PROPOSED AMENDMENTS IN TAX LEGISLATION

Introduction

In an effort to improve the tax system in Cyprus, eliminate provisions which create issues in the day to day application of the law and make it more attractive, the Government of Cyprus has been working closely with the private sector over the last few months in order to agree on specific changes in the tax legislation of Cyprus.

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

The provisions of the legislations described below should be applicable once voted by the House of Representatives and publication in the Cyprus government gazette.

A. Draft Proposed Law for Amendment of the Special Defence Contribution

PROVISIONS

As per draft law for 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 as per the provisions of the Income Tax Law* (183 days rule) and in **addition** is **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;

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 in Cyprus but **at least one** of the exemptions mentioned in **Point B** above are 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 she/he is not considered domiciled in Cyprus as per conditions above. Consequently that individual would be exempt from SDC regarding income from Dividends, Interest and Rent.

B. Draft Proposed Amendment of the Income Tax Law

1. Proposed amendment - Article 21:

Existing Law - **20% exemption** with a maximum amount of €8,550 from the remuneration from any office exercised in Cyprus by an individual who was not resident in Cyprus before the commencement of his employment, for a period of three years commencing from 1 January of the next year following commencement of employment.

Proposed amendment - The exemption would commence from the year of employment and would apply for a maximum period of five years. The enforcement of this law would be applicable up to the tax year 2020 and will apply for employment that begins during or after 2012.

2. Proposed amendment - Article 23:

Existing Law - **50% exemption** of the remuneration, from employment that exceeds €100,000 per annum by an individual who was not resident of Cyprus before the commencement of his employment. This applies for the first five years of employment and commencement from 1 January 2012.

Proposed amendment - The 50% exemption would apply for a period of 10 years if remuneration from employment exceeds €100,00 per annum and it would not be granted to an individual that was Cyprus tax resident in any of 3 out of 5 years preceding the tax year of commencement of employment in Cyprus. Also it would not be granted to an individual resident in Cyprus during the year preceding the tax year of commencement of employment in Cyprus.

The exemption under Article 21 should not be applicable in case the provisions of article 23 apply.

Our view is that the extension of the exemption from five to ten years increases the incentives for foreign tax residence individuals to become Cyprus tax residents and would indirectly help to enhance the substance of Cyprus International Business Companies as they can act as Directors of those Companies.

3. Proposed Introduction -Article 8:

Foreign exchange differences:

a. As per draft legislation, the introduction of paragraph 24 under article 8 (exemptions), any profit deriving from exchange differences, incurred due to exchange rate fluctuations is exempted.

b. However, the above is not applicable to a person (i.e. a company) that is engaged in the trading of currencies, including also a person trading in rights or derivatives that arise through exchange differences.

c. Our view is that there was a general misinterpretation on the tax treatment of foreign exchange differences. With the provision of the above proposed law, tax computations will be much simpler, as there is no need to check and separate unrealised / realised exchange differences.

4. Article 9 (e)-IP BOX Regime

As per proposed draft law, a new sub-paragraph under article 9(e) would be introduced where any loss incurred under the provisions of the above article which can be utilised and carried forward, would be **restricted to 20%** as in the case of gains.

It has been clarified that for the purposes of computation of profits either for the sale of IP or for any royalty income rights, amortisation costs are considered as direct costs.

5. Introduction of new Article 9B- Deduction on New Capitals

As per draft legislation, with the introduction of new Article 9B, a deemed expense is allowed on the taxable income of a person (i.e. a company) who exercises business operations in the Republic. The deemed expense is calculated, as the product of the **"reference rate"** on the New Capitals that is held by the company during the assessment year and used for the operation of its activities;

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

e. For the purpose of computation of the deemed expense only the capitals in excess of the old capital is considered;

f. In case New Capitals of a Cyprus resident company are derived directly or indirectly from the New Capitals of another Cyprus tax resident company, the deemed expense is only allowed for one of the above companies;

g. The allowable deemed expense on New Capitals 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.

h. In case the New Capitals are derived directly or indirectly from loans where an interest expense is claimed, then deemed expense is reduced with that amount of interest expense allowed to the other associate company;

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

j. In case New Capitals are contributed in the form of Assets in Kind, then the amount of New Capitals for the purpose of tax allowance for deemed expense cannot exceed the market value of the assets received.

k. 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 Capitals. He has also the right to reject the provisions of the above legislation in case New Capitals 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 New Capital, 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 deemed 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.

6. Proposed amendment Article 13-Tax Losses

Under Proposed amendment, Cyprus domestic legislation would fully comply with the decisions of European Court for Group Losses relief.

The company surrendering tax losses can also be a company other than a Cyprus Company, being a tax resident of another European member state and given that this has exhausted all the possibilities of surrendering its tax losses in its country of residence or in another member state that may have a subsidiary company.

7. Propose amendment of Article 29 with the introduction of article 29A

The Tax Commissioner with the introduction of the above legislation will have the right to reject any forms of reorganisations under articles 26-29 (EU Merger Directive) upon lack of economic and commercial substance of the reorganisation scheme.

8. Proposed amendment of Article 33- Arm's length principle

Under the new proposed provision of the law ,in case of a deemed income imposed by the tax authorities, as per Article 33, for transactions between associate companies not at arm's length, then the corresponding company would be eligible for that "expense" as it was a real expense incurred by that company.

C. Proposed Changes to Capital Gains Tax

1. Capital Gains from the sale of property acquired between the date the law comes into effect and 31 December 2016

It is proposed that gains from the subsequent disposal of immovable property acquired between the date the law comes into effect and 31 December 2016 will be exempt from capital gains tax.

2. Capital Gains from sale of shares in property companies

i. Currently, capital gains tax is charged on disposal of immovable property located in Cyprus or on disposal of shares of companies, which own immovable property situated in Cyprus.

ii. Under the proposed legislation, gains from the sale of shares in companies which indirectly own immovable property in Cyprus by holding directly or indirectly shares in a company, which owns immovable property located in Cyprus will also be subject to capital gains tax. This will apply only in case the value of the immovable property represents more than 50% of the value of the assets of the company whose shares are sold.

iii. In the case of sale of shares of a company owning immovable property, the gain to be taxed will be calculated only based on the market value of the immovable property.

D. Proposed changes to Immovable property tax Law

1. The existing immovable property law is replaced by a new law.

2. The immovable property tax will be levied at the rate of 1 % on the value of the immovable property, located in Cyprus.

3. The value of the property on which tax will be levied at present will be the general valuation as at 1 January 2013.

4. The tax must be paid by 31 October of each year. A 10% discount is given if the tax is paid at least 30days before the above deadline.

5. If the tax due is up to €25, then no tax is payable

6. No immovable property tax will be levied as from now on by municipalities or villages.

E. Proposed changes to Land Registry fees

1. For transfers of immovable property to be effected until 31 December 2016 the land transfer fees are reduced by 50%.