Corporate Tax - Cyprus

Amendments to tax laws

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Income Tax Law
Special Defence Contribution Law
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Capital Gains Tax Law

In July 2015 the government submitted a package of amendments to the tax laws to the House of Representatives with the aim of:

- encouraging economic activity;
- attracting inward direct investment; and
- simplifying the tax regime to make it more attractive, effective and equitable.

Only some of the proposals were enacted on July 16 2015 before the summer recess. The rest will be considered when the House of Representatives reconvenes.

Income Tax Law
Notional interest deduction for new equity capital
To level the playing field between debt and equity finance, the Income Tax (Amendment) Law introduces a deemed interest deduction on new equity capital – paid-up share capital and share premium – introduced after January 1 2015 into companies and permanent establishments of foreign companies to finance business assets.(1) The deemed interest deduction will be deductible for the purpose of calculating taxable profit. The reference rate for calculating the deemed interest deduction is the 10-year government bond yield of the country in which the assets funded by the new equity are utilised plus three percentage points or the 10-year Cyprus government bond yield plus three percentage points, whichever is higher. The bond yield rates to be used are those from December 31 of the year preceding the year of assessment.

New equity may be contributed in cash or in the form of other assets, in which case the amount of new equity will be the market value of the assets agreed with the tax authorities. No deemed interest deduction is available for:

- the capitalisation of reserves;
- the revaluation of assets; or
- companies that benefit from the reorganisation exemptions included in the tax laws.

Deemed interest deduction may also be refused if the tax department considers that the transaction concerned has no economic or business purpose.

The deemed interest deduction will be limited to 80% of taxable profit before it is deducted and no deemed interest deduction will be allowed in the event of losses. Unutilised deemed interest deduction cannot be carried forward to be offset against future profits.

Taxation of widows' pensions

Widows' pensions were exempt from income tax until the end of 2013. From the beginning of 2014, a special basis of taxation applied under which the first €19,500 per year was tax-free and any amount above €19,500 was taxed at 20%.

The July amendment gives taxpayers the option to elect on a year-by-year basis between the special basis set out above or to be taxed under the general rules. The amendment is effective from the 2014 tax year onwards.

Special Defence Contribution Law

Up to and including July 15 2015, Cyprus resident individuals and companies were subject to a special defence contribution, commonly referred to as 'SDC tax', on dividends, passive interest and rents received at 17%, 30% and 3% (applied to 75% of rents) respectively. Dividends and passive interest (but not rents or active interest) are exempt from personal or corporate income tax.(2)

The Special Defence Contribution (Amendment) Law restricts liability to SDC tax with effect from July 16 2015 to taxpayers who are resident and domiciled in Cyprus for the year of assessment concerned.(3) Coupled with the income tax exemptions that apply to such income, individuals who are resident but not domiciled in Cyprus are exempt from tax on dividends and passive interest, regardless of the source.

To determine liability for SDC tax, an individual is considered domiciled in Cyprus if he or she has a domicile of origin in Cyprus as defined in the Wills and Succession Law, unless he or she has acquired and maintains a domicile of choice outside Cyprus and was not a tax resident in Cyprus as defined in the Income Tax Law for any period of at least 20 consecutive years prior to the year of assessment, or was non-resident for purposes of the Income Tax Law for any of the immediately preceding 20 tax years.(4) An individual will be deemed to be domiciled in Cyprus if he or she has been a tax resident for at least 17 of the 20 tax years immediately preceding the year of assessment.

The principles of the Wills and Succession Law regarding domicile follow English law. An individual acquires a domicile of origin at birth. It is generally the same as the domicile of the father at the time of birth and in exceptional cases that of the mother. A domicile of origin may be replaced by a domicile of choice if an individual permanently establishes himself or herself in another country with the intention of living permanently and dying there.

The amendment includes an anti-avoidance provision that restricts its application in cases where domiciled individuals transfer assets to related non-domiciled persons to take advantage of the changes. It inserts a new Article 3(11) into the Special Defence Contribution Law that allows the tax authorities to disregard the transfer of assets from any person domiciled in Cyprus to an individual who is not domiciled in Cyprus and who is a spouse or relative within the third degree of kindred of the transferor.

SDC tax anti-avoidance

The SDC Amendment Law also introduces a new anti-avoidance measure to deal with a common device used to reduce or postpone the payment of SDC tax. It inserts a new Article 3(4) into the Special Defence Contribution Law, which enables the tax authorities to disregard the interposition of a company without any real business or economic purpose between an individual and a company making profits, if this has been done with the principal objective of reducing or deferring the payment of SDC tax.

Capital Gains Tax Law

Capital gains tax in Cyprus is charged only on disposals of immovable property situated in Cyprus and shares in unlisted companies to the extent that their value derives from such property.(5) To stimulate the real estate market, the Capital Gains Tax (Amendment) Law introduces a further exemption for property acquired between July 16 2015 and December 31 2016, provided that the property was acquired on an arm's-length basis and not under the foreclosure provisions of the Transfer and Mortgage of Immovable Properties Law.(6) Any gain on the disposal of property will be exempt from capital gains tax, irrespective of the date of disposal.

As an added incentive, the normal transfer fee payable to the Department of Lands and Surveys on acquisition of immovable property will be discounted up to 50% of the standard rate until December 31 2016, provided that it was acquired on an arm's-length basis and not under the foreclosure provisions of the Transfer and Mortgage of Immovable Properties Law. Alternatively, if value added tax is payable on the purchase of property, no transfer fee is payable at all, provided that the sale agreement is deposited with the Land Registry by December 31 2016.

For further information on this topic please contact Philippos Aristotelous at Andreas Neocleous & Co LLC by telephone (+357 25 110 000) or email (aristotelous@neocleous.com). The Andreas Neocleous & Co LLC website can be accessed at www.neocleous.com.

Endnotes

(1) The Income Tax (Amendment) Law (116(I)/2015), which amended Law 118(I)/2002.

(2) Law 117(I)/2002.

(3) Law 19(I)/2015.

(4) Cap 195.

(5) Capital Gains Tax Law (52/1980).

(6) Law 117(I)/2015.

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