

This amendment will be effective as from January 1, 2015.

PwC Observation

The above amendment aims to be fairer to businesses on their related party transactions.

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.

In accordance with the amendment, the period for which the exemption is available is increased from 5 years to 10 years.

It is also clarified that the exemption is available for any year during which the remuneration from employment in the Republic exceeds €100.000 p.a. irrespective of whether during a specific year the remuneration from employment of the individual was lower than €100.000. Such exemption is available provided that upon commencement of the employment in Cyprus, the remuneration exceeded €100.000 p.a., and that the Commissioner is satisfied that the fluctuation in the annual remuneration from the employment in Cyprus is not an arrangement that aims to benefit from the exemption.

In addition, for employments commencing from January 1, 2015, the exemption is not available if the individual was tax resident in Cyprus for any 3 (or more) tax years in the 5 years immediately prior to the tax year of commencement of the employment in Cyprus, or was 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 per year. This 20% exemption applies for a period of three years commencing from the tax year following commencement of the employment.

The amendment provides that in the cases of employments which commenced during or after 2012 the three year period is increased to five years with the last year for which the 20% exemption will be available being 2020.

The amendment additionally provides that those individuals eligible for the 50% exemption are not eligible for the 20% exemption.

These amendments are 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. The extension of the exemption period would further enhance the attractiveness of this measure.

Harmonization of the tax framework with the European Directive 2011/96/EU and related amending directives

The above-mentioned amendment is obligatory for the EU member states and involves the introduction of anti-hybrid and general anti-avoidance measures in relation to the distribution of profits from a subsidiary to a parent company within the EU.

In accordance with the anti-hybrid provision, to the extent where the profits which are distributed from a subsidiary company to its Cypriot parent company are deductible from the taxable income of the subsidiary company, Cyprus is required to tax such profits. The respective profits are subject to taxation in accordance with the provisions of the Income Tax Law and are not considered as dividends for Special Contribution for Defence purposes.

In accordance with the general anti-avoidance provisions any benefits provided by the Directive should not be granted in cases where an arrangement or a series of arrangements have been put in place with the main aim or one of the main aims being to abuse the tax advantages under the Directive.

An arrangement or a series of arrangements are considered as not being genuine to the extent where their application does not reflect economic reality.

In the cases where dividend is received from a company which is a resident of another member state and where it is considered that there is abuse, a credit will not be granted against the Cypriot tax liability, for the foreign tax which relates to the portion of the tax which was suffered on the profits of the company paying the dividend and of each sub-subsidiary from which the dividend originates.

The amendment is effective as from January 1, 2016.

PwC Observation
The above-mentioned amendment achieves the complete compliance of Cyprus with the specific Directive, including the two amending directives which were issued at a subsequent stage. In addition, the amendment contributes to the creation of a single market as defined by the EU, whereby member states may operate on equal terms, irrespective of the place of establishment.

The takeaway

The amendments aim to make the Cyprus tax system even fairer, simple, competitive and harmonized with the European Directives.

The above amendments are expected to 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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