AMENDMENTS IN TAX LEGISLATION

Introduction

In an effort to improve the tax system in Cyprus and make it more attractive to foreign investors, the Government of Cyprus has been working closely with the private sector over the last few months in order to modernise the framework of the tax legislation of Cyprus.

Through this reform package, Cyprus tax system will become more fair, simple and competitive.

The provisions of the new laws described below have been voted by the House of Representatives on 9 July 2015 and published in the Cyprus government gazette on 16 July 2015.

A. Amendment of the Special Defence Contribution- Personal Taxation

PROVISIONS

According to the amendment of the Special Defence Contribution Law, an individual is tax resident of Cyprus for the purposes of the above Law if she/ he is tax resident under the provisions of the Income Tax Law* (183 days rule) and in **addition** has domicile in the Republic of Cyprus.

An individual **has domicile** in the Republic of Cyprus if:

A. An individual is a Cyprus tax resident (as per provisions of the Income Tax Law*) for at least 17 out of the last 20 years before the year of assessment under consideration; or

B. The individual has a **domicile of origin** in the Republic of Cyprus as per Wills and Succession Law, except for:

  i. An individual who has chosen and currently maintains a **domicile of choice** other than Cyprus, **and** that individual was not tax resident in Cyprus (as per provisions of the Income Tax Law*) for any period of at least 20 consecutive years before the year of assessment under consideration; or

  ii. An individual was not tax resident in Cyprus (as per provisions of the Income Tax Law*) for a period of at least 20 consecutive years before the commencement of this Law provision.

***Resident in the Republic of Cyprus when applied to an individual and for purposes of the Income Tax Law means an individual who stays in the Republic for a period or periods in aggregate more than 183 days in a calendar year.**

An individual is **not domiciled** in the Republic of Cyprus if:

1. **a.** An individual **doesn't have** domicile of origin in Cyprus;

   and

   b. The individual **was** Cyprus tax resident for less than 17 out of the last 20 years before the year of assessment under consideration,

   or

2. An individual has domicile of origin Cyprus but **at least one** of the exemptions mentioned in **Point B** above is satisfied.

TAX EFFECT

A Cyprus tax resident individual who spends more than 183 days in the Republic of Cyprus would be liable **ONLY** for Income Tax Law purposes and **would be exempted** from Special Defence Contribution (SDC) given that the individual is not considered domiciled in Cyprus under conditions above. Consequently that individual would be exempt from SDC regarding income from Dividends, Interest and Rent.

The above provisions are applicable as from 16 July 2015, the date published in the Cyprus Government Gazette.

B. Amendment of the Income Tax Law

Introduction of new Article 9B- Notional Deduction on New Capital

With the introduction of the new Article 9B, a deemed expense is allowed on the taxable income of a company resident in Cyprus or a company not resident in Cyprus which maintain a permanent establishment in Cyprus and exercises business operations in the Republic. The deemed expense is calculated, by multiplying a **"reference interest rate"** on the New Capital that is held by the company during the assessment year and used for the operation of its activities;

PROVISIONS

a. The deemed expense is allowed annually, during the periods that the New Capital is held by the company;

b. The term "new capital" means the capital that has been contributed to the company during or after 1 January 2015. The term "old capital" means the existing capital as at 31 December 2014;

c. The term "capital" for companies is the issue of share capital and the issue of share premium, if paid by the shareholder;

d. The term "reference interest rate" is the ten year government bond rate of return of the State that the new capital is invested in, increased by 3%. However, the rate of return cannot be lower than the ten-year Cyprus Government bond increased by 3%.

e. The allowable deemed expense on New Capital cannot exceed 80% of the taxable income. The 80% is before the deduction of the deemed expense and in case of a tax loss the deemed expense on the New Capital cannot be claimed.

f. The deemed expense is considered as interest cost, and the provisions of Article 11 (15) apply;

Anti-abuse measures:

- For the purpose of computation of the deemed expense only the capital in excess of the old capital is considered and does not include amounts that have been capitalised and which were derived from revaluation of movable or immovable property;
- In case New Capital of a Cyprus resident company is derived directly or indirectly from the New Capital of another Cyprus tax resident company, the deemed expense is only allowed for one of the above companies;
- In case the New Capital is derived directly or indirectly from loans where an interest expense is claimed, then the deemed expense is reduced with that amount of interest expense allowed to the other associate company;
- In case New Capital is contributed in the form of Assets in Kind, then the amount of New Capital for the purpose of tax allowance for deemed expense cannot exceed the market value of the assets received.
- The Tax Commissioner has the right to reject tax-deduction for deemed expense as per provisions of the above legislation, in case the transactions are incurred without any significant economic and commercial purpose with the main purpose being the tax allowance on New Capital. He has also the right to reject the provisions of the above legislation in case New Capital derived from capitals that existed before 1 January 2015 and are presented as New Capital through the transactions of associate companies.

Our view is that the new proposed legislation will provide an incentive for companies to substitute borrowing with investment in equity, in order to reduce their taxable income. For example a company that increased its share capital and share premium by €1million during or after 2015, can benefit from a notional interest expense of €80,000 (Cyprus 10- year bond rate being around 5%+3%=8%). Therefore a company with €100,000 taxable income will be taxed only on €20,000 and reduce the overall effective tax rate from 12,5% to 2,5%.

The amendment will be applicable as from the tax year 2015 onwards.

C. Amendment of the Capital Gains Tax Law

Capital Gains from the sale of property acquired between 16 July 2015 (date published of the Law) and 31 December 2016

Any gains from the subsequent disposal of immovable property acquired between 16 July 2015 and 31 December 2016 will be exempt from capital gains tax, if acquired through purchase or by purchase agreement at a market value from a non-related party and not through a donation/gift or an exchange.

The sale of immovable property can be made at any time.

D. Changes to Land Registry fees

For transfers of immovable property between 16 July 2015 (date published of the Law) and 31 December 2016 the land transfer fees are reduced by 50%.

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