



**BRIEF OUTLINE ON CYPRUS TAXATION ON INTEREST
DIVIDENDS AND PROFITS FROM THE SALE OF TITLES**

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A. General

The below mentioned comments relate only to companies which are tax residents of Cyprus and refer to the worldwide income these companies may have. Precise reference to relevant provisions of the Income Tax Law or Special Defence Contribution Law, examples and definitions of terms used may be found in our separate extensive reports:-

“Cyprus – Taxation of Interest Income”

and

“Cyprus – Tax Legislation on Companies (The Foreign Investors’ Approach)”

B. Taxation of Interest Income

The Law distinguishes in an indirect way between trading interest income and passive interest income. The following questions and their respective reply identifies the nature of the interest income:-

- a. Is the particular interest income acquired from the ordinary activities of the company?
- b. Is the particular interest income acquired from activities **closely connected** with the ordinary activities of the company?

If the answer to either of the above two questions is positive, then the interest is treated as **trading interest income** and if not, as **passive interest income**.

The trading interest income is taxed as income according to the Income Tax Law. On such trading interest income there will be 12.5% taxation on **net profits**, if any.

If the answer to the above two questions is negative, then the interest is treated as **passive interest income** and is taxed only under Special Defence Tax at a rate of 30% on the interest received or credited.

It is important to note that this taxation is imposed not only on the received interest but also on the credited interest to be received by the company at a future date. The taxation is due even if the interest is not received by the company but only credited / due to it by the debtor.

C. Taxation of Dividends

- **Income Tax – FULL EXEMPTION**

Dividends received from Cyprus companies (either resident or non-resident) or dividends received from overseas companies (foreign) do **not bear** any corporation tax.

- **Special Defense Contribution Tax**

a. Dividends received from another Cyprus resident company

There is no Special Defence Contribution Tax in this case.

Any dividend paid from a Cyprus company indirectly after four years from the end of the financial year in which the profits that generate the relevant dividend were recognised, will not be exempt.

The Law provides for the deemed distribution of dividends every two years in case of tax resident shareholders.

It should be noted that the above will not apply in cases where the shareholders of the company are non-residents of Cyprus whether directly or indirectly.

b. Dividends received from a non-resident company

Such dividend is exempt from Special Defence Contribution Tax.

However, this **exception is not granted if**

- (a) the company paying the dividend is engaged directly or indirectly by more than 50% in activities which result in investment income

AND

- (b) the rate of the foreign taxation on the income of the company paying the dividend is substantially lower than the 12.5% payable, by the recipient Cyprus resident company.

If the exception does not apply, the dividend income received from the non-resident company is taxed at the rate of 17%.

If on any dividend income any foreign tax was paid, then unilateral tax credit is granted in Cyprus as explained in section E below.

D. Taxation on Profits from the Sale of Titles

Definition of Titles

The word "titles" according to the income Tax Law N.118(I)/2002 means: *"shares, bonds, debentures, founders' shares and other titles of companies or other legal persons incorporated in Cyprus or abroad and rights thereon"*.

As the above definition was not clear; a circular was recently issued by the Income Tax Authorities listing the financial instruments that fall within the definition of "titles" as mentioned in the Income Tax Law N118(I)/2002. The legislation provides that any gain on the disposal of titles is exempt from income tax.

The full list of financial instruments that fall within the definition is as follows:

- Ordinary shares
- Founder's shares
- Preference shares
- Options on titles
- Debentures
- Bonds
- Short positions on titles
- Futures/forwards on titles
- Swaps on titles
- Depositary receipts on titles (ADRs and GDRs)
- Rights of claims on bonds and debentures (rights on interest of these instruments are not included)
- Index participations only if they result in titles
- Repurchase agreements or Repos on titles
- Participations in companies; Russian OOO and ZAO, US LLC provided that their profits are subject to taxes, Romanian SA and SRL and Bulgarian AD and OOD.
- Units in open-end or closed-end collective investment schemes that have been incorporated, registered and operate in accordance with the provisions of the relevant legislation of the incorporated country

Examples of such units are:

- Investment trusts, investment funds, mutual funds, unit trusts, real estate investment trusts
- International collective investment schemes - ICIS
- Undertakings for collective investments in transferable securities or UCITS
- Other similar financial institutions

The circular applies for tax years 2003 onwards. Cases that have already been settled shall not be re-examined. It is important to note that the circular states that tax returns submitted before the date of issue of the circular and which are not under objection will not be revised with regards to the tax treatment of titles as defined in the circular.

In cases where it is not certain whether a specific financial instrument falls under any of the above mentioned categories, a request for a ruling should be submitted to the Commissioner of Income tax.

Promissory notes – Not Titles

Crucial to mention at this stage that promissory notes are NOT titles according to Cyprus tax law and any profit from the sale of promissory notes increases the taxable income of the company and on any resulting net profit of the company there will be 12.5% corporation tax.

In addition, for any *interest* received from promissory notes the considerations indicated in section B above as to the ordinary or closely connected to the ordinary activities of the company apply and is taxed accordingly.

Income Tax

There is full exemption from corporation tax on profits from the sale of titles.

Capital Gains Tax

There is also exemption from any capital gains tax from profits realized from the disposal of titles.

If the company whose shares are sold is the owner of immovable property situated in Cyprus then there is Capital gains tax at the rate of 20% calculated in a particular way specified in the relevant law.

E. Tax Credit

Tax credit is granted in Cyprus for any tax paid on the particular income abroad. This applies also to Income Tax and Special Defence Contribution tax.

The tax credit is possible either by unilateral tax credit relief provided specifically in the law or by the operation of the double taxation treaties in place for the particular case.

Special reference is made to the double taxation treaty signed between the Republic of Cyprus and the Russian Federation whereby Article 23 (2) (a) reads as follows:- "subject to the provisions of Cyprus Tax Law regarding credit of foreign tax, there shall be allowed as credit against Cyprus tax payable in respect of any item of income derived from Russia...".

Further, Article 23 (2) (b) of the same treaty referring particularly to dividends, reads as follows:- "where such income is a dividend paid by a company which is resident of Russia to a company which is a resident of Cyprus the credit shall take into account (in addition to any Russian tax on dividends) the Russian tax payable in respect of its profits by the company paying the dividends".

In effect, the local Russian tax paid by the Russian company on its income is given as tax credit in Cyprus. This is crucial as if the tax paid in Russia by the local Russian company is more than 17%, then there will never be any taxation paid in Cyprus in respect of this income received in Cyprus by the Cyprus Company as dividends.

Similar provisions exists in some other tax treaties that Cyprus has signed giving tax credit as to the underlying tax payable by the local foreign company.

F. Disclaimer

This publication has been prepared as a general guide and for information purposes only. It is not a substitution for professional advice. One must not rely on it without receiving independent advice based on the particular facts of his/her own case. No responsibility can be accepted by the authors or the publishers for any loss occasioned by acting or refraining from acting on the basis of this publication.

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Our Firm

Kinanis LLC, a law and consulting firm, is one of the leading and largest business law firms in Cyprus and advises for over 35 years the international investor and private clients on all aspects of law, tax and accounting.

Kinanis LLC absorbed the business of its shareholders which are in the legal and consulting profession since 1983, with local and international dimensions.

Experience and practice over the years brought forward the need for transformation from a traditional law firm to a more innovative multidisciplinary firm providing a full range of services combining law and accounting with the extensive expertise in corporate and tax advice to ensure that our clients will obtain the best possible spherical advice adopting the principle as to the services offered "All in one place", so that the client will find a quick, correct and efficient solution to its daily legal, accounting and tax issues in a trustworthy environment.

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