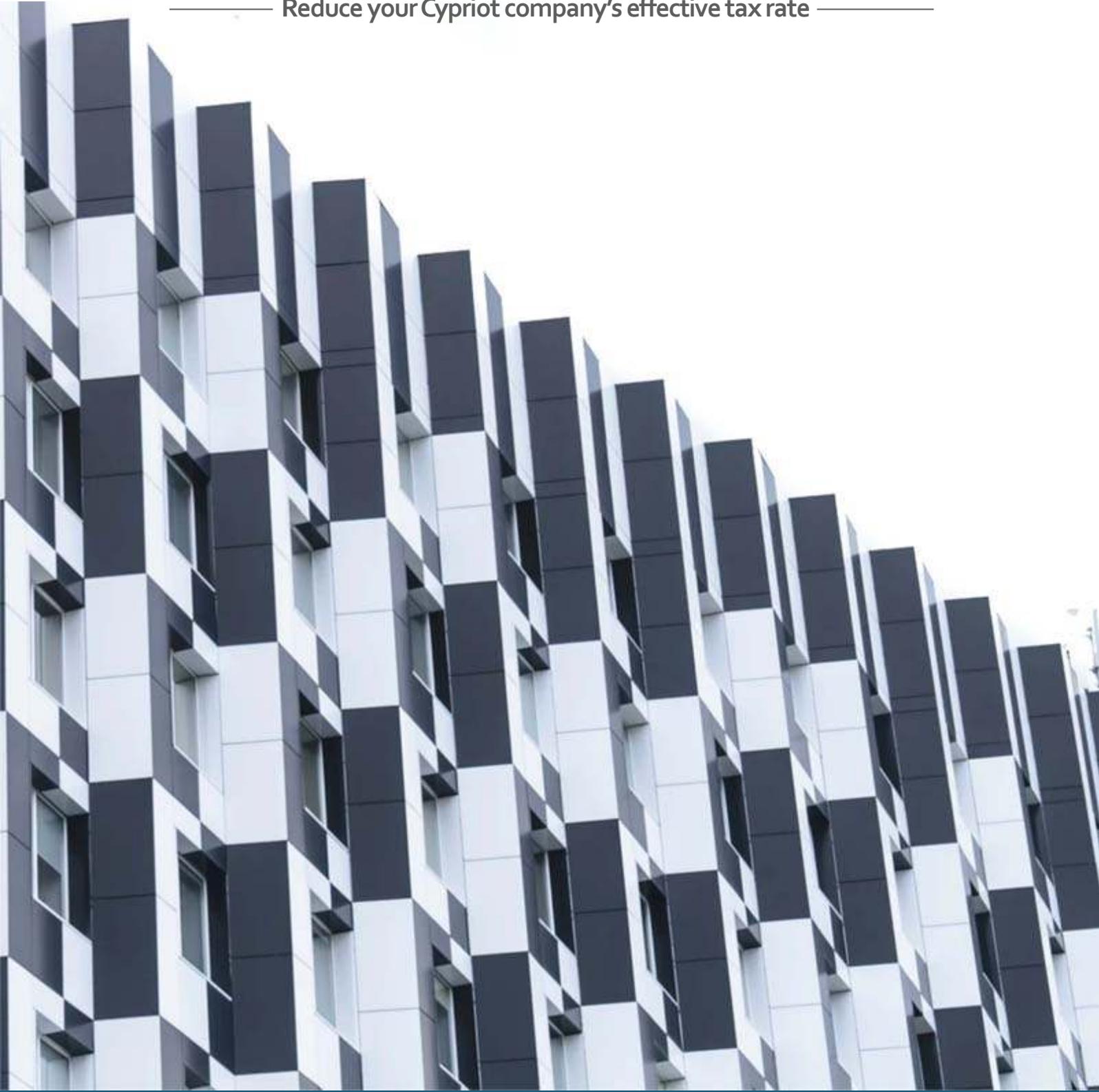


# Cyprus Notional Interest Deduction

Reduce your Cypriot company's effective tax rate



**ATCA Co. Ltd**  
Chartered Certified Accountants

## **IN BRIEF**

### **THE CHALLENGE**

The profits of a Cyprus company can be significantly reduced by shifting profits to a zero-tax offshore jurisdiction. Although this may create significant tax savings for the Cyprus company and its owners (as most of the profits are shifted to an offshore jurisdiction), it also creates tax and reputational risks.

### **THE OPPORTUNITY**

If properly structured and by taking advantage of the Cypriot NID provisions, the effective tax rate of a Cypriot company can be as low as 2,5%. This, without using an offshore jurisdiction or any complex/exotic arrangements. NID provisions apply to all Cyprus companies generating taxable income, including those providing finance, trading, licensing IP and other.

### **WE CAN HELP**

We can review your current position and advise you as to how you can take advantage of the Cypriot NID provisions. Moreover, we can handle the relevant tax compliance and track your NID calculations in line with relevant regulations and calculate your NID deductible expense.

### **CONTACT US**

**Constantinos Markou**  
Director  
Head of Tax Services  
markou@atca.com.cy  
+357 25661717

## **PREFACE**

Companies can be financed via debt, equity or a combination of both. Debt- mostly in the form of loans- generates interest expense, which is usually a tax-deductible expense for the borrower.

Equity on the other hand is associated with dividends, which are not deductible for tax purposes. This creates an incentive for companies to be funded via debt as opposed to equity.

The Cypriot Notional Interest Deduction provisions (NID) introduced on 18 July 2016 aim to equalize this imbalance by introducing a servicing cost for equity.

In simple terms, a Cyprus company financed with new equity is eligible to an annual notional deduction like interest. This deduction, if properly structured, can significantly reduce the taxable profits of a Cyprus company to an effective tax rate as low as 2,5%.

## **HOW NID WORKS**

New share capital introduced in a Cyprus company after 1 January 2015 used in business activities to produce taxable income is eligible to an annual notional interest deduction. This deduction will be claimed in perpetuity provided the new capital funds are in use to produce taxable income. It is to be noted, that the NID deduction does not trigger any accounting entries as the deduction is made purely for tax purposes.

## **HOW NID IS CALCULATED**

In a nutshell, NID is calculated by multiplying the New Capital introduced in the company with a Reference Rate.

## **RESTRICTIONS**

By way of a restriction, the NID deduction cannot exceed 80% of the taxable income generated via application of the new capital funds. There is also another restriction calculated based on the total income generated by all the assets and activities resulting from New Capital funds (see examples below).

## NEW CAPITAL AND REFERENCE RATE

New Capital generally represents shares of any type and class issued and paid after January 2015. The following may also be considered as New Capital funds:

- Unpaid share capital for which the company has recognized the claim of the receivable.
- Issue of share capital by capitalization of reserves created after January 2015.
- Issue of share capital by capitalization of reserves created that existed on 31 December 2014, provided that it can be proved that they related to new assets that generate taxable income.
- Issue of share capital by conversion of loans payable and other lending products.
- Issue of share capital by conversion of non-refundable capital contributions existed.

Asset contributions and the resulting issue of share capital can also be recognized as New Capital subject to the fulfillment of certain conditions.

### REFERENCE RATE

Reference rate is the yield rate of the 10-year government bond of the country in which the new capital has been invested, increased by a premium of 3%. The yield rate to be used is the one which was in effect on 31 December of the year prior to the tax year. In case the Cypriot 10-year bond rate (plus the 3% premium) results to a higher reference rate, the taxpayer can use the higher rate.

The Cypriot Tax Department is publishing the 10-year government bond yields for selected countries on an annual basis. You can find the relevant rates below. In case the yield rate for any country is not published, the taxpayer can obtain the yield from Bloomberg.

Type of income	2016	2015	2014
Cyprus	3,489%	3,685%	5,037%
Germany	0,204%	0,568%	0,54%
United Arab Emirates	3,326%	7,490%	-
United Kingdom	1,326%	-	-
India	6,878%	7,758%	7,86%
Latvia	0,894%	1,104%	-
Ukraine	8,705%	9,622%	-
Poland	3,627%	2,937%	-
Romania	3,748%	3,703%	3,57%
Russia	8,380%	9,570%	13,73%
Russia denominated in US	4,409%	6,600%	6,580%
Czech Republic	0,414%	0,499%	-

## OTHER PROVISIONS

### MATCHING CONCEPT

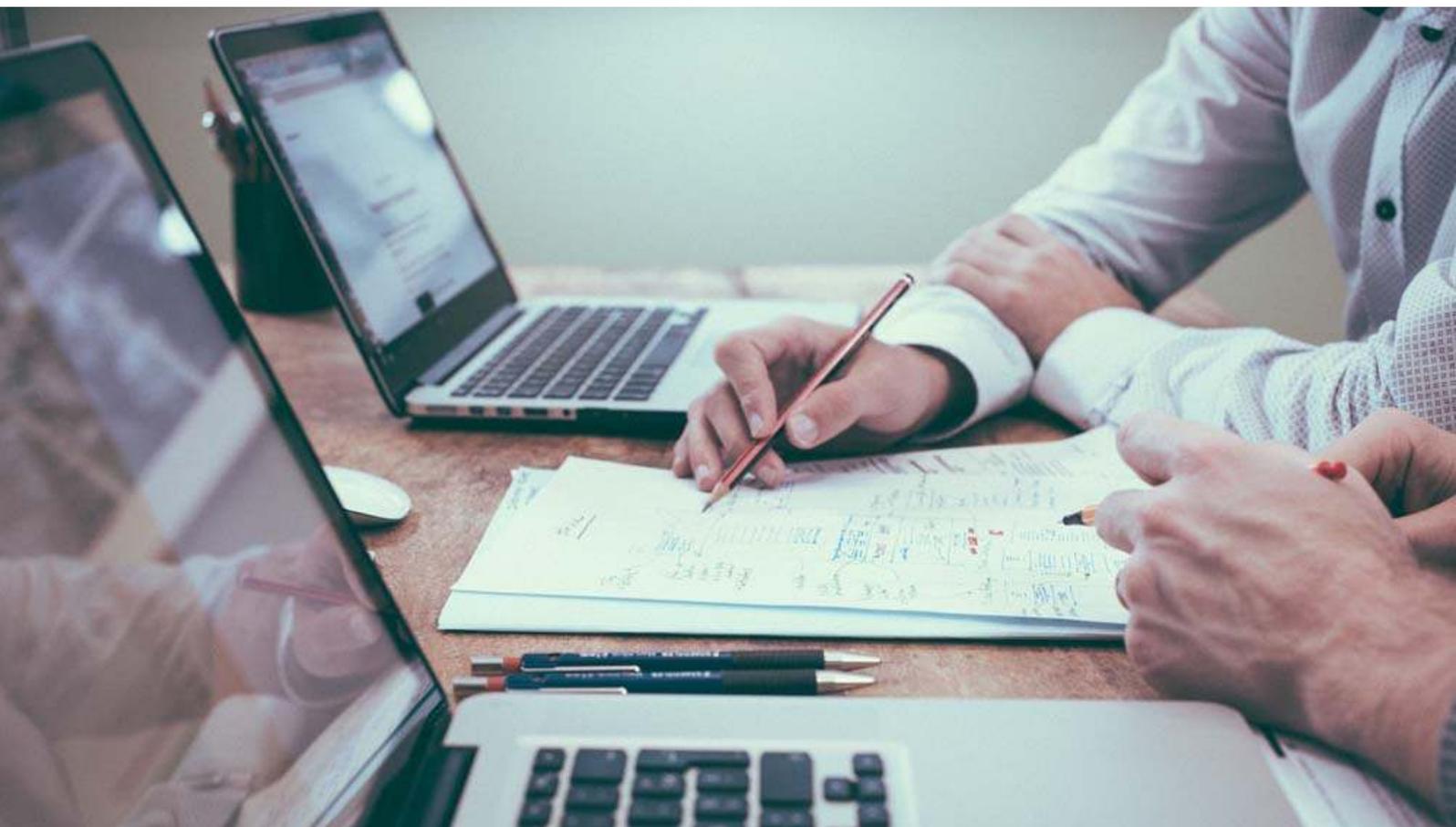
For the purposes of claiming the NID deduction, the Cyprus company needs to maintain a schedule of the New Capital introduced, the application of those new funds (e.g. loans provided, acquisition of business assets etc) and the taxable income generated by each asset or activity. In the case where the New Capital funds cannot be linked with a particular asset or activity, the NID should be calculated on a pro-rata basis in a particular way.

### TO WHOM NID APPLIES

NID can be claimed by all Cyprus tax resident companies and Permanent Establishments of non-resident companies. NID can also be applied to companies redomiciling to Cyprus on or after January 2015 as well as companies shifting their management and control (i.e. tax residence) to Cyprus.

### ANTI-AVOIDANCE PROVISIONS

Certain anti-avoidance and limitation provisions exist, including a general anti-avoidance rule whereby the Tax Commissioner may disallow the deduction of NID in case that actions or transactions took place without any commercial reasoning other than the intention to erode the tax base.



## EXAMPLES

You can find below examples as to how the NID provisions can be successfully implemented for different types of companies.

### TRADING COMPANY

A Cyprus company increased its share capital and the shareholders injected €10m as new capital. The new capital funds were used in the operations of the company and the acquisition of business assets, resulting in taxable profits of €3m. For calculation purposes the reference rate is assumed to be 10%.

#### Facts

- Taxable Profits: 3m
- Reference Rate: 10%
- Max. NID: 1m (10m x 10%)
- Allowed NID: 2,4 (3m x 80%)

#### Tax Computation

Tax Computation	With NID		Without NID
	€m	€m	€m
<b>Taxable profits</b>		<b>3</b>	<b>3</b>
<b>NID</b>			
Max. NID	1		
Allowed NID	2,4		
Deducted NID (lower of 2,4m and 1m)		(1)	
Taxable profits after NID		2	3
Tax @ 12,5%		0,25	0,375
<b>Effective Tax Rate</b>		<b>8,33%</b>	<b>12,5%</b>



## QUALIFYING IP COMPANY

A Cyprus company increased its share capital and the shareholders injected in kind a qualifying Intellectual Property asset (IP) with a market value of €10m as new capital. The exploitation of the IP generated taxable profits of €3m. For calculation purposes the reference rate is assumed to be 10%.

### Facts

- New Capital: 10m
- Taxable Profits: 3m
- Reference Rate: 10%
- Max. NID: 1m (10m x 10%)
- Allowed NID: 2,4 (3m x 80%)

### Tax Computation

Tax Computation	With NID		Without NID
	€m	€m	€m
<b>Taxable profits</b>		<b>3</b>	<b>3</b>
<b>NID</b>			
Max. NID	1		
Allowed NID	2,4		
Deducted NID (lower of 2,4m and 1m)		(1)	
Taxable profits after NID		2	3
Qualifying IP 80% deduction		(1,6)	(2,4)
Taxable profits after Qualifying IP 80% deduction		0,4	0,6
Tax @ 12,5%		0,05	0,075
<b>Effective Tax Rate</b>		<b>1,67%</b>	<b>2,5%</b>

## FINANCING COMPANY

A Cyprus company increased its share capital and the shareholders injected €10m as new capital. The funds were given as a loan to a related company generating taxable interest of €1m. For calculation purposes the reference rate is assumed to be 10%.

### Facts

- New Capital: 10m
- Taxable Profits: 1m
- Reference Rate: 10%
- Max. NID: 1m (10m x 10%)
- Allowed NID: 0.8m (1m x 80%)

### Tax Computation

Tax Computation	With NID		Without NID
	€m	€m	€m
<b>Taxable profits</b>		<b>1</b>	<b>1</b>
<b>NID</b>			
Max. NID	1		
Allowed NID	0,8		
Deducted NID (lower of 2,4m and 1m)		(0,8)	
Taxable profits after NID		0,2	1
Tax @ 12,5%		0,025	0.125
<b>Effective Tax Rate</b>		<b>2,5%</b>	<b>12,5%</b>

## ATCA

Established in 1998 as practice, ATCA is an accountancy and audit firm in Limassol, Cyprus. Our main services include accounting, audit, tax and business consulting. Over the years, the firm has experienced substantial growth, achieved by providing practical and effective solutions to our clients. The directors of the firm maintain a personal approach and direct communication with clients resulting in meaningful and mutually beneficial relationships. Our clientele includes individuals and small and medium businesses in Cyprus and abroad.

## Contacts

### **Andreas Theodorou**

Director, Head of Accounting and VAT  
a.theodorou@atca.com.cy  
+357 25661717

### **Antonis Theodorou**

Director, Head of Assurance & Advisory  
antonis@atca.com.cy  
+357 25819021

### **Constantinos Markou**

Director, Head of Tax  
markou@atca.com.cy  
+357 25661717

## Address

256, Arch. Makarios III Avenue, Eftapaton Court, 1st Floor, Office A1, 3105 Limassol, Cyprus  
+357 256 61717

info@atca.com.cy  
www.atca.com.cy

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