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Additional Changes to Tax Legislation of Cyprus Enacted This Week

The House of Representatives voted on 10 December 2015 the remaining changes to the tax laws, which the Government of Cyprus has agreed with the private sector over the last few months.

In an effort to improve the tax system of Cyprus, eliminate provisions which create issues on the day to day application of the law and make it more attractive to both the local and international business community, the House of Representatives voted on 10 December 2015 the remaining changes to the tax laws, which the Government of Cyprus have agreed with the private sector over the last few months.

These changes relate to the income tax and the capital gains tax law and are summarized below.

INCOME TAX LAW

1. Offshore activities

- (i) The law has been amended so that the definition of the term “Republic of Cyprus” now includes specifically and clearly the territorial sea, the contiguous zone, the exclusive economic zone and the continental shelf of Cyprus.
- (ii) The law has also been amended to include in the definition of the term “permanent establishment” all activities for the exploration and exploitation of the seabed in the exclusive economic zone, as well as services related to such exploration or exploitation activities.
- (iii) The gross income which is earned from sources within Cyprus (including those mentioned above) by a person who is not tax resident of Cyprus or who does not have a permanent establishment in Cyprus in consideration for providing services listed in subparagraph (ii) above would be subject to tax at the rate of 5%.





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In case such payments are made by persons who are not tax residents of Cyprus or who do not have a permanent establishment in Cyprus, but such services are born by an associated person in Cyprus, the obligation to withhold and pay this tax (by the end of the following month) to the Cypriot tax authorities is with such an associated person.

This provision applies as from 1 January 2016.

2. Amendments to income exempt from tax

- (i) Local authorities will no longer be exempt from taxation on rental income from property.
- (ii) Exchange differences, both gains and losses, and irrespective of whether they are realized or unrealized will no longer be taxable/tax deductible, irrespective of the purpose for which the funds in a foreign currency have been used for.

This will not apply in the case of companies trading in foreign currencies and related products. Such companies may irrevocable elect not to be taxed on unrealized gains or losses, but instead be taxed only when such gains or losses are realized.

- (iii) The above provisions apply as from the tax year 2015.

3. Anti-avoidance provisions for hybrid instruments and artificial transactions for dividends

- (i) Under current law, dividends are exempt from income tax, but for individuals and, in a number of cases for companies, are subject to defence tax.
- (ii) In a number of cases, dividends received by a Cypriot company from a company located outside Cyprus, whereas in the case of Cyprus these amounts received are considered as dividends, in the country where the company paying the dividend is located these payments are not treated as dividends paid, but instead are treated as tax deductible expense. These are called “hybrid instruments”.





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An example of such hybrid instruments are dividends paid on preference shares, which in the case of Cyprus are considered as dividend income, whereas in the case of the country of the dividend paying company, such as Luxembourg, these payments may be considered as interest paid and allowable as a tax deductible expense.

- (iii) The EU Parent / Subsidiary Directive has been amended last year to exclude such payments from benefiting under the directive and the member states must introduce legislation in order to avoid the double non taxation of these dividends.
- (iv) The tax laws are amended, so that dividends received by a Cypriot tax resident company which fall under the above provisions will no longer be exempt from income tax, but instead will be taxed as normal business income subject to income tax and will be exempt from defence tax.
- (v) In addition, the EU Parent / Subsidiary Directive has been amended so that it does not apply in cases where between the dividend paying company and the dividend receiving company there is an arrangement or a series of arrangements, which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the Directive, are not genuine, having regard to all relevant facts and circumstances.

An arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons, which reflect economic reality.

The tax law has been amended to incorporate the above changes into the Cypriot tax legislation.

- (vi) The change will apply as from 1 January 2016.





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4. Exemptions of income from first employment in Cyprus

- (i) Under current law, 20% of the income from employment in Cyprus of a person who was not tax resident of Cyprus during the previous tax year is exempt from taxation for a period of three years. The maximum amount of the exemption is €8.550 per annum.

This exemption is now extended for the first five years, but the exemption can only be claimed until the year 2020.

The change applies as from the tax year 2015.

- (ii) Under current law, 50% of the income from employment in Cyprus which commences after 1 January 2012 of a person who was not tax resident of Cyprus during the previous tax year is exempt from taxation for a period of five years, provided the income from employment in Cyprus exceeds €100.000 per annum.

The period of five years is now extended to ten years.

For employments which start after 1 January 2015, an individual will be entitled to this benefit, only if he was not tax resident of Cyprus for any three out of the last five tax years prior to the commencement of his employment in Cyprus and at the same time he was not tax resident of Cyprus the previous tax year.

The exemption is granted in any tax year that his income from employment exceeds €100.000 per annum, irrespective of whether the income drops below €100.000 in any year, provided that when the employment started the income exceeded €100.000 and provided the Commissioner is satisfied that the increase/decrease in the annual income is not made for the purpose of obtaining this tax benefit.

- (iii) It should be noted that it will no longer be possible to obtain benefit under both exemptions, i.e. the 20% exemption and the 50% exemption, an issue which has been in dispute for the last few years.





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5. Loss because of using the IP Box regime

In cases where a person is claiming relief under the special provisions for the taxation of income from intellectual property (where a notional deduction is granted, which is equal to 80% of the gross profit from the exploitation or the disposal of such intangible asset) and because of this claim there is a loss, only 20% of such losses can be offset against income from other sources or be carried forward to be offset against income of following tax years.

This provision has a retroactive effect as from the tax year 2012, when the IP Box regime has been introduced in Cyprus.

6. Increased annual allowances for capital expenditure

- (i) Under the existing law, increased annual allowances are granted for new expenditure incurred in the years 2012, 2013 and 2014 for plant and machinery (20% instead of 10%) and for new industrial buildings and hotels (7% instead of 4%).
- (ii) The period during which the expenditure can be made is now extended to cover expenditure incurred in the years 2015 and 2016.

7. Group loss relief

- (i) Under the current provisions of the law, group loss relief can only be given for losses incurred by Cyprus tax resident companies. This means that losses incurred by a member of a group of companies can only be surrendered to another member of the same group, provided that both companies are tax residents of Cyprus.
- (ii) In order to align the Cypriot tax laws with a European Court of Justice's decision in the Marks & Spencer case, the law is amended so that a subsidiary company which is tax resident in another EU member state can surrender its taxable losses to another group member company tax resident in Cyprus, provided the subsidiary has exhausted all the means of surrendering or carrying forward the losses in the member state of residence of the subsidiary or to any intermediary holding company.





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- (iii) In case of surrendering tax losses as above, taxable losses must be calculated on the basis of the Cypriot tax laws.
- (iv) The law has also been amended to allow, for the purposes of considering whether two companies are members of the same group, the interposition of holding companies established in (a) another EU member state, (b) in a state with which Cyprus has concluded a double tax treaty or (c) in a state which has signed the OECD multilateral convention for exchange of information.
- (v) These provisions apply as from the tax year 2015.

8. Anti-avoidance provisions for re-organizations

- (i) A number of anti-avoidance provisions are introduced, which will give the right to the Tax Commissioner to refuse to accept tax free-reorganizations, if the Commissioner is not satisfied that there were real commercial or financial reasons for such reorganization and he can determine that the main purpose or one of the main purposes of the reorganisation is the reduction, avoidance or deferment of payment of taxes.
- (ii) The Commissioner will also have the right to impose conditions on the number of shares which can be issued as part of the re-organization and the period for which such shares should be held (not more than three years).

However such restrictions cannot apply in the case of publicly listed companies and transfers of shares as a result of succession.

- (iii) These provisions apply as from 1 January 2016.

9. Related party transactions

- (i) Under current legislation, the Commissioner has the right to adjust the value of transactions between related parties, if such transactions are not carried out on an arm's length basis. Based on current practice, the Commissioner in the case of transactions between two Cyprus tax resident companies does not grant a corresponding deduction to the





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other party for income adjusted in the hands of the first party to the transaction, thus there was a mismatch.

- (ii) The law is amended so this anomaly is corrected and in case of an adjustment in the income of the one party, a corresponding deduction should be given to the other party to the transaction.
- (iii) This provision applies as from 1 January 2015.

10. Fees for issuing certificates/rulings

The Council of Ministers may issue administrative orders to fix the amount of fees to be paid to the Tax Commissioner for the issuing of tax residency certificates (currently levied at €80) and for issuing tax rulings (no fees charged currently)

CAPITAL GAINS TAX LAW

1. Capital gains from sale of shares in property companies

- (i) Currently, capital gains tax is charged on disposal of immovable property located in Cyprus or on disposal of shares of companies, which directly own immovable property located in Cyprus.
- (ii) Under the new legislation, gains from the sale of shares in companies which indirectly own immovable property in Cyprus by holding directly or indirectly shares in a company, which owns immovable property located in Cyprus, will also be subject to capital gains tax.

This will apply only in case the value of the immovable property represents more than 50% of the value of the assets of the company whose shares are sold.

- (iii) The change in the legislation can be illustrated as follows:
 - (a) Company A owns the shares of Company B, which owns the shares of Company C, which in turn owns immovable property located in Cyprus.





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- (b) Currently, capital gains tax will arise if:
 - 1. Company C sells the immovable property or
 - 2. If Company B sells the shares of Company C
- (c) Under the new legislation capital gains tax will arise also if Company A sells the shares Company B.
- (iv) In the case of sale of shares of a company owning immovable property, the gain to be taxed will be calculated only based on the market value of the immovable property, which is held directly or indirectly.

2. Trading gains from sale of shares of property companies

Currently, if a company is selling shares of companies which would be considered as transactions of a trading nature and thus falling under the provisions of the income tax laws, any gains from the sale of such shares are exempt from income tax. Since these gains would not fall under the capital gains tax law, then the gains are tax free, even if the company whose shares are sold owns immovable property located in Cyprus.

Under the new legislation, such gains which are exempt from income tax would now be subject to capital gains tax.

3. Transactions between related parties

In case there is sale of property between related persons, the Tax Commissioner will have the right to replace the sale price declared by the parties concerned with the market value of the property sold, if, in his opinion, the selling price declared is lower than the market value.

4. Date of entry into force

The above provisions will come into effect as soon as the new law is published in the Official Gazette, which is expected to be done before the end of December 2015.

