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Global Tax Alert

Cyprus amends Notional Interest Deduction rules

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Executive summary

On 5 June 2020, the Cypriot House of Representatives approved a bill amending Section 9B of the Income Tax Law on the application of the provisions of the Notional Interest Deduction (NID) on corporate equity. The relevant law implementing the new provisions will take legal effect once it is published in the *Official Gazette* of Cyprus, which is expected to take place next week.

Detailed discussion

Background

As of 1 January 2015, Cyprus tax resident companies (as well as foreign companies with permanent establishments in Cyprus), which carry on a business, are entitled to claim a NID on their equity capital introduced on or after 1 January 2015.

The NID is deducted from the taxable income of the company for the relevant tax year (subject to any restrictions) for the period of time during which the equity is used by the company for carrying on of its activities. The NID is subject to a number of conditions, including a taxable income limitation.

The NID equals the multiple of the "reference interest rate" and "new equity."

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Amended provisions

The bill introduces a number of amendments which are summarized below.

Change in the definition of the reference interest rate

Under the existing provisions, the "reference interest rate" is the 10-year government bond yield as at 31 December of the year preceding the tax year of the country in which the new equity is invested increased by 3%. However, the reference interest rate cannot be lower than the 10-year government bond yield of Cyprus as at 31 December of the year preceding the tax year increased by 3%.

For more information on the 10-year government bond yields that apply for the tax year 2020, see EY Global Tax Alert, *Cyprus Tax Authorities publish 10-year government bond yield rates for NID purposes*, dated 13 February 2020.

As of 1 January 2020, the relevant 10-year government bond yield will no longer be determined by taking the higher of: (i) the Cyprus yield rate; and (ii) the yield of the country in which the new equity is invested into. Instead, the 10-year government bond yield will be determined only with reference to the jurisdiction of investment (i.e., the Cypriot yield rate will no longer serve as a minimum).

In addition, the risk premium increases from 3% to 5%.

The law will also be amended to provide that in case the country in which the new capital is invested has not issued a government bond on 31 December of the year preceding the tax year, the reference interest rate will be based on the government bond yield of the Republic of Cyprus increased by 5%.

Change in the definition of new equity

Under the existing provisions, "new equity" represents any equity introduced into the business on or after 1 January 2015 but it excludes any equity created from the capitalization of reserves existing on 31 December 2014. An exception to this exclusion rule is when the capitalization of such "old" reserves creates new business assets which did not exist on 31 December 2014.

As of 1 January 2021, it will no longer be possible to claim NID on equity created from the capitalization of reserves existing on 31 December 2014 regardless of whether such equity is funding new business assets.

Change in the definition of the 80% restriction

Under the existing provisions, the NID cannot exceed 80% of the taxable income for the tax year before taking into account the NID.

The relevant provisions are now amended as follows:

- The 80% restriction should apply on the taxable income arising from the introduction of new equity.
- If tax losses arise from the use of new equity into the business, no NID should be available in the relevant year.
- The 80% restriction should apply separately to the taxable income arising from each business asset which is financed by new equity.
- The above amendments will apply retroactively **as of 1 January 2015** as the above changes effectively adopt the so-called matching concept which has been applied in practice since the introduction of NID.

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