Executive summary

On 9 July 2015, the Cypriot House of Representatives voted on significant amendments to the tax laws further improving the long established comprehensive and transparent character of the Cypriot tax system.

The changes serve a multitude of purposes such as promoting economic development by encouraging the introduction of new equity capital as an alternative to excessive debt financing. Moreover, the changes are aimed at encouraging the creation of business substance by offering compelling advantages to individuals from a personal tax perspective.

The Government has ensured that the changes made are aligned with global and European Union (EU) developments in the field of corporate taxation and that the new tax measures will be fiscally viable without resulting in a reduction of tax revenues.

The changes made will further improve Cyprus' international competitiveness as a location of choice for multinational companies doing business in Central South Europe, the Commonwealth of Independent States (CIS), the Middle East and North Africa.

The changes made in the tax laws are the most significant since the introduction of the current tax regime in 2003. It should be mentioned that the changes represent a coordinated initiative between the Government and various stakeholders.

Detailed discussion

**Introduction of a Notional Interest deduction regime on equity**

Over the last years, the supply of credit by financial institutions has been considerably reduced due to the banking crisis. In an effort to help the economy return to a growth path, the Government has introduced a Notional Interest Deduction (NID) regime on corporate equity. The NID regime is expected to encourage the introduction of equity capital into corporate structures which will effectively result in de-leveraging
the economy and foster economic growth. The NID will remove any distortions between equity and debt finance by bringing equity and debt into a level playing field since both will be entitled to a tax deduction.

As per the amended law, corporate entities (including permanent establishments of foreign companies) will be entitled to a NID on equity. The NID will equal the multiple of “reference interest rate” and the “new equity” held and used by a company in the carrying on of its business activities. Both terms are defined in the law:

- “Reference interest rate” means the interest rate of the 10 year government bond yield of the country in which the new equity is invested increased by 3% having as a lower limit the 10 year government bond yield of the Republic of Cyprus increased by 3%. The bond yield is the one applicable as of 31 December of the tax year preceding the relevant tax year.

- “New equity” means any equity introduced in the business on or after 1 January 2015 in the form of issued share capital and share premium (provided it is fully paid) and “old equity” means equity that existed on 31 December 2014. “New equity” does not include amounts that have been capitalized as equity and which are the result of a revaluation of movable or immovable property.

The NID regime is considered as interest expense and is subject to the same limitation rules as interest.

It needs to be mentioned that the NID granted on new equity cannot exceed 80% of the taxable profit before allowing the NID. In the event of losses, the NID will not be available. Effectively, this means that the NID cannot create or increase a tax loss. Taxpayers can elect not to claim the NID or claim part of it for each tax year.

The law includes both specific and general anti-abuse provisions aiming to:

- Limit the classification of capital as “new equity” in case this relates directly or indirectly to reserves that existed on 31 December 2014 and in case the contributed capital is not related to new assets used in the business.

- Tackle arrangements which aim to re-characterize “old equity” into “new equity” or arrangements which have been put into place with the aim of claiming NID without any valid economic or commercial reasons.

- Restrict the NID in case another entity has claimed a NID or an interest expense deduction on the same equity capital.

- Ensure that the NID is calculated as if no company reorganization had taken place.

The NID regime is effective as of 1 January 2015.

**Capital Gains Tax exemption on property acquired up to 31 December 2016**

The Capital Gains Tax (CGT) Law has been amended to provide for an exemption from CGT on gains from the disposal of immovable property which is acquired between the date the amendment law comes into force (17 July 2015) and 31 December 2016 provided that:

- The property consists of buildings
- It is acquired from an independent third party
- It is not acquired through an exchange of property or through donation/gift

**50% reduction of land transfer fees on property acquired up to 31 December 2016**

The land transfer fees are reduced to 50% for any purchase of property made between the date the law is amended and 31 December 2016. This measure aims to revive the real estate sector.

**Introduction of non-dom rules for individuals**

The Special Contribution for the Defense of the Republic Law (SDC) imposes tax on certain categories of income (interest, rents, dividends) received by persons who are considered to be residents for tax purposes of Cyprus, subject to any available exemptions. The SDC Law also includes provisions for the deemed distribution of profits of Cypriot tax resident companies to the extent that the shareholders of such companies are Cypriot tax residents.

An individual is considered to be a resident for tax purposes of Cyprus if he/she is physically present in Cyprus for a period or periods exceeding in aggregate 183 days during the calendar year. The SDC law is amended so that an individual will now be subject to SDC if he/she
is both a resident for tax purposes of Cyprus and is also considered to be domiciled in Cyprus.

With the introduction of “non-domicile” or “non-dom” rules, a Cyprus tax resident individual who is not domiciled in Cyprus will effectively not be subject to SDC in Cyprus on any interest, rents or dividends (whether actual or deemed) regardless of whether such income is derived from sources within Cyprus and regardless of whether such income is remitted to a bank account or economically used in Cyprus. It is noted that no tax is imposed on individuals under the Income Tax Law in respect of interest and dividend income.

The term “domiciled in Cyprus” is defined in the law as an individual who has a Cypriot domicile of origin in accordance with the Wills and Succession Law but it does not include:

(i) An individual who has obtained and maintained a domicile of choice outside Cyprus in accordance with the Wills and Succession Law but it does not include:

(ii) An individual who has not been a tax resident of Cyprus for a period of 20 consecutive years prior to the introduction of the law.

Notwithstanding the above, an individual who has been a tax resident of Cyprus for at least 17 years out of the last 20 years prior to the tax year will be considered to be “domiciled in Cyprus” and as such be subject to SDC regardless of his/her domicile of origin.

The law includes anti-abuse provisions as per which the tax authorities have the right to disregard the transfer of property made by a person who is domiciled in Cyprus to a relative up to a third degree of kindred who is not domiciled in Cyprus in case such transfer was made with the aim to avoid the imposition of SDC as a result of the introduction of “non-dom” rules.

The non-dom rules are expected to further encourage the relocation of corporate executives and encourage high-net-worth individuals to take up residency in Cyprus. The non-dom rules are effective as of the date of publication in the Official Gazette of the Republic (17 July 2015).

Future developments
It should be mentioned that the relevant tax bills submitted to the House of Representatives included a number of other amendments which were postponed for further discussion and consultation. These include among others:

- Amendment the Income Tax Law so that all foreign exchange differences are treated as tax neutral (neither taxable nor deductible) unless they result from trading in currencies or currency derivatives.
- Amendment of the Income Tax Law so that it is harmonized with the jurisprudence of the European Court of Justice regarding group loss relief provisions.
- Amendment of the arm’s length principle provisions included in the Income Tax Law so that they provide for downward transfer pricing adjustments.
- Extension of the 50% exemption from 5 to 10 years for employment income exceeding €100,000 per annum.
- Extension of the provisions for accelerated depreciation to tax years 2015 and 2016 in respect of plant and machinery (20% as opposed to 10%) and industrial and hotel buildings (7% as opposed to 4%).
- Introduction of anti-avoidance rules for re-organizations. The exemption is denied in case one of the main purposes of the reorganization is to avoid, reduce or defer the incurrence of tax.
- Change of the definition of the terms “Cyprus Republic” and “permanent establishment” to include all activities relating to the exploration and exploitation of the seabed in Cyprus’ exclusive economic zone.
• Amendment of the Capital Gains Tax Law to bring within its ambit the disposal of shares which directly or indirectly participate in other companies which hold immovable property in Cyprus.

• Amendment of the Capital Gains Tax Law to tax any trading nature profits derived from the sale of shares of companies which own immovable property in Cyprus in case such profit is exempt under Income Tax Law.

The proposed changes are expected to be discussed in the House of Representatives in the coming September.

Implications
The amendments to the Cypriot tax laws provide both individual and corporate investors a broader scope of options in structuring their investments into Cyprus. Nevertheless, investors should undertake a review of their existing arrangements and structures in order to assess the impact of the changes and ensure their conformity with relevant amendments. Businesses should therefore reconsider their structures in an effort to assess options and consider taking any necessary actions.

For additional information with respect to this Alert, please contact the following:

Ernst & Young Cyprus Limited, Limassol

• Philipppos Raptopoulos  +357 25 209 740  philippos.raptopoulos@cy.ey.com
• Petros Liassides  +357 22 209 797  petros.lliassides@cy.ey.com
• Petros Krasaris  +357 22 209 790  petros.p.krasaris@cy.ey.com
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2015 EYGM Limited.
All Rights Reserved.

EYG No. CMS570

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com