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a closer look

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SUBJECTS TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

SECTORS MANUFACTURING RETAIL/WHOLESALE INSURANCE BANKS/FINANCIAL INSTITUTIONS RESTAURANTS/FOOD SERVICE CONSTRUCTION AEROSPACE ENERGY AUTOMOTIVE MINING AND MINERALS ENTERTAINMENT AND MEDIA OIL AND GAS

COUNTRIES AND REGIONS EUROPE AUSTRIA BELGIUM BULGARIA CYPRUS CZECH REPUBLIC DENMARK ESTONIA FINLAND FRANCE GERMANY GREECE HUNGARY IRELAND ITALY LATVIA LITHUANIA LUXEMBOURG MALTA NETHERLANDS POLAND PORTUGAL ROMANIA SLOVAKIA SLOVENIA SPAIN SWEDEN SWITZERLAND UNITED KINGDOM EMERGING MARKETS ARGENTINA BRAZIL CHILE CHINA INDIA ISRAEL MEXICO RUSSIA SOUTH AFRICA SOUTH KOREA TAIWAN VIETNAM CENTRAL AND EASTERN EUROPE ARMENIA AZERBAIJAN BOSNIA CROATIA FAROE ISLANDS GEORGIA KAZAKHSTAN MONTENEGRO NORWAY SERBIA TURKEY UKRAINE UZBEKISTAN ASIA-PAC AUSTRALIA BANGLADESH BRUNEI HONG KONG INDONESIA JAPAN MALAYSIA NEW ZEALAND PAKISTAN PHILIPPINES SINGAPORE THAILAND AMERICAS BOLIVIA CANADA COLOMBIA COSTA RICA ECUADOR EL SALVADOR GUATEMALA PANAMA PERU PUERTO RICO URUGUAY UNITED STATES VENEZUELA MIDDLE EAST ALGERIA BAHRAIN BOTSWANA DUBAI EGYPT ETHIOPIA EQUATORIAL GUINEA IRAQ KUWAIT MOROCCO NIGERIA OMAN QATAR SAUDI ARABIA TUNISIA LOW-TAX JURISDICTIONS ANDORRA ARUBA BAHAMAS BARBADOS BELIZE BERMUDA BRITISH VIRGIN ISLANDS CAYMAN ISLANDS COOK ISLANDS CURACAO GIBRALTAR GUERNSEY ISLE OF MAN JERSEY LABUAN LIECHTENSTEIN MAURITIUS MONACO TURKS AND CAICOS ISLANDS VANUATU

Cyprus Tax Roundup 2015

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Introduction

Tax professionals in Cyprus have had plenty of new developments to keep abreast of during 2015, including several new or substantially modified double tax agreements entering into force and a wide-ranging package of tax incentives and other amendments. The main changes are summarized in the following paragraphs.

Amendments To The Tax Laws

In July the Government submitted a package of proposed amendments to the Income Tax Law,¹ the Special Defence Contribution Law² and the Capital Gains Tax Law,³ with the objective of stimulating economic activity, attracting inward direct investment, and simplifying the tax regime in order to make it more attractive, fair and effective and aligning it with recent developments in EU legislation and case law. There was not sufficient time for all the proposals to be enacted before the summer recess and consideration of some of them was deferred, with the following changes taking effect from July 16, 2015.



Amendments To The Income Tax Law

Notional Interest Deduction For New Equity Capital

In order to level the playing field between debt and equity finance, the Income Tax (Amendment) Law⁴ introduces a notional interest deduction ("NID") on new equity capital (paid-up share capital and share premium) introduced into companies and permanent establishments of foreign companies after January 1, 2015 for the purpose of financing business assets. The NID will be allowed as a deduction against taxable profit, calculated by applying a reference rate to the new equity. The reference rate is the higher of the ten-year government bond yield of Cyprus or the country in which the assets funded by the new equity are utilized, in each case plus three percentage points. The bond yield rates to be used are as at December 31 of the year preceding the year of assessment.

New equity may be contributed either in cash or in the form of other assets, in which event the NID will be based on the market value of the assets agreed with the tax authorities. No NID is available in respect of capitalization of reserves, revaluation of assets or for companies benefiting from the reorganization exemptions included in the tax laws, and NID may be refused if the tax authorities deem that the transaction concerned has no economic or business purpose.

The NID is limited to 80 percent of the taxable profit before deducting the NID, and no NID will be allowed in the event of losses. Unutilized NID cannot be carried forward to be offset against future years' profits.

Taxation Of Widows' Pensions

A further amendment addressed an anomaly in the taxation of widows' pensions, which had been exempt from income tax until the end of 2013. From the beginning of 2014 a special basis of taxation applied under which the first EUR19,500 per year was tax-free and any amount above EUR19,500 was taxed at 20 percent.

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

Amendments To The Special Defence Contribution Law

Introduction Of A "Non-Domiciled" Regime

Up to and including July 15, 2015, both Cyprus-resident individuals and Cyprus-resident companies were liable to pay Special Defence Contribution, commonly referred to as SDC tax, on dividends, passive interest and rents received, at rates of 17 percent, 30 percent and 3 percent (applied to 75 percent of the rent) respectively. Dividends and passive interest (but not rents or active interest) are exempt from personal or corporate income tax.

With effect from July 16, 2015 the Special Defence Contribution (Amendment) Law⁵ exempts individuals who are not domiciled in Cyprus for the year of assessment concerned from liability to SDC tax. Coupled with the income tax exemptions applying to such income, this provides individuals who are resident but not domiciled in Cyprus with complete exemption from any form of Cyprus tax on dividends and passive interest, regardless of source. Companies are not affected by the change.

For the purposes of determining liability to SDC tax, the principles set out in the Wills and Succession Law⁶ regarding domicile, which follow the principles of English common law, apply. In summary, 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 in actual fact an

individual permanently establishes himself or herself in another country with the intention of living there permanently and dying there. An individual will be deemed to be domiciled in Cyprus if he or she has been a tax resident for 17 or more of the 20 tax years immediately preceding the year of assessment.

The SDC Amendment Law inserts a new article into the SDC Law allowing the tax authorities to disregard transfers of assets from any person domiciled in Cyprus to a spouse or relative within the third degree of kindred who is not domiciled in Cyprus, providing a specific anti-avoidance provision against domiciled individuals transferring assets to related non-domiciled persons in order to take advantage of the changes.

SDC Tax Anti-Avoidance

The SDC Amendment Law also introduces a new anti-avoidance measure to deal with a common scheme used to reduce or postpone the payment of SDC tax. It inserts a new article into the SDC Law enabling 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.

Amendments To The Capital Gains Tax Law

Capital gains tax in Cyprus is charged only on disposals of immovable property situated in Cyprus and disposals of shares in unlisted companies to the extent that their value derives from such property.

In order to stimulate the real estate market, the Capital Gains Tax (Amendment) (No. 2) Law⁷ introduces a further exemption for immovable 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. Any gain on the disposal of the 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 to 50 percent of the standard rate until 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. Alternatively, if VAT is payable on the purchase of the property, no transfer fee is payable at all, provided that the sale agreement is deposited with the Land Registry by December 31, 2016.

The December Package Of Amendments

On December 10, 2015, the remaining amendments to the Income Tax Law and the Capital Gains Tax Law were enacted by parliament. They will enter into force on publication in the government gazette, which is likely to occur before the end of 2015. The changes include:

- New provisions to simplify taxation of offshore hydrocarbon activities;
- Alignment with the latest amendments to the EU Parent-Subsidiary Directive;

- Extension of group relief to overseas companies;
- Changes to arm's length adjustments;
- Tax neutrality of foreign exchange gains and losses;
- Limitation of losses carried forward on IP activities;
- Anti-abuse provisions for corporate reorganizations;
- Extension of income tax exemption for new individual taxpayers;
- Changes to capital gains tax relating to shares in companies holding real estate in Cyprus.

These will be analyzed in detail in a future issue of *Global Tax Weekly* as soon as the new laws are published in their final form.

Double Taxation Agreements

Entry Into Effect Of New DTAs With Iceland, Lithuania, Norway And Spain

On January 1, 2015, the new or revised double tax agreements (DTAs) with Iceland, Lithuania, Norway and Spain, all of which had entered into force during 2014, became effective. They all follow the 2010 OECD Model and their detailed provisions are set out and analyzed in earlier issues⁸ of *Global Tax Weekly*, so they are not repeated here.

Entry Into Force Of DTAs With Guernsey And Switzerland

Ratification of the DTAs with Guernsey and Switzerland, both of which were signed in 2014, was completed and the DTAs entered into force on March 4, 2015 and October 15, 2015, respectively. They will take effect from the beginning of 2016.

Further details of the DTAs can be found in earlier issues of *Global Tax Weekly*.⁹

Signature Of New DTAs And Protocols

Bahrain, Georgia and Iran: During 2015, Cyprus signed new DTAs with Bahrain, Georgia, and Iran, and Protocols to the existing agreements with South Africa and Ukraine. Like Cyprus's other recent DTAs, they closely follow the 2010 OECD Model Tax Convention. Their provisions (and those of the other jurisdictions outlined below) have been analyzed in detail in previous issues of *Global Tax Weekly*,¹⁰ and so are not repeated here.

The three new DTAs are the first agreements with the countries concerned: unlike many former members of the USSR, Georgia did not adopt the 1982 Cyprus–USSR DTA when it became independent. The new DTA with Iran comes at a particularly opportune time of increased rapprochement between Iran and the West. After years of sanctions, there are immense opportunities for investment into Iran, and the new DTA will provide an excellent conduit.

South Africa: The Protocol to the DTA with South Africa, which was signed on April 1, 2015 and which will take effect from the beginning of 2016, implements a commitment in the original DTA to reconsider the provisions regarding taxation of dividends in the event of any change in domestic tax law. South Africa introduced taxation of dividends at shareholder level in 2012 and the principal purpose of the Protocol is to implement this change. The Protocol also updates the definition of residence and the

information exchange provisions. Most importantly, it does not change the existing, highly beneficial arrangements regarding taxation of capital gains.

Ukraine: Unlike Georgia, Ukraine adopted the 1982 Cyprus–USSR DTA on independence. This was very taxpayer-friendly and when it was replaced by a new DTA in 2012, most people expected the benefits to be significantly reduced. These expectations were not realized, and the new DTA, which took effect from the beginning of 2014, was also very taxpayer-friendly, particularly regarding taxation of gains on shares in property-rich companies, which can be fully sheltered from tax. The DTA was the target of attacks from populist politicians in Ukraine from the day it was published, and at one stage the Ukrainian Government began to take steps to denounce it. The new Protocol waters down the benefits provided by the DTA, particularly regarding capital gains on shares in "property-rich" companies and withholding taxes on dividends, but only after a considerable time, as the earliest date on which it can enter into force is January 1, 2019.

According to the Cyprus Ministry of Finance, a "most favored nation" clause has been agreed for the taxes on interest, dividends, royalties and capital gains, ensuring that Cyprus is treated no less favorably than any other of Ukraine's DTA counterparties in the future.

Subject to ratification by both countries, the new Protocol provides a basis for the existing DTA to continue until at least January 1, 2019. The benefits provided by the Protocol are slightly less attractive

than those under the current DTA, but the "most favored nation" provision means that they will be at least as good as under any other of Ukraine's DTAs.

Improvements To The Tax Rulings Procedure

An important change for tax professionals was the issuing by the tax authorities of a circular formalizing the procedures for obtaining advance tax rulings and setting out the terms on which they are binding. The new arrangements took effect on October 1, 2015. A recent survey of tax professionals carried out by KPMG found that one of the key factors in assessing the merits of competing jurisdictions is the degree of predictability and reliability they provide. Advance tax rulings are a key element in giving taxpayers and their advisors the assurance they desire, and the clarification and formalization of the advance rulings procedure is highly beneficial.

Revision Of OECD Global Forum Rating To "Largely Compliant"

Another positive development towards the end of the year was the decision by the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes to revise its Phase 2 rating for Cyprus. Following the initial Phase 2 assessment carried out in mid-2013, Cyprus was rated "non-compliant" in two of the ten areas assessed, and was given an overall "non-compliant" rating, despite having achieved a satisfactory rating in more areas than other countries which escaped a "non-compliant" rating.

In an October 2015 meeting, the Global Forum considered a supplementary Phase 2 report for

Cyprus, and concluded that it had satisfactorily resolved all the deficiencies and assigned it a "largely compliant" rating overall.

ENDNOTES

¹ Law 118(I) of 2002.

² Law 117(I) of 2002.

³ Law 52 of 1980.

⁴ The Income Tax (Amendment) Law, 116(I) of 2015.

⁵ Law 119(I) of 2015.

⁶ Cap. 195.

⁷ Law number 117(I) of 2015.

⁸ Issues 122 dated March 12, 2015, and 133 dated May 28, 2015.

⁹ Issues 95 dated September 4, 2014, and 94 dated August 28, 2014, respectively.

¹⁰ Issue 127 dated April 16, 2015 for the DTA with Bahrain; issue 142 dated July 30, 2015 for the DTA with Georgia; issue 150 dated September 24, 2015 for the DTA with Iran; issue 146 dated August 27, 2015 for the Protocol to the DTA with South Africa; and issue 150 dated September 24, 2015 for the Protocol to the DTA with Ukraine.