

How the global tax developments affect Cyprus Real Estate sector

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Global tax developments... Real Estate

Link between:

- Global Tax Developments (G7/G20/OECD)
- Cyprus Special tax regimes (Incentives)
- Real Estate



Global tax developments

The OECD's Inclusive Framework on BEPS

- Pillar 1 – affects MNEs with global revenues in excess of Euro20bn
- Pillar 2 – 15% min tax - affects multinational groups with revenues of Euro750m+

EU Level - Directives

- DAC 6 (Directive on Administrative Cooperation):
to combat “aggressive tax planning” obligation to “intermediaries” for RCBAs (Reportable Cross Border Arrangements)
- ATAD 3 (Anti – Tax avoidance Directive) (?) un-shelling!!!



Global tax developments

As a result of the changes, we will be operating in a world of:

- Full Transparency
- Automatic Exchange of Information
- Nexus approach



Can Cyprus ignore the changes?

- Member of the OECD? No... but voluntary compliance
- ✓ Member of the EU – so directives must be implemented

...otherwise – blacklisted – isolation – foreign investors will not be attracted to invest.

Cyprus current model

- Last major tax reform was made almost 20 years ago (2003)
- Companies Tax Residency was based on “management and control” – No definition in the legislation but was achieved following specific measures:
 - ✓ Majority of local directors residing in Cyprus
 - ✓ Board meetings to be held in Cyprus
 - ✓ Strategic decisions were taken in Cyprus
 - ✓ The taxpayer is declaring tax residency in the annual tax return

By applying the guidelines and directives, it is concluded that the above model is no longer valid/acceptable by the rest of the world.

CURRENTLY it can be said that we are in a transitional period, but a new era will commence with the implementation of ATAD 3 (2 years look-back period 1/1/2023).

Cyprus NEW model

- NEXUS approach - The term "nexus" is used in tax law to describe **a situation in which a business has a tax presence in a particular state**. A nexus is basically a connection between the taxing authority and an entity that must collect or pay the tax.

The nexus approach has been incorporated in the Special Regimes.

Therefore, **CY entities MUST HAVE PROPER SUBSTANCE** which means that both commercial and residential properties will be on high demand!

TAX INCENTIVES

to attract foreign investors

- Intellectual Property regime
- Notional Interest Deduction regime
- Special treatment for foreign employees
- Non-Domicile status for individuals

Intellectual Property (IP) regime

IP Regime (Section 9 (1) (K))

Under the new IP regime, 80% of **'qualifying profits'** generated from **'qualifying assets'** will be deemed to be tax-deductible expenses for **qualifying taxpayers**.

In calculating the qualifying profits, the **'nexus' approach** is adopted.

For an intangible asset to qualify for the new tax benefits there must be a direct link between the **'qualifying income'** and the **'qualifying expenditure'** contributing to the income.

End result: The tax rate could go as low as 2,5% and as much as 12,5%

$$QP = OI \times \frac{QE + UE}{OE}$$

Where:

- ❖ **QP** is the profits qualifying for favourable tax treatment
- ❖ **OI** is the 'overall income derived from the QIA'
- ❖ **QE** is the 'qualifying expenditure on the QIA'
- ❖ **UE** is the 'uplift expenditure on the QIA' and
- ❖ **OE** is the 'overall expenditure on the QIA'.



Intellectual Property (IP) regime

- **Qualifying Intangible Asset (QIA)**

means an asset which is acquired, developed or exploited by a person in the course of its business and that relates to IP (excluding IP associated with marketing) and which is the result of research and development expenditure and for which the person is the economic owner.

These assets could be:

- ✓ Patents (as defined in the Patents Law),
- ✓ Copyrighted software programs, and
- ✓ Other IP assets that are non-obvious, useful and novel/innovative.

For an intangible asset to be considered as qualifying, this needs to be certified by the relevant authorities in Cyprus or abroad.

Intellectual Property (IP) regime

Overall Income (OI):

it's the gross income earned from a qualifying intangible asset less any direct costs incurred for generating the income. (Royalties / license fees / any amount received as a compensation in relation to the asset / proceeds from the disposal of the asset)

Direct costs:

- all costs incurred wholly and exclusively for the production of the income
- NID
- Amortization (up to 20 years)

Qualifying Expenditure (QE): Total Research and Development costs incurred wholly and exclusively for the development, improvement or creation of a qualifying asset. It includes wages and salaries/direct costs/general expenses associated with R&D activities and costs associated with R&D outsourced to non-related persons **BUT it does not include cost for acquisition of an asset.**

Uplift Expenditure (UE): It's the lower of:

- 30% of Qualifying expenditure
- The total acquisition cost of a QIA + any R&D costs outsourced to related parties.

IP regime - Example

	Scenario 1	Scenario 2	Scenario 3
	\$	\$	\$
Overall Income from QIA (after deduction of direct costs)	5.000.000	5.000.000	5.000.000
Overall Expenditure			
Cost of acquisition	NIL	1.500.000	1.500.000
R&D costs incurred internally	2.500.000	NIL	NIL
R&D costs outsourced to related parties	NIL	1.000.000	NIL
R&D costs outsourced to non-related parties	NIL	NIL	1.000.000
	2.500.000	2.500.000	2.500.000
Qualifying expenditure			
Cost of acquisition	NIL	IGNORE	IGNORE
R&D costs incurred internally	2.500.000	NIL	NIL
R&D costs outsourced to related parties	NIL	IGNORE	NIL
R&D costs outsourced to non-related parties	NIL	NIL	1.000.000
	2.500.000	NIL	1.000.000
Uplift Expenditure			
R&D costs outsourced to related parties is the lower of:			
30% of the qualifying expenditure	750.000	NIL	300.000
Total cost of acquisition plus cost outsourced to related parties	NIL	2.500.000	1.500.000
Applying the formula $QP=OI * (QE+UP)/OE$	$5.000.000 \times (2.500.000 + 0) / 2.500.000$	$5.000.000 \times (0 + 0) / 2.500.000$	$5.000.000 \times (1.000.000 + 300.000) / 2.500.000$
	5.000.000	0	2.600.000
<u>Tax Benefit max 80% of the QP</u>	4.000.000		
Scenario 1		0	
Scenario 2			2.080.000
Scenario 3			
Actual tax	125.000	625.000	365.000
Effective tax rate	2.5%	12.5%	7.3%

Notional Interest deduction (N.I.D)

- Article 9B of the Cyprus Income Tax Law

Objective: to harmonise from a tax perspective, the treatment of equity finance with the treatment of finance by debt (equal treatment).

The notional interest can be treated as a tax deductible expense provided that it represents an expense incurred for financing assets used to generate taxable income.

- **NID= Reference Interest Rate X New Equity**
 - ✓ 10 year Government bond yield of the country in which the new equity is invested INCREASED by 5% (in case there isn't available use the CY's gov yield +5%)
 - ✓ New Equity defined as funds that have been introduced into the company in the form of fully paid-up share capital and share premium. The new equity can be introduced in cash actually paid or in-kind payments (e.g assets)
 - ✓ NID deduction cannot exceed 80% of taxable profit (in case of a taxable loss no relief applies)

INCENTIVES

Notional Interest deduction - Example

Issue share capital of say USD1m in year 2022;

Based on the below data a notional interest expense of $((€1m * (1.919\%+5\%))$ €69.190 will be deducted.

The government bond yield for each country is provided by the Cyprus Tax Dept every year. For Israel, as at 31/12/2021:

- 1.919% (USD)
- 1.290% (Shekel)

The relief is available as long as the capital is kept invested in assets producing taxable income without a time limitation!

Cost to issue share capital - €105 fixed fee and €40 for every increase

INCENTIVES

Special provision for employees

Section 8 (21) (A) (applies from 26 July 2022)

- ✓ 20% reduction on employment income OR deduction of €8.550 per year, whichever is the lower;
- ✓ deduction is available for employees that were employed abroad to a non-Cyprus tax resident employer, for at least 3 years right before their employment in Cyprus;
- ✓ exemption for maximum 7 years, and it is available from the year following the year of employment;
- ✓ employment in Cyprus should commence during the period 26/7/2022 up to end of 2027.

* Exemption cannot be claimed in parallel with Section 8 (23) (A)

Special provision for employees

Section 8 (23) (A) (applies from 1 January 2022)

- ✓ 50% reduction from any employment in the Republic by a person who was resident outside Cyprus before the start of his/her employment in Cyprus for a period of 10 consecutive years;
- ✓ the commencement of the employment must commence after 1/1/2022 and the income should be at least €55.000 in the first or second year of employment;
- ✓ the exemption is valid for a period of seventeen (17) years, starting from the year of employment, for all years that the income exceeds the threshold;

Non-Domiciled Individuals

CY Tax residents in two ways 183/60 days per calendar year BUT with Non-Domicile status there is an exemption from Special Defence Contribution (SDC) for 17 years.

SDC law captures 3 sources of passive income:

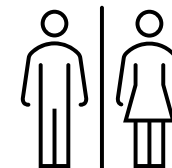
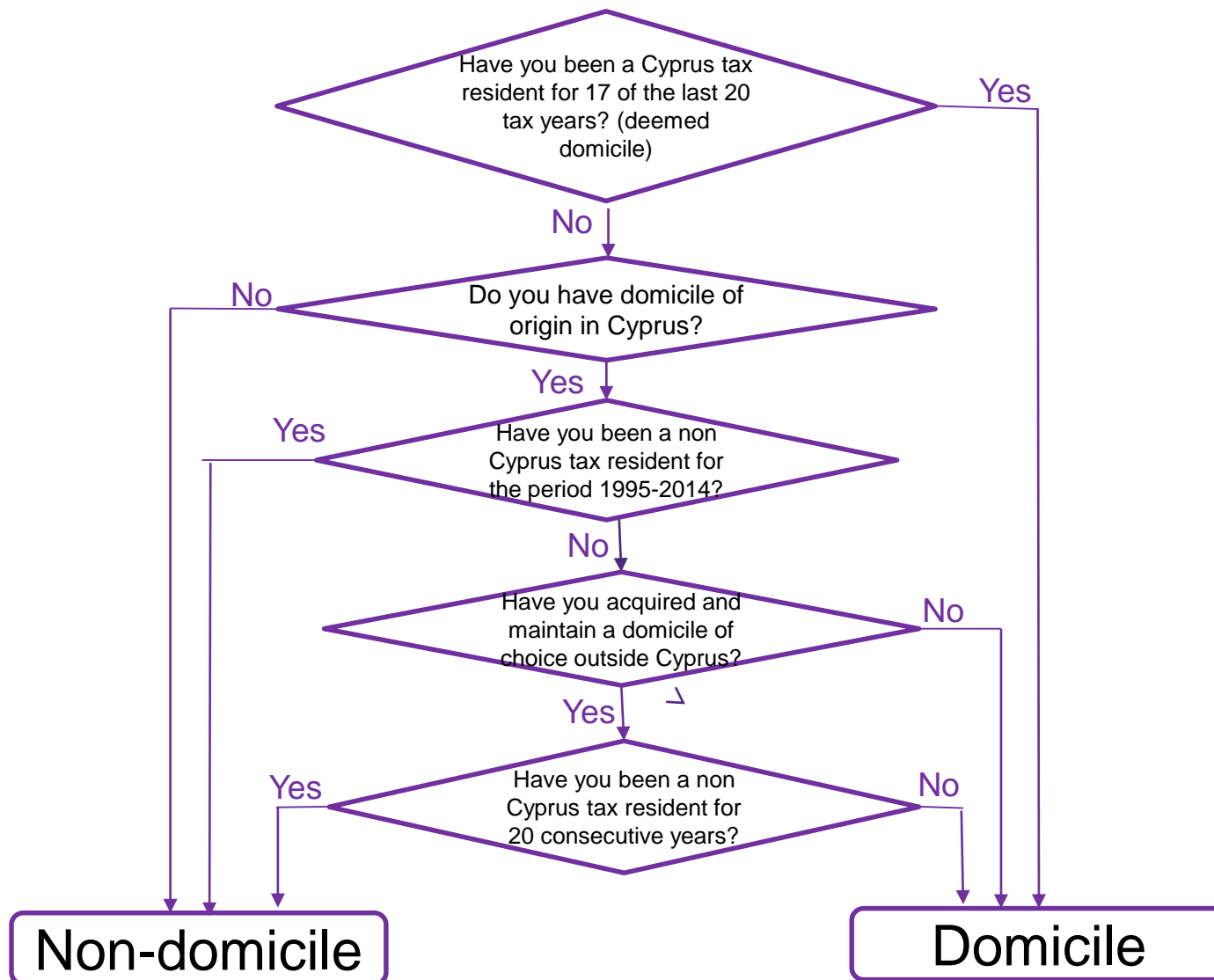
- Dividend
- Interest
- Rental

- Dividend Income (Tax resident AND Domiciled taxpayers are subject to 17% SDC)
- Interest Income (Tax resident AND Domiciled taxpayers are subject to 30% SDC or 3% on specific cases)
- Rental Income (Tax resident AND Domiciled taxpayers are subject to 2,25% SDC)

Foreign pensions

Foreign pensions of a Cyprus resident individual which exceed the amount of €3.420 per annum are taxable at the rate of 5%. The recipient of such pension may elect, for each year of assessment, to be taxed at the normal rates.

Domicile/Non-Domicile Status (SDC)



Tax framework on Real Estate

Immovable Properties situated in Cyprus





Real Estate Acquisition and related costs

1. Immovable property acquisition and other related costs – comparison between acquiring under an entity and on a personal basis

	BUYER	
	Company	Individual
Upon acquisition of property		
Transfer fees (if not subject to VAT)	Same (LRO values)	Same (LRO values)
Upon acquisition of Shares	NIL (but...)	NIL (but...)

Immovable property transfer fees

Value per plot €	Rate %
First €85.430	3,0
€85.431 - €170.860	5,0
Over €170.860	8,0

Stamp duty

Contracts:	
• First €5.000	0%
• €5.001 - €170.000	0.15%
• Over €170.000	0.2%
Stamp duty ceiling	Max €20.000

No transfer fees will be payable when the immovable property to be transferred is subject to VAT.
 If the immovable property to be transferred is not subject to VAT, the transfer fee will be reduced by 50%.



Real Estate Taxation of Income

2. Taxation of income

	OWNER	
	Company	Individual
Corporation Tax / Income Tax	12,5% (on amount after deducting expenses incurred wholly & exclusively for the production of income)	Up to 35% (on 80% of gross rent amount)
Special Defence Contribution	2,25% (same)	2,25% (same if tax resident and domiciled)

Taxable Income €	Rate €	Tax €	Cumulative taxable Income €	Cumulative Tax €
First 19.500	-	-	19.500	-
Next 8.500	20	1.700	28.000	1.700
Next 8.300	25	2.075	36.300	3.775
Next 23.700	30	7.110	60.000	10.885
Over 60.000	35			

Real Estate

Disposal of properties



3. Investment in CY properties (short term Vs long term) Corporation Tax Vs CGT

	SELLER	
	Company	Individual
Short term	Corporation tax 12,5%	Income tax up to 35%
Long term	CGT 20% (same)	CGT 20% (same)
Dividend Distribution to SHs INDIVIDUALS	Non-CY Tax Resident OR CY-Tax Resident but Non-Domiciled (17 years) NIL WHT	No additional tax NIL Repatriation cost
<u>Sale of shares of the CYCO</u> owning the immovable property or owning immovable property indirectly	CGT 20% (same) BUT assessment on MV estimated by LRO and not the actual transaction price	CGT 20% (same) BUT assessment on MV estimated by LRO and not the actual transaction price

תודה על הסבלנות - יש לך שאלות?

Thank you for your patience!

Any Questions?

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