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ALERT
KPMG in Cyprus

Tax Alert

17 July 2015

Tax measures for a more competitive and fair environment

The new amendments to the Cyprus tax system aim primarily to:

- Attract new equity capital in an attempt to phase-out debt financing
- Create business substance and attract high-net worth entrepreneurs and individuals by setting out a bundle of attractive incentives

Corporate Taxation

Notional Interest Deduction (NID):

In an attempt to reduce excessive debt financing and encourage the investing of equity in corporate structures (hence reducing the overall debt exposure and de-leveraging the economy), the new amendments provide for a deduction on new equity by way of a Notional Interest Deduction (NID) as of 1 January 2015. The NID will be calculated on the basis of a reference interest rate on new equity held by the company and used in the business.

The much expected developments in taxation are expected to considerably enhance the competitiveness of the Cyprus tax system without taking away from its already established nature. A set of draft Bills were submitted to the Cyprus Parliament, and have been voted into law.

A second pack is expected to be voted into law in September.

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NID Formula **= (Reference Interest Rate) *x* (New Equity)**

Definitions	• **Reference Interest Rate:** The interest rate of the 10 year government bond yield of the country in which the new equity is invested or of the Republic of Cyprus (as at 31st December of the previous tax year), whichever is the highest, increased by 3%. • **New Equity** Any equity introduced in the business on or after January 1, 2015. This includes issued fully paid share capital and share premium introduced into the business on or after January 1, 2015, but does not include amounts which have been capitalized and result from a revaluation of movable or immovable property or retained earnings (prior to 31st December 2014). • **Old Equity** Equity that existed on 31st December 2014.
Anti-abuse provisions	• In the calculation of the NID, only equity in excess of old equity will be taken into account. Any equity introduced into the business on or after January 1, 2015 which results directly or indirectly from reserves existing on 31st December 2014 and such equity does not relate to new assets used in the business, will not be treated as new equity. • If a taxpayer's new equity is derived, directly or indirectly, from the new equity of another taxpayer, or if an interest expense has been claimed on the same equity investment, the NID is granted in only one of those taxpayers. • In order to safeguard the coherence of the tax base, the NID will not be available in the case of losses neither can it exceed 80% of the profit. • The NID will be restricted in the event where the new equity is the result of a qualified reorganization. • The NID may be restricted by the Tax Commissioner in the case where arrangements have been put into place aiming to benefit from the deduction, with no valid economic or commercial reason or in the case where old equity is attempted to be re-characterized as new equity through related party transactions and other arrangements.

The NID is primarily characterized as interest and as such it is subject to the same restrictions.

The claiming of the NID is not compulsory; taxpayers may elect whether to claim the NID, and they may also elect whether to claim part of the NID only.

The amendment will be applicable as of tax year 2015 onwards.

Personal Taxation

Introducing the Non-Domicile Principle:

The current Special Contribution for Defence (SCD) provisions will exclude from SCD, dividends, interest and rents (as well as from deemed dividend

distribution provisions), of individuals who are Cyprus tax residents ***but are*** ***<u>not</u>* domiciled in Cyprus** (as defined in the SCD Law) irrespective of the origin of the relevant income (i.e. from sources within Cyprus or abroad).
The new provisions define domicile in accordance with the rules of the Wills and Succession Law under which two main kinds of domicile are identified:

- A domicile of origin (i.e. the domicile received by him at his birth); and,

- A domicile of choice ((i.e. the domicile acquired by him by establishing a home with the intention of a permanent or indefinite residence).

A person who has his domicile of origin in Cyprus will be treated as “domiciled in Cyprus” for SCD purposes with the exception of:

- An individual who has obtained and maintained a domicile of choice outside Cyprus under the provisions of the Wills and Succession Law, provided that this individual was not a Cyprus tax resident for any period of at least 20 consecutive years prior to the tax year in question; or

- An individual who was not a Cyprus tax resident for a period of at least 20 consecutive years immediately prior to the entry into force of the introduced provisions (i.e. prior to 16 July 2015).

An individual who is resident in Cyprus for a period of at least 17 years out of the last 20 years prior to the tax year in question shall be deemed as domiciled in Cyprus for SCD purposes regardless of whether or not he has his domicile of origin in Cyprus.
The above provisions will result to the complete exemption from SCD of a Cyprus tax resident individual, who, in adopting the rules above is not a domicile of Cyprus for SCD purposes.

However, the exemption from SCD will not apply in the event of any assets that may give rise to SCD have been transferred from an individual domiciled in Cyprus to an individual not domiciled in Cyprus where one of the main reasons for the transfer was to benefit from the exemption. In such a case, SCD will be imposed on the income derived from such assets and may be collected either from the transferor or the transferee accordingly.

<u>Anti-abuse rules on multiple-tiered dividend distributions</u>:

Given that many individuals have interposed multiple corporate structures between themselves and their investments as an attempt to defer (and sometimes avoid) the payment of SCD on dividends distributed by such investments, the amendments vest the Cyprus tax authorities with the discretion to ignore any interposing companies that have been interposed for no valid commercial reasons reflecting economic reality, and treat the dividend as distributed directly to the individual.

Both amendments are applicable as of their date of publication in the Official Gazette (published on 16 July 2015)

Real Estate Taxation

<u>Capital Gains Tax (CGT) Exemption</u>:

A full exemption from capital gains tax will be granted for the sale to an independent party, of immovable property consisting of land, or land with a building or buildings, which will be acquired from an independent party, at market value, from the date the law will enter into force until 31/12/2016. That is, regardless of when the property will be sold, in essence it is enough that it has been bought up until 31/12/2016 and no capital gains tax will be payable. The exemption does not apply to immovable property that was acquired not by purchase or by purchase agreement but by a donation/gift or by way of an exchange.

Transfer Fees Exemption:

A 50% exemption from transfer fees under the Land and Surveys (Fees) Law will apply to ALL transfer applications effected until 31/12/2016.

Both amendments are applicable as of their date of publication in the Official Gazette (published on 16 July 2015).

We trust the above are sufficient for your purposes; in the event of further information required, please do not hesitate to contact your trusted KPMG advisor.

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