



Introduction

This paper discusses about dividend income and when it is taxed in Cyprus, Article 33 of the Cyprus Tax Law, the treatment of loans other than B2B, the treatment of loans outstanding receivables and the treatment of interest received from bank current accounts.

Dividend received

I) Income tax

According to the Cyprus tax legislation dividend income received by a Cypriot tax resident company from a foreign corporation is unconditionally exempt from Cypriot income tax.

II) Special defence contribution

Dividend income received by a Cyprus company is also usually exempt from special defence contribution (SDC).

The exemption will not be granted if:

- Directly or indirectly more than 50% of the activities of the paying company result in investment income, and
- The dividend paying company suffered tax burden substantially lower than the Cypriot rate (i.e. less than 5%)

When the exemption does not apply dividend is subject to special defence contribution (SDC) at the rate of 20% for the years 2012 and 2013 (17% from 1 January 2014).

Article 33 of the Income Tax Law

According to the Cyprus tax legislation, article 33 of the Income Tax Law, transactions between related parties must be carried out on an arm's length basis. This means that they should be carried out at no different terms to those applied in transactions between unrelated parties.

In case the Cyprus Tax Authorities (CTAs) consider that transactions between related parties are carried out on a non-arm's length basis, they could adjust the tax base of the company accordingly (restrict cost of sales), in order for the company to generate an acceptable taxable margin from its business activities.

Loans other than Back to Back

In relation to provision of financing facilities to related parties, other than back to back loan arrangements, a "market interest rate" should be charged on the loan facilities.

There are no provisions in the tax legislation or any tax technical circulars by reference to which one could determine what constitutes a "market interest rate". It could be said that currently in practice the CTAs generally consider as an arm's length interest rate the rate of say 6%, although different factors should also be taken into consideration in order to determine the arm's length rate (e.g. currency, economic risks of the jurisdiction of the borrower).

Long outstanding receivables

It should be noted, that there is a risk the CTAs to consider such receivables as provision of interest free financing facilities to related parties on the basis that the company did not benefit from this receivables. In such case, they could



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try to impose deemed interest at an arm's length interest rate. The risk is increased in case the receivable has no movement for a long period (no partly repayment)

3.2.4 Interest income from bank current account

According to a circular issued by the CTAs, interest income is distinguished as follows:

- Interest received by companies in the ordinary course of their business including interest closely connected to the ordinary course of business. The same circular further clarifies that interest derived by group finance companies is considered as closely connected to the ordinary course of business (i.e. "active")
- Interest received by companies which does not satisfy the conditions prescribed above (i.e. "passive")

"Active" interest income is subject to income tax at the rate of 12.5%.

"Passive" interest income is taxed only under Special Defence Contribution (SDC) at the rate of 30%, without deducting any expenses.