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Recent Tax Developments In Cyprus

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Rates For Calculating Notional Interest Deduction

As reported previously [1] in *Global Tax Weekly*, in July 2015 the Cyprus Government introduced a notional interest deduction ("NID") on new equity capital, aimed at leveling the playing field between debt and equity finance. For the 2015 tax year and future years, a deduction against taxable profits is available in respect of new equity (paid-up share capital and share premium) injected into companies and permanent establishments of foreign companies on or after January 1, 2015 for the purpose of financing business assets. The deduction, which can be up to 80 per cent of taxable profits before NID, is calculated by applying a reference rate to the new equity.

The reference rate is three percentage points above the higher of the ten-year government bond yield of Cyprus or of the country in which the assets funded by the new equity are utilized. The bond yield rates to be used are as at December 31 of the year preceding the year in which the new equity is introduced.

The Cyprus Tax Department has recently announced the ten-year government bond rates at December 31, 2014 on which the NID for the 2015 tax year will be based, for the following countries:

- Cyprus: 5.037 percent
- India: 7.860 percent
- Russia: 13.730 percent
- Romania: 3.570 percent
- Germany: 0.540 percent

After applying the uplift of three percentage points, the NID for equity introduced during 2015 in order to fund assets used in India will be 10.86 percent of the amount of new equity introduced, and for equity introduced in order to fund assets used in Russia it will be 16.73 percent of the amount introduced. For equity used to fund assets used in Cyprus or in the other countries, whose rates are lower than the Cyprus rate, the NID will be 8.037 percent, three percentage points above the Cyprus bond rate.

Amendments To Promote Restructuring

In December 2015, further amendments to the Cyprus tax laws were made in order to exempt loan restructurings carried out in 2016 and 2017 from tax. The exemptions were aimed at facilitating and encouraging the restructuring of non-performing debt, which is the biggest issue currently facing Cyprus banks, and the greatest obstacle to economic recovery. The laws affected are the Income Tax Law, the Capital Gains Tax Law, the Special Defence Contribution Law, the Stamp Duty Law, the VAT Law, the Collection of Taxes Law, and the Department of Lands and Surveys (Fees and Charges) Law. [2]

In all of these laws a new definition of the term "restructuring" has been introduced, referring to:

- The direct or indirect sale and transfer of immovable property and transfer of rights;
- Under a sale contract deposited with the Department of Lands and Surveys;
- Between one or more borrowers, debtors or guarantors regarding the same credit facility or debt on the one hand, and one or more creditors on the other;
- That takes place in 2016 or 2017 in order to reduce or repay credit facilities or loans or debts granted by one or more licensed credit institutions operating in Cyprus.

The effect of the amendments is to exempt from income tax any benefit, profit or gain arising in the context of restructuring, and to exempt any gain arising from the disposal of property in the context of a restructuring from capital gains tax. In the context of restructuring, a lender disposing of a property or taking possession of it for the lender's own use is deemed to acquire it at the value attributed to it for the purpose of the restructuring, and the disposal proceeds in the hands of the lender are reduced by any amount returned to the borrower. In the event of part of the proceeds subsequently being returned to the borrower, any tax exemption granted to the borrower may be liable to clawback: the lender is responsible for withholding the appropriate amount and paying it to the tax authorities.

The amendment to the Special Contribution for Defence Law provides that accounting profits arising in the context of restructuring are not subject to the deemed distribution provisions of the law, which require Special Contribution for Defence tax to be paid on undistributed profits after a specified period. However, in the event of any part of the disposal value being refunded to the borrower, then this amount is included in the accounting profit of the borrower in the tax year in which the amount was refunded, and is subject to the deemed distribution provisions.

The amendments to the Stamp Duty Law provide that any contracts, mortgages or other documents created within the context of a restructuring are exempt from stamp duty.

The amendments to the VAT Law and the Collection of Taxes Law provide that any property acquired by a lender in the context of a restructuring remains subject to any existing charges or encumbrances, and that the tax authorities may require the borrower to replace any such encumbrances with equivalent security over another property. The tax authorities are given discretion to enter into a negotiated agreement with the borrower to settle any outstanding taxes in order to allow the discharge of any security.

The Department of Lands and Surveys (Fees and Charges) Law already provided that no fees or charges should be levied for transfer or registration of immovable property in the context of a restructuring and the only change to that law is the insertion of the new definition.

Endnotes

1 "Cyprus's New Package Of Tax Incentives And Technical Amendments," *Global Tax Weekly*, No. 141, July 23, 2015.

2 Laws 208(I) and 209(I) of 2015 amending the Special Defence Contribution Law 117(I) of 2002; Law 210(I) of 2015 amending the Department of Lands and Surveys (Fees and Charges) Law Cap 219; Law 211(I) of 2015 amending the Stamp Duty Law 19 of 1963; Law 212(I) of 2015 amending the Income Tax Law 118(I) of 2002; Law 213(I) of 2015 amending the Capital Gains Tax Law 52 of 1980; Law 214(I) of 2015 amending the Collection of Taxes Laws 31 of 1962 and 80(I) of 2014; and Law 215(I) of 2015 amending the Value Added Tax Law 95(I) of 2000.