



## Second batch of Cyprus tax reform bills approved

**21 December 2015 - The long-awaited second batch of Cyprus tax reform bills, which aim at streamlining and further enhancing the island's tax system and encouraging investments, was approved and made official, earlier this month.**

### Introduction

The second phase of the amendments to the Cyprus tax legislation was published in the Cyprus Government Gazette on 17 December 2015, although the start dates for the changes vary.

We welcome the passing of these amendments although they should have come at an earlier date to provide an opportunity to businesses to analyse their impact to their taxable profits and make any necessary amendments to their 2015 provisional tax, the possibility of which is only available until 31 December 2015.

The first batch of amendments were analysed in Tax Alert 12: Cyprus Tax Reform in Full Swing, available in the [E-Library](#) section of our website.

### What's in the box?

Amendments were made to the income tax legislation, which also regulates corporation tax, the capital gains tax legislation and the collection and assessment of tax legislation. The amendments are analysed below.

### **[A] Amendments to the Taxation of Income Law, Law 118(I), as amended**


Unless otherwise stated, the amendments stated below are effective as of **1 January 2015**.

#### (1) Clarification on the scope of the law

The definition of the 'Republic of Cyprus' as well as of what constitutes a 'permanent establishment' were redrafted to include the Exclusive Economic Zone (EEZ) of Cyprus, thus bringing into the scope of the tax legislation the sea zone, which includes the exploration and use of marine resources.

#### (2) Amendments to the exemptions afforded in the law

(a) The exemption afforded to the income of local authorities, which is not from the carrying on of any business by them, has been amended to explicitly include income from the leasing of property.



(b) The exemption from income and corporation tax on the receipt of dividends has been amended to include the following clarifications:

When a Cyprus tax resident company, or a Cyprus permanent establishment (such as a branch) of a non-Cyprus tax resident company, receives dividends, the exemption will not apply to the extent that the dividends are tax deductible from the taxable income of the company that is paying out the dividends.

For example, where a company in another country declares a dividend to its Cyprus parent, and this dividend is deductible for the purposes of the taxable income as per the tax legislation of the foreign company, then the dividends will not be exempt from Cyprus income tax.

In this case, the amendment to the Cyprus tax law provides that such income will be considered as business income, taxable under corporation tax, currently 12,5%, and will **not** be taxable under Special Defence Contribution legislation, which is taxable currently at 17%.

The above amendment was done in order for the Income Law, Law 118(I), as amended, to be harmonized with the European Directives 2011/96/EU and 2014/86/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (the Parent-Subsidiary Directive).


This amendment with regards to dividend income is effective from **1 January 2016**.

(c) The exemption provided to physical persons that were not Cyprus tax-resident in the year before commencing their employment in Cyprus, being 20% of the gross emoluments, up to a maximum of €8.550, has been amended as follows:

the exemption will apply from the start of the year following the year of employment and will continue until the 2020 tax year inclusive, but cannot be granted for a total period exceeding five years. Previously, the exemption was only available for a total period of three years. The amendment clarifies that persons that claimed the exemption from the tax year 2012 can now benefit from the increased time period, meaning that this provision is effective from **1 January 2012**.

(d) The exemption provided to physical persons that were not Cyprus tax-resident in the year before commencing their employment in Cyprus, whose emolument exceed €100.000, being 50% of their gross emoluments, has been amended as follows:

- the exemption will apply for a total period of ten years of exercising employment in Cyprus, commencing from the year of employment; and
- the exemption will **not** be available where the person was a Cyprus tax resident in any three of the previous five tax years preceding the

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- commencement of employment in Cyprus, although this only applies to employments that commence on or after 1 January 2015; and
- the exemption will **not** be available where the person was a Cyprus tax resident in the year preceding the year of commencement of employment in Cyprus, although this only applies to employments that commence on or after 1 January 2015; and
  - the exemption will be granted for any tax year in which the annual total gross emoluments from the employment exceed €100.000, regardless if in a specific tax year, these were less than €100.000. This is subject to the total emoluments exceeding €100.000 at the start of the employment and the Commissioner of Taxation being satisfied that the fluctuation in total gross emoluments is not solely to obtain the exemption; and
  - where a person is benefiting from the 50% exemption, this person cannot benefit at the same time from the 20% exemption, with a maximum of €8.550, as stated in point (c) above.

(e) An important amendment, that has been awaited, is the exemption of any profit arising from foreign currency exchange differences. This exemption applies to all types of foreign currency exchange differences, which include options and rights in currencies (e.g. forward exchange contracts) **except for** foreign currency exchange differences arising from currency trading.


Persons trading in currencies have the option to **irrevocably** elect for unrealizable profits or losses from currency trading to affect the taxable income. Such irrevocable election can be made with a declaration that the Department of Taxation will approve, with the next income tax declaration to be submitted, provided that such declaration is submitted on time.

The above amendment aims to simplify the Cypriot tax treatment of exchange differences.

### (3) Amendments to the deductions afforded in the law

The intellectual property box scheme (see our tax update dated 4 January 2013, updated 17 January 2014), involving income from intellectual property, is amended to clarify that where a loss arises from the intellectual property, such loss is restricted for tax purposes to 20% of the amount of the loss. The loss is calculated in the same manner as the profit.

The law also provides that where an amendment is made by the Commissioner of Taxation on the grounds of arm's length principles (see paragraph 10 below), any



deduction made is considered to be a direct expense for the purposes of calculating the taxable income.

The law also clarifies that the notional interest deduction relating to the newly introduced provisions on the subject matter, which corresponds to qualifying IPs will be treated as a direct expense in the determination of the taxable profit.

#### (4) Amendment to the granting of capital allowances

Accelerated capital allowances have been extended to capital assets acquired up to, and including, the 2016 tax year. As a reminder, this allows for increased capital allowances of 20% on equipment, fixtures and fittings (instead of 10%) and 7% on industrial and hotel buildings (instead of 4%).

#### (5) Amendment to the deduction afforded for losses

The law has been amended to place the national legislation in line with the decision in the ECJ case of Marks & Spencer (Case C-446/03 Marks & Spencer Plc vs David Halsey (Her Majesty's Inspector of Taxes), judgment of 13/12/2005), albeit the decision having been in place since 2005. The tax office was in practice enforcing the decision. As per the amendment, a company established and tax resident in any member state of the EU, can transfer losses to a group company resident in Cyprus, so long as all possibility of utilizing or transferring those losses, either in the member state where the company is tax resident, or in another member state where an intermediary holding company may exist, have been exhausted.

#### (6) Amendment with regards to personal allowances

The law was amended to authorize the Commissioner of Taxation to personally approve pension or medical plans. Previously, these were approved by the Council of Ministers.


#### (7) Amendment with regards to Cyprus source income

A new article has been inserted in the tax legislation providing for a 5% tax on the gross amount, or other income, arising from rendering services, by a non-Cyprus tax resident person, with regards to the exploration and use of marine resources in the Exclusive Economic Zone (EEZ) of Cyprus.

This provision is effective from **1 January 2016**.

#### (8) Amendment with regards to the obligation to withhold tax

The legislation has been amended to obligate the Cyprus resident person effecting the payment of the 5% tax as noted in paragraph (7) above, withhold the tax and pay it to the Department of Taxation. Where the person effecting the payment is not Cyprus tax resident, by is paying on behalf of a related company that is Cyprus tax-



resident, then the obligation to pay the tax to the Department of Taxation falls on the Cyprus tax-resident related party.

This provision is effective from **1 January 2016**.

#### (9) Reorganisation schemes

Anti-avoidance provisions have been included in the articles regulating reorganization schemes. In order to obtain the tax exemptions, reorganization schemes must have a commercial and economic purpose. Where the Commissioner of Taxation can justify that a reorganization scheme was primarily undertaken for the purpose of tax avoidance, the Commissioner of Taxation may deny the tax exemptions.

The Commissioner of Taxation has also been afforded powers to impose conditions in relation to the number of new shares to be issued with regards to a reorganization scheme, as well as the number of years that such shares should be held by the recipient, which cannot exceed three years.

The period of compulsory holding does not apply to shares listed on a recognized stock exchange, as well as shares transferred due to inheritance.

This provision is effective from **1 January 2016**.

#### (10) Amendment to arm's length principals

The amendment to the arm's length principles explicitly state that where the Commissioner of Taxation adjusts the profits of a transaction, carried out between two Cyprus tax resident persons, because the transaction was not carried out at arm's length, a deduction will be afforded to the other person equal to the increase in profit or benefit. Where such adjustment relates to a loan, financial assistance or a debit balance, the resulting deduction afforded to the other person is deemed to be 'interest' in nature, and the provisions concerning restriction of interest will apply.

The above amendment aims for the application to Article 33 to be fairer to companies on their related party transactions.

#### (11) Unilateral relief for double taxation

Based on existing provisions, where a double tax treaty does not exist, the Commissioner of Taxation will allow for unilateral relief provided he is satisfied that double taxation has been paid by the same person on the same income. The amendment allows the Commissioner of Taxation to reject such unilateral relief where a transaction, or a series of transactions, were fictitiously put in place, primarily for the purpose of obtaining a tax benefit under the unilateral relief provisions.



This provision is effective from **1 January 2016**.

(12) Decree by the Council of Ministers

The amendment to the law provides that the Council of Ministers may issue a decree in order to regulate the duty for the issue of a tax residency certificate as well as for the issuance of tax rulings by the Department of Taxation.

Currently the duty for a tax residency certificate is €80, and there is no charge by the Department of Taxation to reply to requests for tax rulings, although a recent discussion within the Ministry of Finance considered the imposition of a fee of €1.000 per ruling, but only for direct tax purposes. It is still unclear whether any such charge will be made.

**[B] Amendments to the Assessment and Collection of Taxes Law, Law 4/78, as amended**

An amendment has been made with regards to temporary tax paid by a taxpayer during a tax year. Where a taxpayer has paid excess temporary tax in a tax year, such person has a right to a refund of the difference. The amendment removes the automatic right to refund that existed before, with interest commencing on the 1<sup>st</sup> January of the following tax year, and instead places the right to refund in line with the right to a refund on the final tax payable, where the date of commencement of the interest depends on such things as whether the tax return was filed on time.

The amendment is effective as of **1 January 2015**.


The reason of the amendment was to harmonize the corporation tax refund relating to provisional overpayments with the general provisions relating to refunds.

**[C] Amendments to the Capital Gains Tax Law, Law 52/80, as amended**

The amendments analysed below are effective from the date of their publication in the Gazette, being **17 December 2015**.

(1) Amendment to the definition of property

The definition of the term 'property, was amended to include shares in companies that directly or indirectly hold company or companies that own immovable property located in Cyprus, and at least 50% of the market price of the shares results from the market price of that immovable property. There is also a clarification that states that in calculating whether the value of the immovable property represents at least 50% of the value of the shares, no obligations are taken into account.



This amendment is made to widen the scope of the capital gains tax law to capture structures that used a two-tier minimum holding structure, and sold the shares of the holding company to avoid capital gains tax.

## (2) Amendment to the definition of profit

The definition of the term 'profit' was amended to explicitly state that it includes profit that is exempted from the Income Tax Law.

The reason of the updated definition of the term 'profit' is to tax under capital gains any profit relating from the disposal of shares of companies which direct or indirectly own immovable property in Cyprus in cases where such profit is considered as trading profit which is also exempt from corporation tax. This is an anti-avoidance provision to counter practices widely used mainly by banks, whereby each property is placed under a company and the bank 'trades' in these company shares, thus avoiding both capital gains and corporation tax. We are however not certain that this ability to tax trading in shares transactions can be derived from the amended wording in the law.

## (3) Amendment to the determination of the taxable gain

### (a) 1.1.1980 value with regards to land that has or will be separated into building plots


Provision with regards to how to the 1.1.1980 value, of land that has or will be separated into building plots, will be calculated, were amended so as to not be dependent on whether a new title deed has been issued or not.

### (b) Calculation of taxable gain in case of sale of shares

A new provision is inserted in the law with regards to the sale of shares. Where company shares are sold, the value of the immovable property is the **later of**:

- the value as at 1.1.1980, or
- the value on the date of the acquisition of the immovable property by the company that is the direct owner, or
- the value on the date of the acquisition of the shares by the person now disposing of them.

Where the shares are disposed, the base cost will be the previous disposal value. Where the shares were acquired without the imposition of capital gains tax, e.g. such as in the case of a reorganization scheme, such date is ignored for the purposes of the above calculation.



#### (4) Amendment to the sales price

Provisions determining the sales price when shares are sold were inserted, stating that the price is based exclusively on the price of the immovable property held by the shares sold, and would be equal to the market price that the Commissioner of Taxation believes would be realised had the property itself been sold on the open market at the point in time of the disposal of the shares.

Anti-avoidance provisions are also inserted whereby where a sale is made between related persons, and the selling price is less than the open market value of the property, the selling price will be that determined by the Commissioner of Taxation. In our opinion, the Commissioner of Taxation will most likely base his opinion on the price determined by the Department of Lands and Surveys, which is seldom correct or fair.