PICCO Tax Newsletter
February 2021

Notional Interest Deduction (NID) regime in Cyprus

The tax efficiency tool

During July 2015, Republic of Cyprus introduced the Article 9B in the Income Tax Law (ITL), titled, “deduction on new equity”. According to this new Article, with effect from 1 January 2015, Cyprus tax resident companies are entitled to a notional interest deduction (NID) upon the introduction of new equity employed in the production of taxable income.

The NID regime was introduced to encourage Cypriot businesses to strengthen their equity base. While companies leveraged with debt would generally deduct accrued interest expenses, the NID allows Cypriot taxpayers funded with equity to claim a deduction of notional interest expense, computed as a percentage of any equity introduced after 2015.

The NID is effectively a notional interest tax deductible expense that arises upon the introduction of new equity employed in the production of taxable income by a Cyprus company. The fact that it is a notional expense, it means it does not trigger any accounting entries and therefore it does not affect the accounting profit/loss. It is considered just as a tax adjustment.

<table>
<tr><th colspan="5">NOTIONAL INTEREST DEDUCTION (NID) REGIME</th></tr>
<tr><td rowspan="12">Equity Financing</td><td rowspan="5">Qualifying New Equity (QNE)</td><td rowspan="5">New equity introduced from 01/01/2015 onwards and invested on business asset (i.e. asset which generates taxable income).</td><td>Issuance of share capital from 01/01/2015 onwards.</td><td rowspan="5">Qualified types of shares:
- Ordinary Shares
- Preference Shares
- Redeemable Shares
- Convertible Shares
* Share Premium (if any) is considered as qualified equity.</td></tr>
<tr><td>Capitalization of old realized reserves (i.e.as at 31/12/2014) to share capital (subject to conditions).</td></tr>
<tr><td>Capitalization of realized reserves that were created after 01/01/2015.</td></tr>
<tr><td>Capitalization of shareholders liability and other Loan Payable.</td></tr>
<tr><td>Conversion of Non-Reciprocal Capital Contribution.</td></tr>
<tr><td>Reference rate (R)</td><td colspan="3">10-year government bond yield at 31 December of the year preceding the assessed tax year of the country in which the new equity is invested into plus a premium rate of 5%. 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.</td></tr>
<tr><td rowspan="4">Main Conditions</td><td>Time Apportionment</td><td colspan="2">NID is granted for the period within the new equity issued and paid.</td></tr>
<tr><td>Limitation 80%</td><td colspan="2">The maximum NID that can be claimed is 80% of the net taxable income which was produced by new equity.</td></tr>
<tr><td>Matching concept</td><td colspan="2">The new equity should be matched to the assets or activity in which it is invested in. In case that new equity has not been matched, it is deemed to have been financed in priority unmatched assets / activities that do not produce taxable income.</td></tr>
<tr><td>Country of Investment</td><td colspan="2">The new equity is deemed to has been invested in the state in which the company invested directly this equity.</td></tr>
<tr><td>NID (Notional Expense)</td><td colspan="3">QNE x R</td></tr>
<tr><td colspan="2">Effective Tax rate</td><td colspan="2">up to 2,5%</td></tr>
</table>

Numerical Example:

We assume a newly established CY Company, during the tax year 2020, has issued share capital of EUR 50.000 at a premium of EUR 50.000. Therefore, there is a total new equity of EUR 100.000. This amount has been invested in two assets:

1. Business Asset → EUR 80.000
2. Shares → EUR 20.000

CY tax resident company	A
Share Capital	**50.000,00**
Share Premium	**50.000,00**
Total New Equity	**100.000,00**
Invested to:	
Business Asset	**80.000,00**
Shares	**20.000,00**
Tax Computation	
Trading Profits	15.000
Dividends	5.000
Total Profits	20.000
Less exempted income	5.000
Taxable Profit	**15.000**
Tax payable	**1.875**
Effective tax rate	**12,50%**

NID calculation:

New Equity	100.000		
New Equity qualified for NID		**80.000**	
Reference rate	0,536%	+5%	**5,536%**
NID	**4.429**	=80.000*5,536%	
Taxable Profit	**10.571,20**	=15.000-4.4289	
Tax payable	**1.321,40**		
Effective tax rate	**8,81%**		
Tax Saving	**3,69%**		

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PICCO Professional Services Limited

Alexander II Building 6 Constantinou Paleologou Avenue 6036 Larnaca P.O. Box 42226 – 6532 LCA Cyprus	Tel.: (+357) 24 258525 Fax: (+357) 24 250028 Email: info@piccocy.com Website: www.piccocy.com
Demetres Gregoriou Senior Tax Manager Email: demetres.gregoriou@piccocy.com	**George Gregoriou** Audit Partner Email: george.gregoriou@piccocy.com

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