Michalis Avraam & Partners Limited
AUDITORS AND BUSINESS ADVISORS

TAX UPDATE

AMENDMENTS IN CYPRUS TAX LEGISLATION

The amendments were voted on 14 December 2010 by the Cyprus Parliament and their main aim is to combat tax evasion and tax avoidance, as well as to simplify certain provisions of the Cyprus Tax Legislation. The following provisions will come into force six months after their publication in the official Gazette of the Republic.

INCOME TAX LAW

1) Disallowed Expenditure:

From tax year 2011 and subsequent tax years, any expenses incurred for business purposes which are not supported by invoices and receipts or other supporting documents as required by the relevant Regulations will not be deductible under Income Tax. *This is a simplification of the Law as in practice all audit firms were applying this clause before the change in Law.*

2) Imposition of Notional Interest on Directors/Shareholders Debit Balances:

Under section 39 of the Law, notional interest of 9% was imposed on the debit balances of Directors/Shareholder. This provision will not apply, as from 1 January 2011, in the case where the Directors/Shareholders are companies.

In this case the provisions of section 33 of the Law relating to transactions between related parties (arm's length conditions) will apply. In accordance with section 33, the Commissioner of Income Tax has the right to impose notional interest on balances or loans in those cases where interest is not imposed using market interest rates.

3) Tax withheld on payments to Non-Residents:

Taxes withheld on payments to Non-Cyprus Residents in respect of the following should be paid to the tax authorities by the end of the following month:

- Copyrights for use within Cyprus (tax 10%),
- Cinematographic film rights (tax 5%),
- Income of individuals for professional services, artists, etc (tax 10%).

In case of delay in payment, interest of 5,35% and an additional tax of 5% is applied on the amount of tax withheld. The above withholding rates may be reduced or even eliminated through utilisation of Double Tax Treaties or for payments to EU residents.

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SPECIAL CONTRIBUTION FOR THE DEFENCE OF THE REPUBLIC LAW

1) Deemed Dividend Distribution Provisions:

- In accordance with the Law, companies which do not distribute 70% of their **profits after taxation** within two years after the end of the relevant tax year, will be deemed to have distributed as dividends 70% of these profits and defence contribution is paid at 15%. Until now the term taxation (above) included only income tax paid in Cyprus. In addition to income tax the amendment now also includes Special defence contribution, capital gains tax and overseas tax.
- Companies under voluntary liquidation are obliged to submit the deemed distribution forms with respect to the profits of the specific tax year and the preceding two years and pay any contributions due, one month from the date of approval of the resolution for voluntary liquidation. In case where profits arise during the liquidation of a company, no defence contribution is paid for deemed distribution if the assets of the company are not adequate for repaying the company's creditors and any defence contribution cannot exceed the value of the net assets distributed to the shareholders.
- Any amount paid to a shareholder (individual, not legal person), in case of capital reduction, that is in excess of the amount of share capital actually paid by the shareholder, will be deemed as dividend and 15% defence contribution will be payable.

Note: The provisions regarding deemed dividend distribution are applicable only when shareholders of the Company are Cyprus Tax Residents.

2) Rents:

Companies, partnerships, the Republic or local administration authority must withhold at source special defence contribution on payment of rents. The contribution is 3% on the 75% of the amount of rent and is paid to the tax authorities six monthly.

ASSESSMENT AND COLLECTION OF TAXES LAW

1) Registration with the Cyprus Tax Authorities:

Following the incorporation or registration of a company with the Cyprus Registrar of Companies, the company is obliged to submit an application for registration with the Cyprus Tax Authorities and obtain a Tax Identification Code (TIC) within 60 days.

Transitional provisions of six months (by 30 June 2011) for obtaining a TIC have been granted for companies which have been registered before the commencement of this law.

Additionally, companies already registered with the tax authorities should inform the authorities within 60 days of any relevant amendments to their records which affect the Tax Authorities Register.

2) Lifting of banking secrecy:

The Commissioner of Income Tax has the right, in relation to the examination of any person, to request from a bank to provide the Commissioner with any information (in possession of the bank) for a period of 7 years preceding the date of the request, provided that the Commissioner has written approval of the Attorney General of the Republic.

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Under the law, the Commissioner of Income Tax is required to provide the bank and the Attorney General of the Republic the following:

- Identification of the person under investigation.
- Nature and form of information requested.
- The reasons that the Commissioner believes the bank is in possession of the information.
- The period to which the requested information relates.
- A statement declaring that the tax authorities exhausted all available means for collecting the information.
- The justified tax reasons for which the information is requested.

3) Electronic submission of tax returns:
Tax returns may be submitted electronically in cases where these have been prepared based on audited financial statements or are submitted by a professional accountant. In such case the deadline for submission is extended by 3 months.

4) Tax assessments issued by the Commissioner:
In case where a taxpayer has not submitted a return for a tax year by the time limit set out within the law, or in case where a tax payer does not maintain proper books and records, the Commissioner may issue an assessment for the payment of tax (based on available information to the Commissioner).

5) Tax objections:
Any objections against assessments issued by the tax authorities should provide the following:

- The reasons for the objection, outlining the reasons that the taxpayer considers the assessment to be incorrect and that no obligation arises to pay the tax as per the assessment,
- Computation of the amount of tax as per the position of the tax payer,
- Appropriate supporting evidence.

The deadline for submission of objections is the end of the month following the month that the assessment has been issued. The deadline for submission of objections against assessments issued in December is extended to the end of February of the following year.

6) Exchange of information between Tax Authorities and other Government departments:
The Commissioner of Income Tax has the right to request information from other governmental departments, local authorities and semi-governmental departments excluding the Central Bank and the department of Supervision and Development of Cooperative Companies.

7) Tax Visits:
It has been clarified that the Commissioner has the right during the normal hours of operation of a business to enter into any space (excluding private residences) used by the business and inspect any goods and documents, which are used for business purposes, situated therein.

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8) Updating of accounting records and issuance of invoices:
Companies which have an obligation to keep books and records for every tax year are obliged to:
- Update these accounting records within 4 months from the date of each transaction,
- Issue invoices within 30 days from the date of the transaction (unless approval has been obtained by the Commissioner for issuing invoices at a later stage),
- Businesses which maintain stocks should carry out annual stock takes and the related documentation should be available for inspection by the tax authorities.

9) Payment of disputed tax in case of court appeals:
In the case of appeals by taxpayers to the Supreme Court against an assessment issued by the tax authorities, the payment of the disputed amount of tax for which the appeal has been made (and not the total amount of tax) will be postponed until the decision by the court.

ADMINISTRATIVE PENALTIES

1) Administrative penalty of €100 to €200 will be imposed to a person (company or individual), which refuses, omits, or neglects to give a notice or to submit a return or to provide information requested by the Commissioner or to perform any compliance obligations, within the deadline given in the relevant tax law and/or within the deadline given in a written notice issued by the Commissioner which is not less than 60 days.

2) Additional tax of 5% on the tax due will be imposed in case where a person does not pay the amount of tax due within the due date in accordance with the provisions of the relevant law or determined in a notice issued by the Commissioner.