



COSTAS TSIELEPIS & CO LTD

TAX UPDATE

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BENEFIT ON DEBIT BALANCES



“knowledge”

Facts, information and skills acquired through experience or education; the theoretical or practical understanding of a subject.

OXFORD DICTIONARY

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ΓΝΩΣΗ

UNDERSTANDING THE BENEFIT ARISING FROM DEBIT BALANCES

1.0 Introduction

From 1 January 2012, Article 5 of the Income Tax Law 118(I)/2002, was amended to include a new 'type' of income that is subject to tax, which applies only to physical persons. This is the 'benefit' that arises from maintaining a debit balance with a company.

2.0 Application and calculation of the benefit

Specifically, from 1 January 2012, on the amount of any loan or other financial facility, or on any drawings, granted by a Cyprus tax-resident company to:

- a director who is a physical person, or
- a shareholder of that company who is a physical person, or
- the spouse of a director or shareholder, or
- a relative of up to second degree of a director or shareholder,

The person who receives the benefit of the loan/drawings/financial facility (referred to as the «recipient») is deemed to have a benefit, which is calculated monthly, at a rate of 9% per annum, on the debit balance amount. This benefit is included in the taxable income of that person. The benefit includes debit balances created before 1.1.2012.

As of 1.1.2012, the provision in the tax legislation (Article 39), which imposed deemed interest income on the company itself, equal to 9% on such debit balances, was abolished.

The benefit is a separate source of income and increases a persons' s taxable income. If the benefit is less than the tax free amount of €19.500, and there are no other sources of income, then no tax arises. In cases where tax arises, then the company must calculate the tax and pay it through the Pay-As-You-Earn (PAYE) system.

3.0 Scope of the benefit

A recipient person cannot be an employee of the company who is not also a director or a shareholder, or a spouse of either, or a relative of up to second degree of either. Furthermore, the benefit does not apply to debit balances arising out of trading transactions between the company and the recipient.

The Cyprus tax authorities have confirmed that for persons who are not Cyprus tax-residents, the benefit will be reduced pro-rata by the number of days that the person was physically outside of the Republic of Cyprus. This will minimise significantly the tax for Cyprus non-resident persons (see example 2 below).

In case the company charges interest to the recipient on the debit balance, then that amount of interest reduces the value of the benefit.

The company may also have to restrict interest payable, up to the amount of the debit balance.

4.0 Examples

Example 1

A recipient, who is employed by Company A, has a fixed debit balance of €150.000 during a tax year, with the company. She has no other income from the company and has not declared any other forms of income to the company through form IR59.

The benefit is calculated at $9\% \times €150.000 = €13.500$. This amount is less than the tax free amount of €19.500. Company A does not have an obligation to withhold any tax.

Example 2

A non-Cyprus tax-resident person is shareholder of Company B. During 2013, he was in Cyprus for a total of 10 days. In 2012, he received an interest free loan from the company amounting to €5.000.000. The amount remained unpaid throughout the whole of 2013.

The benefit for 2013 is calculated at $9\% \times €5.000.000 = €450.000$, and is reduced by the number of days that the recipient was not in Cyprus i.e. by $(356/366) \times €450.000 = €437.705$. This leaves a taxable benefit of $€450.000 - €437.705 = €12.295$. This amount is less than the tax free amount of €19.500. Company B does not have an obligation to withhold any tax.

Example 3

During 2014, a recipient has a fixed debit balance amounting to €150.000 during the tax year with Company C. In addition, he receives a salary from the company equal to €14.000 for the year. He has no other income or personal allowances, except for social insurance.

The benefit is calculated as $9\% \times €150.000 = €13.500$ and this is added to his salary of €14.000. Total remuneration amounts to €27.500. It is the position of our firm that the benefit is not subject to social insurance contributions.

The tax that must be withheld by Company C, and paid to the Income Tax Office through the PAYE system during the 2014 tax year is €1.381,60. This is calculated as follows:

	€
Salary	14.000
Benefit	<u>13.500 +</u>
Total Income	27.500
Social Insurance: $7,8\% \times 14.000$	<u>(1.092) -</u>
Taxable Income	26.408
Tax from €0 - €19.500 @ 0%	Nil
Tax From €19.501 - €26.408 @ 20%	<u>1.381,60 +</u>
Tax Payable	<u>1.381,60</u>

Example 4

A recipient has a fixed debit balance of €150.000 during the tax year with Company D, which in turn charges her interest on her debit balance at a rate of 6%. The recipient also receives a salary from the company equal to €14.000 in the tax year, and has no other income.

The benefit for the tax year amounts to €4.500 and is calculated as follows:

	€
9% x €150.000	13.500
Less: interest charged by the company on the debit balance [6% x €150.000]	<u>(9.000) -</u>
Benefit	<u>4.500</u>

The benefit is added to the salary of €14.000. Total remuneration amounts to €18.500. This amount is less than the tax free amount of €19.500. Company C does not have an obligation to withhold any tax.

NOTE

The above is issued as guidance only and should not be solely relied upon to structure business transactions without expert advice. Helping to implement the low effective tax rate that the Cyprus tax system can offer, minimising potential withholding taxes from other tax jurisdictions, as well as negotiating with Cyprus and foreign tax authorities, will contribute significantly to minimising tax 'leakage' within a group.

Our experienced team at Costas Tsielepis & Co, supported by our strong and capable network of associates around the world, is ready to help you plan your business ventures.