

## Introduction

The House of Representatives on 14 December 2011 passed a series of increases in existing taxes and introduced new taxes as well as measures for the reduction of public spending in order to face the current economic crisis in Cyprus.

The principal changes in the legislation are the following.

## Income tax Law

### Payroll costs

- ▶ Salaries for which contributions in respect of provident funds, pension funds, social security and other related funds were not paid within the year due for payment will not be allowed as a tax deductible expense.
- ▶ If the contributions and related penalties are paid within two years from their due date, then the salaries and the related contributions will be allowed as a tax deductible expense in the tax year that they were paid.

### Loans and advances to company directors and shareholders

- ▶ In cases where a company grants a loan or other financial facility to an individual/ director or shareholder (including the spouse and relatives up to the second degree of kindred), then the director or shareholder will be treated as having a benefit in kind equal to 9% per annum on the monthly balance of such loan or facility. The benefit will be taxed as income subject to tax under the PAYE system.
- ▶ It should be noted that these provisions do not apply in the case of balances resulting from normal commercial transactions between the company and its director/shareholder, as for example in the case of loans granted by a bank to its shareholders (individuals).
- ▶ Article 39 of the law, which provided for deemed interest at the rate of 9% on such balances at the level of the company which was taxed at 15% defence tax is revoked.

## Entry into force

The above provisions apply as from the year 2012.

## Special Contribution to the Defence of the Republic Law

### Dividends paid after four years from the generation of the profits

- ▶ Defence contribution is levied on dividends which are paid after four years from the year the profits were generated, in cases where the shareholder is tax resident of Cyprus, irrespective of whether the shareholder is a company or individual. This provision will affect groups of companies where more than three Cypriot resident companies are interposed.
- ▶ It should be noted that these provisions do not apply in cases where the shareholders of the company directly or indirectly are non residents of Cyprus.

### Defence contribution rate on dividends

- ▶ Following the increase in the rate from 15% to 17% in August 2011, the rate for defence contribution on the payment of actual dividends or in the case of deemed distribution, is increased from 17% to 20%. This increase will apply for the years 2012 and 2013.
- ▶ It should be noted that no defence contribution is payable in case the dividend is paid to non residents. Furthermore the provisions for deemed distribution do not apply in cases where the shareholders of the company directly or indirectly are non residents of Cyprus.

## Value Added Tax Law ("VAT")

### Increase in the standard rate of VAT

- ▶ The standard rate of VAT is increased as of 1 March 2012, from 15% to 17%. The reduced rates of 5% and 8% remain the same.

### Obligation to issue receipts

- ▶ It is made now compulsory for receipts to be issued in case where a taxable person supplies goods or provides services to a non taxable person. The receipt should contain information as the name, address and VAT registration number of the person, description of goods or services and the total amount payable including VAT.
- ▶ In cases where a receipt is not issued, the taxable person is subject to a penalty of 20% of the amount of the receipt and in addition is liable in case of conviction by the court, to a penalty of €1.700 or imprisonment of six months or to both a penalty and imprisonment.

## Special contribution for employees, self employed and pensioners in the private sector

Special contribution is levied for the period from 1 January 2012 to 31 December 2013 on salaries, income of the self employed and pensions in the private sector. The contribution is levied as follows:

- ▶ for gross monthly emoluments which do not exceed €2.500 no contribution is payable
- ▶ for gross monthly emoluments which exceed €2.500 an amount is paid equal to a percentage on the gross emoluments as follows:
  - ▶ for every euro from €2.501 to €3.500 a percentage of 2.5% with a minimum amount of €10
  - ▶ for every euro from €3.501 to €4.500 a percentage of 3.0%
  - ▶ for every euro in excess of €4.500 a percentage of 3.5%

There is no upper limit on the amount of emoluments.

In the case of an employee, the contribution is shared equally between the employee and the employer.

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In the case of an employee no contribution is payable on:

- ▶ retirement gratuities
- ▶ payments out of provident funds
- ▶ emoluments of foreigners employed by a foreign government
- ▶ emoluments of the crew of a Cypriot ship
- ▶ allowances to cover business expenses for the account of the employer.

In the case of self employed persons the income on which the contribution is payable is the earned income of the individual with a minimum the amount on which social insurance contributions is made.

The contribution in the case of employees or pensioners will be deducted and paid in the same way as PAYE, whereas in the case of self employed the contribution will be paid on the basis of self assessment.

All the above contributions are deductible for income tax purposes.

## Other changes in the legislation

- ▶ As from 2012 income criteria are set for the payment of student subsidy which provide for the gradual reduction and the abolition of the subsidy where family income exceeds a certain amount.
- ▶ As from 2012 income criteria are set for the payment of child allowances which provide for the gradual reduction and the abolition of the allowance where family income exceeds a certain amount.
- ▶ All salary increases and cost of living allowances are frozen for all employees and all pensions paid by the government, semi governmental organisations and local government for the years 2012 and 2013.
- ▶ Legislation has been introduced for the establishment and operation of an independent fund for financial stability, to which financial institutions (banks and cooperative credit societies) which are operating in Cyprus will contribute. A levy of 0.03% will be paid on the liabilities of the financial institutions.  
This provision will come into effect as from 1 January 2013, where the existing legislation where the financial institutions pay a levy of 0.095% on their deposits will terminate.
- ▶ Legislation has been introduced for the handling of a financial crisis, with the objective of granting powers to the Council of Ministers so in the case of financial crisis to be able to take measures to deal with liquidity or going concern issues of the banking system or to provide capital to financial institutions in Cyprus.