

# TAX update

07/15

AMENDMENTS TO THE TAX LEGISLATION  
IN CYPRUS

  
KINANIS

## A. INTRODUCTION

In an effort to accelerate growth and attract foreign investment, the Government of Cyprus proposed a major tax reform. The changes proposed are very positive for the international investors who do business through Cyprus and create a new dynamic for the island.

The major elements of the tax reform were voted to laws by the House of Representatives this month, whilst the rest of the proposed changes will be reviewed by the House after the summer vacation in September.

In this month's Tax Update we will analyse in more detail the changes introduced by the tax reform which include the introduction of Notional Interest deduction on qualifying equity, the introduction of the "Resident but not-domicile" tax status for individuals and their full exemption from Special Defence Tax Law as well as various incentives to boost the real estate sector. We will also briefly mention the proposed amendments that are expected to be voted in September.

## B. INCOME TAX LAW

### Notional Interest Deduction on Qualifying Equity

The main and extremely positive change in the Income Tax Law is the introduction of the Notional Interest Deduction (NID) on the company's equity. Under the new law it is now possible for a company to claim a notional tax 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.

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

"**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.

This gives a great flexibility to the international investors doing business through Cyprus since the new provision reflects economic realities by linking the tax benefit with the jurisdiction where the capital is really invested. Therefore an investor that utilises the capital introduced in investments in Russia for example, will be able to get a tax deduction based on the Russian 10 year government bond yield.

"**New Equity**" is defined as any equity introduced in the business on or after 1<sup>st</sup> 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 introduced to the company after 1<sup>st</sup> of January 2015.

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.

In addition, the NID is considered as interest expense and as such is subject to the same limitation rules as interest especially when the New Equity is invested in non-business assets.

We believe that this change in the Income Tax Law creates great opportunities to international investors and especially to international financing companies who due to the lack of available borrowing decide to invest by lending their own funds. Such companies will now be able to claim a notional interest deduction from their taxable income.

## **C. SPECIAL DEFENCE TAX**

### **Introducing of “non domicile” provisions for individuals**

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.

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.

The challenge was to correct this disincentive whilst maintain the above taxation for local native individuals.

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.

The term “Domiciled in Cyprus” is defined as an individual who has a Domicile of Origin, in accordance with the Wills and Succession Law, in Cyprus but it does not include:

- 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.

- 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.

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.

It is our view that this change in the Special Defence Tax Law puts Cyprus into the map of jurisdictions that are considered ideal for HNWI to reside in. If we consider that the main source of income for such type of individuals is largely generated from dividends it is clear that Cyprus has a huge advantage since dividend income is exempt from Income Tax and now (for Non-Domiciled individuals) will also be exempt from SDC. Further when we combine the tax incentive with the additional benefits that Cyprus has to offer such as the good weather, the infrastructure and its geographical location, Cyprus is certainly becoming a considerable option for relocation.

#### **D. CAPITAL GAINS TAX**

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

For Capital Gains Tax, the new law provides that there will be no Capital Gains Tax on the future sale of an immovable property situated in Cyprus that will be acquired from the date the amending law comes into force up until 31st of December 2016.

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

With the above changes, it is the belief that properties in Cyprus will become more attractive for local and foreign investors.

#### **E. OTHER AMENDMENTS IN THE PIPELINE**

It is expected that in September the Parliament will vote for additional positive changes in the Tax laws of Cyprus. A summary of the amendments in the pipeline is given below:

##### **Foreign exchange differences**

As of 1<sup>st</sup> of January 2015, any foreign exchange (FX) gains or losses will be exempt from taxation irrespective of whether they are realised or unrealised.

It should be noted that the above provisions will not apply to companies that are trading in currencies and currencies derivatives. 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.

### **Limitation of loss carried forward on IP activities**

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 1<sup>st</sup> of January 2015 only 20% of taxable losses will be carried forward.

### **Extending the available exemptions of personal income tax for those taking up residency in Cyprus**

Currently non Cyprus tax resident individuals who are taking up residency in Cyprus for work purposes, were entitled to choose one of the following two exemptions.

- 20% of employment income is exempted from personal income tax for a period of 3 years to a maximum of EURO 8,550 per year.
- 50% of employment income earned in Cyprus to be exempted from income tax for a period of 5 years provided that the employment income earned is more than EURO 100,000 per year.

The new law extends the period of the first exemption from 3 to 5 years (this exemption will be valid until 2020). For the second exemption, the years for which the 50% exemption can be obtained will be extended from 5 to 10 years.

### **Increase of annual allowances for capital expenditure**

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. 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%.

### **Group loss relief**

Under the current provisions of the Law, taxable losses of one Cyprus Company could only be surrendered to another Cyprus company of the same group provided they are both Cyprus tax residents.

The amending law will allow a Cyprus company to utilise the losses of a company in the same group which is resident in an EU member state. The only condition will be that the surrendering EU Company has exhausted all means of surrendering its tax losses in its own member state.

## **F. CONCLUSION**

With the new amendments voted almost unanimously by the House of Representative shows that there is the political ambition to support and improve the position of Cyprus as an international business centre.

We believe that the new laws represent a quick response to the ever changing global economic and fiscal conditions and trends and provide great incentives to international investors especially to those who wish to relocate and create a strong substance for their companies in Cyprus.

## **G. DISCLAIMER**

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## Our Firm

Kinanis LLC, a law and consulting firm, is one of the leading and largest business law firms in Cyprus and advises for over 30 years the international investor and private clients on all aspects of law, tax and accounting.

Kinanis LLC absorbed the business of its shareholders which are in the legal and consulting profession since 1983, with local and international dimensions.

Experience and practice over the years brought forward the need for transformation from a traditional law firm to a more innovative multidisciplinary firm providing a full range of services combining law and accounting with the extensive expertise in corporate and tax advice to ensure that our clients will obtain the best possible spherical advice adopting the principle as to the services offered “All in one place”, so that the client will find a quick, correct and efficient solution to its daily legal, accounting and tax issues in a trustworthy environment.

This combination of legal, accounting and tax services through our well qualified personnel and our involvement and participation in international transactions over the years, have established our firm as one of the key players in the field. Our involvement in international financial transactions has also provided us with the extensive expertise in representing groups, corporations, funds as well as the private client.

The firm is staffed with around 80 young, energetic and ambitious professionals, including lawyers, accountants and administrators who provide prompt, efficient and high quality services and who are capable of meeting the current demanding challenges of the local and international business environment.

We always look to give solutions in a simple and as possible quick way focusing on the needs of each client trying to anticipate the issues before becoming a problem.

## Contact Us

If you would like to receive further information or to contact us on any relevant matter, please contact the below persons at the respective divisions or departments.

### Kinanis LLC

#### Lawyers' Limited Company

12 Egypt Street, 1097, Nicosia

P.O. Box 22303, 1520 Nicosia, Cyprus

Tel: + 357 22 55 88 88 | Fax: + 357 22 66 25 00

E-mail: [KinanisLLC@kinanis.com](mailto:KinanisLLC@kinanis.com) | Web site: [www.kinanis.com](http://www.kinanis.com)

#### Corporate Division

Christos Kinanis

Fax: +357 22 76 28 08

[corporate@kinanis.com](mailto:corporate@kinanis.com)

#### Accounting Division

Charalambos Meivatzis

Fax: +357 22 75 14 74

[accounting@kinanis.com](mailto:accounting@kinanis.com)

#### Litigation Division

Andrianna Solomonides

Fax: +357 22 45 81 95

[litigation@kinanis.com](mailto:litigation@kinanis.com)

#### Banking Department

Myroulla Kyriacou

Fax: +357 22 75 39 15

[banking@kinanis.com](mailto:banking@kinanis.com)

#### Tax Department

Marios Palesis

Fax: +357 22 75 14 74

[tax@kinanis.com](mailto:tax@kinanis.com)

#### Accounting & VAT Department

Demetra Constantinou

Fax: +357 22 75 14 74

[accounting@kinanis.com](mailto:accounting@kinanis.com)