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a closer look

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Recent Tax Developments In Cyprus

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Amendments To Cyprus Tax Laws

In July 2015, the Cyprus Government submitted a package of proposed amendments to the existing tax laws to the House of Representatives. The amendments, which were summarized in an earlier article,¹ were aimed at encouraging economic activity, attracting inward direct investment and simplifying the tax regime in order to make it more attractive, fair, and effective. There was not sufficient time for all the changes to be considered before the summer recess, and consideration of certain proposals was deferred. This article gives a detailed description and analysis of the changes that have actually entered into force (in all cases with 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, by amending the existing income tax legislation,² the Income Tax (Amendment) Law³ 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 the country in which the assets funded by the new equity are utilized plus 3 percentage points, or the ten-year Cyprus government bond yield plus 3 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 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 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; NID may also 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 (USD21,950) 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

Up to and including July 15, 2015, Cyprus resident individuals, like Cyprus resident companies, were liable to pay Special Defence Contribution,⁴ 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 and 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, individuals who are resident but not domiciled in Cyprus are exempt from Cyprus tax of all forms on dividends and passive interest, regardless of source. Companies are not affected by the change.

For the purposes of determining liability to SDC tax, an individual has a domicile in Cyprus if he or she has a domicile of origin in Cyprus as defined in the Wills and Succession Law,⁶ unless he or she:

- has acquired and maintains a domicile of choice outside Cyprus and was not a tax resident of 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.

In any event, 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 principles of the Wills and Succession Law regarding domicile follow English law. 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 him- or herself in

another country with the intention of living there permanently and dying there.

The amendment includes an anti-avoidance provision restricting its applicability in cases where domiciled individuals transfer assets to related non-domiciled persons in order to take advantage of the changes. It inserts a new article 3(11) into the Special Defence Contribution 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.

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 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 of shares in unlisted companies to the extent that their value derives from such property.⁷ In order to stimulate the real estate market, the Capital Gains Tax (Amendment) (No. 2) Law⁸ 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.

ENDNOTES

- ¹ "Cyprus's New Package Of Tax Incentives And Technical Amendments," *Global Tax Weekly*, No. 141, July 23, 2015.
- ² Law 118(I) of 2002.
- ³ The Income Tax (Amendment) Law, 116(I) of 2015.
- ⁴ Law 117(I) of 2002.
- ⁵ Law 119(I) of 2015.
- ⁶ Cap. 195.
- ⁷ Under the Capital Gains Tax Law, No. 52 of 1980.
- ⁸ Law 117(I) of 2015.