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Parliament Relaxes Tax Rules to Lure Investors

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The Cypriot parliament on October 22 passed amendments to the Income Tax Law and the Special Contribution for Defence (SDC) of the Republic Law that make Cyprus even more attractive to investors. The amendments entered into force immediately, with retroactive effect from January 1.

The objective of these legislative developments is to contribute to the promotion of Cyprus as an attractive jurisdiction for the establishment of collective investment schemes (CISs) and to attract companies holding interests in Cypriot and non-Cypriot CISs. The legislation provides new benefits for CISs and their investors as well as clarity and certainty for corporate portfolio investors in general.

A key result of the amendments is the relaxation of the eligibility conditions for the participation exemption for dividends received from nonresident companies. Before the changes, dividend income received by a Cypriot tax resident company from abroad was subject to a 15 percent SDC if a minimum 1 percent holding in the payer company was not maintained, regardless of whether other exemption criteria were met. The 1 percent minimum holding requirement has now been abolished so that investors can qualify for the participation exemption for their portfolio holdings.

The amendments also clarify the tax treatment of interest earned by open-ended and closed-ended CISs. According to the amended legislation, interest income earned by a CIS is subject only to income tax (less any allowable expenses) and is exempt from SDC.

The buyback or redemption of units or other ownership interests in a CIS is not considered a capital reduction for Cypriot tax purposes. As a result, any amounts payable to investors of a CIS will not be deemed as distributed dividends and will therefore be free of the SDC that would otherwise be chargeable at 15 percent (in the case of resident unit holders).

The amendments provide further clarity following a circular issued by the Cypriot tax authorities in December 2008, which stated that units in a CIS are considered ''titles'' for Cypriot tax purposes, meaning that gains derived on their disposal are exempt from tax.

There are two types of taxes that may apply to interest income earned by a Cypriot company: income tax levied at 10 percent on the interest derived, less any allowable expenses; and the 10 percent SDC applied to gross interest income.

Interest earned by a Cypriot tax resident company in the ordinary course of business or in close connection to its business is subject only to income tax. Before the amendments, other sources of interest income were subject to both SDC and income tax (with a 50 percent exemption). Now, interest income earned by companies is entirely outside the scope of income tax. The result is that where an effective tax rate of up to 15 percent previously was possible for interest earned by a Cypriot company, the maximum rate is now 10 percent in all cases. ◆

♦ *Paul Mallis and Olga Gaponova, Deloitte Cyprus.*