**Notional Interest Deduction**

*The Basics*

The Notional Interest Deduction (“NID”) is a new powerful tool provided to local and international businesses which enables them to deleverage and realise a tax efficient return on new (qualifying) equity. This return is achieved through the deduction of a “notional” interest expense from their taxable income.

**Purpose and Scope**

**Why was the NID introduced in Cypriot legislation?**
- Alignment of the tax treatment of equity finance with tax treatment of debt finance. Before the introduction of the NID, remuneration for debt financing was generally tax deductible while equity financing was not.
- Promotion of capital-intensive investments in Cyprus. Through the introduction of the NID Cypriot companies can be used as financing, central procurement and factoring centres of international groups.
- As an additional support for small and medium-sized businesses.

**Who can benefit from the NID?**
Cyprus tax resident companies and the Cyprus permanent establishments of non-Cyprus tax resident companies.

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*The NID is a useful tool for enterprises seeking new options for financing their operations.

Equity financing can now be considered as a useful alternative to the debt financing norm as Cypriot companies can achieve through the NID effective tax rates of up to 2.5%.*
The NID Explained

General

A tax deduction is allowed following the application of the NID rate to the amount of New Equity injected to Cyprus companies or permanent establishments of non-Cyprus tax resident companies.

The NID is deductible in a similar manner as for actual interest expense (i.e. only if it is used to finance most types of business assets).

NID is deducted following the determination of a company's taxable profit. The deduction cannot exceed 80% of the taxable profit (as calculated prior to NID) of the Company/permanent establishment.

As the NID is a “notional” deduction there is no need for any expense being booked or any exchange of funds to take place in order for the NID to apply.

New Equity

New equity for the purposes of the NID means equity contributed as from 1 January 2015 in the form of paid up share capital or share premium. New equity can be contributed either in cash or 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. Reserves existing as at 31 December 2014 can only be considered as new equity if they are used for financing new business activities.

NID Rate

The NID rate is the yield on the 10 year government bonds (as at 31 December the year preceding the tax year the NID is claimed) 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 (defined similarly as above) plus a 3% premium.

Practical Examples

For the purposes of the below example it is assumed that New Equity amounting to EUR 1,000,000 is contributed to CyCo and that an 8% NID rate is applicable.

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\text{NID} = \text{New Equity} \times \text{NID interest Rate}
\]

<table>
<thead>
<tr>
<th></th>
<th>Not taking into consideration the NID</th>
<th>After taking into consideration the NID</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable Profit</td>
<td>100.000</td>
<td>100.000</td>
</tr>
<tr>
<td>NID</td>
<td></td>
<td>80.000</td>
</tr>
<tr>
<td>Taxable Profit</td>
<td>100.000</td>
<td>20.000</td>
</tr>
<tr>
<td>Tax</td>
<td>12,500</td>
<td>2,500</td>
</tr>
<tr>
<td>ETR</td>
<td>12.5%</td>
<td>2.5%</td>
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Advantages

- Can be applied with other incentives provided for in Cypriot legislation (e.g. intellectual property regime)
- Similar benefits to debt financing
- Companies can maintain tax benefits while increasing their financial robustness

How can PwC Help

- Tax efficient structuring of new financing structures
- Review of current structures from a financing point of view
- Identify possibilities of efficient debt restructuring

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