



AMENDMENTS IN CYPRUS TAX LEGISLATION

On 22 October 2009 the Cyprus Parliament passed amendments to the Income Tax Law and the Special Contribution for Defence of the Republic Law removing a number of disadvantages mainly to companies with investment activities.

The changes in legislation come into force immediately with retroactive effect to 1 January 2009.

1. DIVIDENDS RECEIVED FROM INVESTMENTS IN FOREIGN COMPANIES

The participation exemption for dividends received from non-resident companies has been relaxed in the following way:

Prior to the amendment:

Dividend income – **15% Defence tax**: In case that the dividends are received from a company, the shareholders of which hold directly at least 1% of the share capital, then the dividends are exempt from the payment of defence tax. This exception does not apply if:

- the company paying the dividend engages more than 50% in activities that lead to investment income (passive income), and
- the foreign tax burden on the income of the company paying the dividend is substantially lower than the tax burden of the company that receives the dividend (i.e. the foreign tax burden is lower than 5%)

After the amendment:

The 1% holding requirement is abolished so that investors can now qualify for the participation exemption for dividends received from non-resident companies provided that the other 2 conditions do not hold.

2. INTEREST INCOME

Prior to the amendment:

Interest income in Cyprus is taxable under both Defence Tax and Income Tax:

Defence Tax: 10% on interest income. However, in cases where “Interest accruing to any person from the ordinary carrying on of business, including interest closely connected with the ordinary carrying on of business”, is not treated as interest. Instead it is treated as profits and is not taxable under defence tax.

Income Tax: Interest income is included in taxable income which is subject to 10% tax. However, in case the interest income was also taxed under Defence tax above then 50% of interest income is exempt, hence, the effective charge is 5%. In case the interest was treated as profits for defence tax purposes then 10% income tax applies.

Where:

- Ordinary carrying on of business applies to financial institutions such as banks, leasing and hire purchase companies.
- Closely connected with the ordinary carrying on of business applies to insurance companies, or in case of group companies the Company that borrows funds and then lends these funds to other companies of the group.



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From the above it can be concluded that in the cases where interest income was not accruing from the ordinary carrying on of business or closely connected with the ordinary carrying on of business, interest income was being taxed at 15% (Defence Tax 10% + Income Tax 5%).

After the amendment:

Interest income will be EITHER included in the taxable income of the company and be subject to 10% Income Tax (if it is considered to be derived in the ordinary course of business or closely connected to the ordinary course of business) OR be subject to only 10% Defence tax in all other cases.

3. TAXATION OF COLLECTIVE INVESTMENT FUNDS (CIS)

According to the amended legislation it has been clarified that interest income of Open-ended and Closed-ended CISs is subject only to Income Tax at 10% (less any allowable expenses) and exempt from Special Defence Contribution. Additionally it has been clarified that the redemption of units or other ownership interest in a CIS is considered as a disposal of titles and thus is exempt from tax. This is in line with a recent circular issued by the Cypriot Tax Authorities stating that participation in Open-ended and Closed-ended CISs are considered as titles and therefore the gains from the sale of such participations are exempt from taxation.

Finally, dividends received by a Cypriot resident individual from CISs established in Cyprus are subject only to 3% Defence Contribution instead of 15% which applies for all other types of dividends.