



Cyprus Tax News

Significant amendments to the Cyprus tax legislation

On 10 December 2015, the House of Representatives voted into law a number of expected tax law amendments that were published in the Government Gazette on **17 December 2015**.

The amendments made to the Income Tax Law, the Capital Gains Tax Law and the Assessment and Collection of Taxes Law mainly aim to:

- improve Cyprus' competitiveness in attracting foreign investments;
- harmonize the Cyprus tax laws with EU legislation;
- address the tax treatment oil and gas activities taking place offshore Cyprus;
- deal with practical issues and inconsistencies of the existing laws; and
- introduce anti-avoidance measures.

Below we summarize the main tax law amendments:

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Income Tax Law

Tax neutral treatment of foreign exchange (FX) differences which do not relate to FX trading

According to the amended Income Tax Law (ITL), any (realized or unrealized) FX differences (gains or losses) will be tax neutral, except for gains/losses arising from trading in FX.

In other words, FX gains will not be taxable and FX losses will not be tax deductible, regardless of their nature (revenue or capital), with the exception of FX gains/losses arising from FX trading.

For persons trading in FX, the law introduces an option to make an irrevocable election to be subject to tax only on realized FX differences. In case such election is made, any unrealized FX differences will be treated as taxable/tax deductible in the year they are realized.

Effective date

This amendment is effective from **1 January 2015**.

Our view

This development simplifies the tax treatment of FX differences. A company (not dealing in FX trading) should be in a position to estimate its taxable profit more accurately, which will not depend on FX fluctuations.

Extension of employment income tax exemptions (20% and 50%)

Individuals taking up employment in Cyprus, who were previously residents outside Cyprus, are eligible to claim one of the following two tax exemptions:

- 20% of their employment income earned in Cyprus to be exempt from income tax, up to a maximum of €8,550;
- 50% of their employment income earned in Cyprus to be exempt from income tax, assuming such individuals earn more than €100,000 per year;

According to the amending law, the exemption period for the 20% income tax exemption is extended from 3 years to 5 years provided the employment started during or after 2012. This exemption applies for tax years up to 2020 and it is then abolished.

The exemption period for the 50% income tax exemption is extended from 5 years to 10 years. Furthermore, for individuals commencing employment from 1 January 2015, there will be additional requirements in order to be eligible for the 50% tax exemption. More specifically, a qualifying individual should not have been a Cyprus tax resident for at least 3 out of the last 5 years immediately prior to the year of commencement of employment and he/she should not have been a Cyprus tax resident in the tax year immediately prior to the year of commencement of employment.

The 50% tax exemption will be granted in any tax year in which the annual employment income of the qualifying individual exceeds €100,000, regardless if in a year during the 10-year period the employment income falls below €100,000. This provision shall apply where the annual employment income exceeds €100,000 during the first year of employment and the Commissioner is satisfied that the decrease and subsequent increase observed in the annual income of the employee was not intended to take advantage of the 50% tax exemption.

Effective date

The above provisions are effective from **1 January 2015**.

Our view

The extension of the employment income tax exemptions is introduced in an effort to enhance the benefits provided to multinational enterprise groups to set-up and/or enhance their business presence in Cyprus by relocating senior management to Cyprus.

Personal income tax deductions for contributions to approved pension and/or medical schemes

The ITL has been amended in order for individuals to be eligible to claim as tax deductible expenses, contributions made to insurance companies' pension and/or medical schemes which have been approved by the Commissioner of Taxation (rather than in accordance with relevant regulations).

Effective date

The above amendment is effective from **1 January 2015**.

Our view

This amendment clarifies the application of an existing tax benefit available to individuals.

Introduction of a corresponding downward transfer pricing adjustment on related party transactions

Prior to the change, the ITL only provided for upward adjustments to taxable profits, in cases where transactions between related parties were not at arm's length.

The ITL has been amended to provide for corresponding downward adjustments. That is to say, in applying the arm's length principle, where the Commissioner proceeds with an upward adjustment to the taxable profit of a Cyprus resident company or a PE of a non-Cyprus resident company, then the other party involved in the transaction will be eligible for a corresponding downward transfer pricing (TP) adjustment.

The corresponding TP adjustment will be subject to the provisions of the ITL with regards to its tax deductibility. Furthermore, if the upward adjustment is calculated upon a loan, financial assistance or a debit balance, the corresponding downward adjustment would be deemed as interest expense and would be subject to the provisions of the ITL regarding the tax treatment of interest expense.

Effective date

The above provisions are effective from **1 January 2015**.

Our view

The introduction of the downward TP adjustment aims to treat transactions between related parties in a fairer way.

Group relief of taxable losses

Prior to the change, for group relief purposes, only a Cyprus tax resident company could surrender losses to another Cyprus tax resident company. According to the amended ITL, losses may be surrendered to a Cyprus tax resident company by a company tax resident in another Member State of the European Union (EU) provided that such company has exhausted all the possibilities of carrying forward or surrendering its losses in its resident state or in another Member State where an intermediary holding company maybe be based.

Furthermore, according to the amending law, in establishing whether two Cyprus tax resident companies are eligible for group relief, the interposition of a non-Cyprus tax resident company will not affect their group relief eligibility as long as the interposed non-Cyprus tax resident company is tax resident in an EU country or in any other country with which Cyprus has signed either a (bilateral or multilateral) tax treaty or an exchange of information agreement.

Effective date

The above provisions are effective from **1 January 2015**.

Our view

The introduction of these amendments aligns the ITL with recent European Court of Justice (ECJ) decisions and enhance even further the group relief provisions of the ITL.

Taxation of dividend income arising from hybrid instruments

Prior to the change, dividend income was unconditionally exempt from income tax. According to the amendment, where a Cyprus resident company or a PE situated in Cyprus of a non-Cyprus resident company receives dividend income from another company, the income tax exemption shall not apply to the extent that such dividends are deductible from the taxable income of the dividend paying company. It is explicitly stated that dividends that do not qualify for the income tax exemption are not considered as dividends for Special Defence Contribution purposes.

Effective date

The above amendment will be effective from **1 January 2016**.

Claiming unilateral tax relief for underlying tax on dividend income paid by a company resident in another EU member state to a Cyprus company

According to the amending law, in case where dividend income is received from a company resident in another EU member state and such dividend income is subject to income tax in Cyprus, unilateral tax relief for the foreign underlying tax paid may not be credited against the Cyprus tax liability if an arrangement is considered to have been put in place that has no valid commercial reasons and aims to obtain a tax benefit.

Effective date

The above amendment will be effective from **1 January 2016**.

Our view

The introduction of anti-hybrid and general anti-avoidance measures in relation to dividend distributions within the EU is in line with the updated EU Parent-Subsidiary Directive as well as recent international tax developments with regards to the tax treatment of hybrid instruments.

Restriction of losses arising from the licensing and/or sale of intellectual property (IP) rights

The ITL has been amended clarifying the tax treatment of losses for companies qualifying under the Cyprus IP regime.

Under the IP regime, only 20% of the net profit from the exploitation/disposal of qualifying intangibles is taxable. The net profit is calculated after deducting from the license income/gains from disposal, all direct expenses associated with the production of this income. According to the amendment, in cases where a company (or a PE) generates a taxable loss, only 20% of such loss will be eligible to be surrendered (via group relief) and/or carried forward to subsequent years.

It is furthermore clarified that any corresponding downward TP adjustment that may arise from applying the revised arm's length provisions of the ITL and any notional interest deduction (NID) attributable to qualifying IP, will be deemed as direct expenses for the purposes of calculating the taxable profit/loss.

Effective date

The above provisions have a retrospective effect from **1 January 2012**.

Our view

This amendment clarifies the tax treatment of taxable losses arising from the licensing and/or sale of IP rights.

Extension of “accelerated” capital allowances

The ITL was amended in 2012 in order for plant and machinery purchased during the period 2012-2014 to benefit from a 20% (annual) capital allowance rate, unless the applicable capital allowance rate for the particular asset purchased was greater. In a similar manner, industrial buildings and hotels purchased during the period 2012-2014 benefited from a 7% annual capital allowance rate. The recent amending law extends the period for which accelerated depreciation is available to purchases made during the period 2015-2016.

Effective date

The above amendment is effective from **1 January 2015**.

Our view

This amendment should further encourage investment in qualifying fixed assets.

Definition of “Republic”

The ITL has been amended so that the definition of the term “Republic” is more explicitly defined. The Republic includes: *“Cyprus’ national territory, its terrain, its territorial waters as well as any areas outside its territorial waters including the contiguous zone, the exclusive economic zone and the continental shelf as well as any instalment, construction and artificial island located in these zones”*.

Effective date

The above amendment is effective from **1 January 2015**.

Extension of the Permanent Establishment (PE) definition

In line with the amended definition of the term “Republic”, the “Permanent Establishment” definition has also been amended. According to the amendment in the ITL, the definition “Permanent Establishment” (PE) also includes *“offshore activities relating to extraction, exploration or exploitation of the continental shelf, subsoil or natural resources as well as the installation and exploitation of pipelines and other installations on the seabed”*.

Effective date

The above amendment is effective from **1 January 2015**.

Our view

The amendments of both definitions are in line with the discovery of hydrocarbons offshore Cyprus. The extension of the PE definition, clarifies Cyprus’ right to tax certain offshore activities relating to the O&G industry that are carried within the Republic (as per the revised definition of the term).

Imposition of 5% WHT on income arising from natural gas services

The ITL has been amended providing for the tax treatment of income arising from services related to the O&G industry, performed by non-residents. More specifically: *“the gross amount or other income derived from sources within the Republic by any person who is not resident in the Republic, which does not arise from a permanent establishment in the Republic, as consideration for services carried out in the Republic with respect to the extraction, exploration or exploitation of the continental shelf, subsoil or natural resources, as well as the installation and exploitation of pipelines and other installations on the ground, the seabed or above the surface of the sea, is subject to tax at the rate of 5%.”*

It is further clarified that when the payment (with regards to the above services) is made by a non-resident person and the expense is borne by a related Cyprus tax resident person, the tax must be withheld at source and the latter is responsible for paying it to the Tax Department.

The tax is payable by the end of the month following the month in which the payment was made.

Effective date

The above provisions will be effective from **1 January 2016**.

Our view

The introduction of this amendment provides for an efficient way to tax O&G related activities performed by non-residents in the Republic that may not be captured through a PE. Needless to say that if a tax treaty is in effect between Cyprus and the State of residence of the party providing the services, the relevant treaty provisions apply.

Anti-avoidance provisions for reorganizations

According to the amended law, a re-organization would only be eligible to qualify as tax-free, where the Commissioner is satisfied that such a re-organization has substantial economic or commercial purpose.

According to the amendment, the Commissioner may not exempt from tax any profits arising from a reorganization, where in his judgment, the main purpose or one of the main purposes of such a re-organization was to avoid/decrease/postpone the payment of tax or the direct/indirect allocation of an enterprise's assets to any person without paying the relevant tax or by decreasing/postponing the payment of tax.

The Commissioner may request supporting evidence, if in his judgment he considers necessary, to establish the purpose of the reorganization. In any case though, the Commissioner's decision not to grant the relevant tax exemptions due to reorganization should be fully justified. Such a decision can in anyway be objected in accordance with the relevant articles of the Assessment and Collection of Taxes Law.

Should the Commissioner decide to approve the tax exemptions available due to re-organization, he may still enforce conditions in relation to:

- the number of shares which will be issued as a result of the reorganization and
- the period for which the issued shares must be held by the recipient, which cannot exceed 3 years.

Any shares listed in an approved stock exchange and any shares transferred due to hereditary succession are exempt from the holding period limitation.

In case the conditions set by the Commissioner are not satisfied, then the reorganization would not qualify under the tax-free re-organization provisions of the ITL and any tax initially not due would be considered as payable.

Effective date

The above provisions will be effective from **1 January 2016**.

Our view

The above amendments have been introduced as an anti-abuse measure of the tax-free re-organization provisions of the ITL.

Fees for issuance of tax residency certificates and tax rulings

The ITL has been amended in order to provide the power to the Cabinet of Ministers to set administrative fees for the issuance of tax residency certificates and tax rulings from **1 January 2015**.

Capital Gains Tax Law

Capital Gains Tax (CGT) on disposal of shares in multi-tiered structures

Prior to the amendment, CGT was levied on capital gains derived from the disposal of immovable property situated in Cyprus as well as from the disposal of (unlisted) shares of companies which own immovable property in Cyprus.

The amending law broadened the definition of “property” in such a way that CGT is also now imposed on the sale of shares which directly or indirectly participate in other companies which hold immovable property in Cyprus, provided that at least 50% of the market value (MV) of the shares sold is derived from immovable property situated in Cyprus.

In calculating whether the value of the immovable property represents at least 50% of the MV of the shares, any liabilities should be ignored.

Our view

This amendment closes a loophole in the CGT Law.

“Property” gains that are exempt from income tax will now be subject to CGT

According to the amendment, gains from the disposal of “property” (as defined in the revised CGT Law), that are exempt from income tax will now be subject to CGT.

Our view

With this amendment, any trading profits, derived from the sale of shares of companies which directly or indirectly own immovable property in Cyprus, will be subject to capital gains tax in case such profits are exempt from income tax.

Plots separation

Prior to the amendment, in case where an immovable property was acquired prior to 1 January 1980 and it was separated into plots without new titles being issued, if one of the plots was then sold, the value of the sold plot as at 1 January 1980 would have been deemed to be the MV allocated to the plot, prior to the separation.

The law was amendment removing the phrase “without new titles being issued” and thus the issuance of new titles becomes irrelevant for the above provision to be applicable.

Adjustment of base cost for capital gains tax purposes due to a previous disposal

According to the amendment, in case of a disposal of:

- (i) an immovable property that was directly or indirectly property of a company during a previous share disposal,
or
- (ii) shares in a company that directly or indirectly owns shares in another company

and where in such disposal, immovable property is involved on which tax was imposed and paid on a previous disposal, the value of the immovable property which is deductible (for CGT purposes) is equal to the disposal value that was used for the purposes of calculating the capital gain in the previous disposal of the immovable property in question.

Our view

The above amendment avoids the double taxation of profits that arise from a direct or indirect disposal of immovable property situated in Cyprus.

Determining the disposal proceeds

Upon disposal of the shares of a company which directly or indirectly holds immovable property in Cyprus, the disposal proceeds (for CGT purposes) are calculated based on the MV of the immovable property held directly and indirectly by the company of which its shares are sold.

Furthermore, in case of a disposal between related parties, where the declared disposal proceeds are lower than the MV of the property, the disposal proceeds will be deemed to be the MV of the immovable property on the disposal date as determined by the Commissioner.

Effective date

All of the above amendments in the CGT Law are effective from **17 December 2015**, the date these amendments were published in the Government Gazette.

Assessment and Collection of Taxes Law

Refund of excess provisional tax

According to the amending law, when a taxpayer proves that in any given tax year an excess amount of provisional tax has been paid over the correct amount of tax due, this excess amount is refundable. This amendment is effective from **1 January 2015**.

We are at your disposal to assist you in assessing the impact of these significant tax amendments in your existing or planned tax arrangements.

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