Amending the Notional Interest Deduction (NID) Law

Dear Clients and Associates,

Keynote

The Cyprus NID framework has recently been amended mainly by: (a) removing the Cyprus 'safe harbour', (b) replacing the 3% premium with a 5% premium, and (c) clarifying certain aspects on which the NID law (the "**Law**") was hitherto silent.

Summary of Amendments

1. Main Changes

a. The amending Law displaces (i) the first step (comparison) and (ii) increases the premium from 3% to 5%.

   As a result, determination of NID will henceforth only entail comparison of the 10-year Government bond plus 5% in the situs jurisdiction with the 80% of 'net' taxable income produced from the utilisation of the 'new equity', following which the lower of the two will be selected.

   The above changes will apply as from January 1st, 2020.

b. The amending Law has removed the Cyprus 'safe harbour' provision hence simplifying the NID calculations.

   NID Law previously required a step process for determining the NID, as per which:

- The taxpayer first had to compare the yield on the 10 year's government bond plus 3% in the situs jurisdiction with the equivalent Cyprus yield (Cyprus 'safe harbour') and selecting the higher.

- Next, the taxpayer had to compare (i) the above higher yield multiplied with the specific 'new equity' with (ii) the 80% of the 'net' taxable income derived from the utilisation of the said 'new equity' and had to select the lower which constituted the NID.

  We have compiled indicative calculations (Appendix I) showing the NID calculation (i) pre and (ii) post the amending Law.

2. Secondary (clarification) changes

The amendments also introduce or clarify the following:

- The Cyprus 'safe harbour' plus 5% will be used if the situs jurisdiction does not issue bonds by 31st December of the year preceding the year of assessment.

- That the 80% is a function of the 'net' taxable income.

- If 'new equity' produces net tax loss, then no NID would be allowed.

- The NID limits apply separately to the taxable income derived from each business assets as funded by new equity.

Broadly, the amending Law further codifies how the NID apply in practice.

The above changes will apply as from January 1st, 2015.

Takeaway Points

- Consider the changes for the purposes of computing provisional taxation.
- Perform impact assessment to manage any negative impact.
- Revisit tax rulings granted in the past on NID to assess compatibility with or impact of the changes.

Our team of lawyers, advisors and consultants is at your disposal to discuss and navigate the NID environment.

Appendix I

We lay below a brief NID calculation using the pre and post NID amending Law.

Relevant facts include a Cyprus company obtaining equity capital of Eur 10m for providing loan to a Russia company. The actual interest rate is 6%. For the purposes of this high level calculation we assume that the hypothetical interest income is net of any expenses.

Pre Amending the NID Law	Eur	Eur	Eur
Interest income (6%xEur 10m)			**600k**
Maximum NID is the higher amount of :			
• 10 year Russia government bond yield (5,6% x Eur 10m), and,	560k		
• 10 year Cyprus government bond yield (3,546%x Eur 10m),	353k		
Applicable NID is the lower of :			
a) the above higher amount, and,		(560k)	
b) 80%x 600k (interest income above)		(480k)	(480k)
Taxable income			**120k**

Post Amending the NID Law	Eur	Eur	Eur
Interest income (6%x Eur 10m)			**600k**
Applicable NID is the lower of :			
a) 10 year Russia government bond yield (5,6% x Eur 10m), and,		(560k)	
b) 80%x 600k (interest income above)		(480k)	(480k)
Taxable income			**120k**