New tax developments – 2nd set of draft tax laws approved by the Cyprus Parliament – December 2015

On 10 December 2015, the 2nd set of important amendments to the Cyprus taxation system was approved by the House of Representatives. These developments aim to modernize the Cyprus tax system and encourage new investments.

The main amendments introduced are:

- Elimination of double taxation with regard to arm's length adjustments.
- Neutralisation of the tax treatment of the FOREX.
- Extension of the provision for the accelerated depreciation.
- Extension of the provisions for the employment income exception for the expatriates.
- Harmonization of the Cyprus tax system with the European Directive.
- Introduce anti-avoidance rules and correct inconsistences.

We analyse below in more details the amendments of the tax legislation, which have been voted into law. The amendments are effective as of 1 January 2015, unless otherwise stated.

A. Corporate Taxation

A.1. Arm's length Provision

The provision of the arm's length principles in the income tax law, currently provides for upwards adjustments to profits, in case a related party transaction is not carried out at an arm's length basis.

As per the new amendment to the arm's length provision, a corresponding downwards adjustment may be effected to the other taxpayer. It should be noted that the corresponding provisions of the tax legislation regarding the deductibility of the downwards adjustment will also apply in this case.

Oxilium comments: Now, the applicability of the provision of the arm's length principles will be fairer to Cypriot companies on their related party transactions.

A.2. Forex neutralisation

As per the amendment of the income tax law, foreign exchange differences will be treated as tax neutral for tax purposes (i.e. gain not taxable/loss non tax deductible), irrespective whether these are realised or unrealised.

The above provision does not apply on foreign exchange differences arising from trading in currencies and related derivatives. Taxpayers, trading in currencies may irrevocably opt to be taxed upon realisation of the forex rather than on accrual/accounting basis.

Oxilium comments: Taxpayers with cross-border transactions will not be affected from a tax perspective in case of forex fluctuation. The new provision aims to simplify the tax treatment of the forex.

A.3. Dividend taxation

As of 1 January 2016, dividends received by a Cypriot company will only be exempt from income tax, provided that these are non-tax deductible by the paying company.

If the above condition is not met, then such dividends will be subject under Cypriot income tax and not Special Defence tax.

The above amendment will be introduced by all EU member states and involves the introduction of anti-hybrid and general anti-avoidance measures with regard to distribution of profits between EU member group companies.

Moreover, transactions between EU member companies will not be benefit from the EU directive, if are not to be considered as genuine to the extent that they are not carried out for valid business and commercial reasons (i.e. they are carried out only to abuse the tax advantage under the EU directive).

Oxilium comments: The above amendment aims to harmonise the Cyprus tax legislation with the EU directive, whereby Member States may operate on equal terms, irrespective of the place of establishment.

A.4. Accelerated tax depreciation

The provision for the accelerated tax depreciation has been extended for assets of a capital nature acquired during the tax years 2015 and 2016.

Therefore, tax depreciation of 20% (instead of 10%) will continue to apply on plan and machinery (excluding assets which enjoy higher tax rate) and 7% (instead of 4%) for industrial and hotel buildings acquired the said years.

A.5. Group relief

The provision of the income tax law for the group relief was amended in order to be aligned with the EU Case law, whereby allowing cross-border group relief, as long as the companies are part of the same group according to the Cyprus income tax law.

As per the amendment, a company established and tax resident in any EU Member State, may surrender tax losses to a Cypriot company, provided that the surrendering company has exhausted all other possibilities to use the said losses in its country of residence.

A.6. Intellectual property tax losses

The provision for the Intellectual property (IP) tax regime is amended in order to clarify that under the current IP regime, tax losses will be restricted to 20%, given that only 20% of the related profits from IP are taxed This provision is expected to apply as of 1 January 2012.

A.7. Reorganisation restrictions

As of 1 January 2016, the Commissioner of Taxation may approve the tax neutrality of a reorganisation, subject to conditions which ensure that the reorganisation was not made in order to avoid the payment of taxes.

Furthermore, the Commissioner of Taxation may deny the tax exemption of the profits generated as a result of a reorganisation, if there are no valid business and commercial reasons which reflect economic reality.

A.8. Administrative fee for rulings

In accordance with the amendment, Council of Ministers may issue a decree in order to impose a fee for the issuance of tax rulings.

A.9. Oil and Gas provision

Non Cypriot tax resident persons rendering services within the Exclusive Economic Zone of Cyprus will be subject to 5% withholding tax on the gross amount or other income generated.

The non Cypriot tax resident person is obligated to pay the 5% withholding tax to the Tax Department, unless the services have been provided to a Cypriot tax resident company, whereas upon payment of the services the Cypriot company is also obligated to withhold and pay the 5% withholding tax to the Tax Department.

This provision is effective from 1 January 2016.

B. Personal taxation

B.1. Extension of the exemption for employment income over €100.000

As per the current income tax law, 50% exemption is applied for 5 years for remuneration above €100.000 for any employment exercised in Cyprus, for any individual that was not Cyprus tax resident prior to the commencement of employment in Cyprus.

The new provision of the law provides the extension of the period for which the exemption is available to 10 years.

It is also clarified that the exemption will not be available to individuals that were Cyprus tax resident for a period of 3 (or more) out of 5 years preceding the year of employment.

Furthermore, the exemption is available for any tax year whereby the remuneration from the employment in Cyprus is above €100.000 p.a.

The new provision also provides that the taxpayers cannot benefit at the same time the 50% exemption and the 20% exemption (as explained in the point B.2. below).

B.2. Extension of the 20% exemption on employment income

As per the current income tax law, 20% exemption or €8.550 (whichever is lower) is granted for a period of 3 years for any remuneration from any employment in the republic by an individual who was not resident of Cyprus prior the commencement of employment.

The new provision of the law provides that for employment commenced during or after 2012, the 3 year period is increased to 5 years.

This exemption will continue to apply until 2020.

C. Capital gain tax

C.1. Taxation of gain derived from directly or indirectly disposal of shares held to real estate company

As of 17 December 2015, the disposal of shares of companies that directly or indirectly hold immovable property situated in Cyprus will be subject to capital gain tax at the rate of 20%.

The above provision will apply to companies, in case 50% of their value derives from the market value of immovable property situated in Cyprus.

C.2. Calculation of capital gain tax in case of separation into building plots

As per the amendment, immovable property acquired prior 01 January 1980, whereas was separated into plots without new titles issued for each plot, in case of disposal of the plots, the value for capital gain tax purposes as at 01 January 1980 will be deemed to be the market value allocated to the each plot prior to the separation of the immovable property.

The above provision will apply as of 17 December 2015.

C.3. Calculation of capital gain tax in case of disposal of shares

As per the amendment, in order to determine the taxable profit for capital gain tax purposes in case of disposal of shares, the value of the immovable property taken into account is:

- The value of the immovable property on the date of initial acquisition of the shares, or
- The value of the immovable property on 1 January 1980, in case the shares were acquired prior to that date,

If the immovable property was formed part of previous disposals (either by sale of the property itself or by sale of shares of the company directly or indirectly owning the immovable property), the sale proceeds of the immediately prior disposal form the cost of acquisition deducted in the determination of the taxable profit (for capital gains tax purposes) of the current disposal.

The above provision will apply as of 17 December 2015.

C.4. Adjustment to the sales price

Anti-avoidance provisions are also inserted, whereas in case of disposals of immovable property between related parties and the amount reported as sale value is lower than the market value of the property, the sales value will be deemed to consider as the market value of the property on the disposal date as set by the Commissioner of Taxation.

It is expected that the Commissioner of Taxation will most likely base his opinion on the value determined by the Department of Lands and Surveys.

The above provision will apply as of 17 December 2015.

D. Assessment and Collection of Taxes Law

D.1. Tax refund of overpayment of provisional tax

As per amendment of the law, in case a taxpayer has paid excess amount of provisional tax in a tax year, there will be automatic right to refund the excess amount, with interest, commencing on the 1st January of the following year.

Meet the Team

Our tax experts will be glad to discuss with you the new provisions of the law and provide support, if needed. Our initial discussion is free-of-charge and without any obligation.

Contact us

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