

Special Contribution for Defence - 2017

Basis of taxation

Special Contribution for Defence is imposed on dividend income, 'passive' interest income and rental income earned by companies tax resident in Cyprus and by individuals who are both Cyprus tax resident and Cyprus domiciled.

Tax rates

	Individuals (1)	Legal entities (1)
	%	%
Dividend income from Cyprus tax resident companies	17 (5)	Nil (2)
Dividend income from non-Cyprus tax resident companies	17 (5)	Nil (3)
Interest income arising from the ordinary activities or closely related to the ordinary activities of the business	Nil (4)	Nil (4)
Other interest income	30 (5)	30 (5)
Rental income (reduced by 25%)	3 (5) (6)	3 (5) (6)

Notes

1. Legal entities are subject to Special Contribution for Defence if they are tax resident in Cyprus (i.e. if they are managed and controlled in Cyprus). Prior to 16 July 2015, individuals were subject to Special Contribution for Defence if they were tax resident in Cyprus (i.e. if they were physically present in Cyprus for a period or periods exceeding in aggregate 183 days during the calendar year). As from 16 July 2015, individuals are subject to Special contribution for defence if they are both Cyprus tax resident and Cyprus domiciled.

An individual is domiciled in Cyprus for the purposes of Special Contribution for Defence if (s)he has a domicile of origin in Cyprus per the Wills and Succession Law or if (s)he has been a tax resident in Cyprus for at least 17 out of the 20 tax years immediately prior to the tax year of assessment.

An individual who has a domicile of origin in Cyprus may still be considered not to be domiciled in Cyprus if:

- a. (S)he had the domicile of origin in Cyprus on the basis of the Wills and Succession Law but has obtained a domicile of choice in another country, provided (s)he was not a tax resident of Cyprus for any period of at least 20 consecutive years before the tax year in which (s)he became a tax resident of Cyprus, or

- b. (S)he has not been a tax resident of Cyprus for a period of at least 20 consecutive years immediately prior to the tax year 2015.
2. Dividends received by a Cyprus tax resident company from other Cyprus tax resident companies are exempt from all taxes unless they are indirectly declared after the expiry of 4 years from the end of the year in which the profits were generated, in which case they may be subject to Special contribution for defence at 17%.

Dividends which emanate directly or indirectly out of such dividends on which special contribution for defence was previously suffered are exempt.

3. As from 1 January 2016, this exemption only applies to dividends which are not deductible for tax purposes by the paying company. Dividends which are deductible for tax purposes by the paying company are subject to Corporation Tax.

The exemption does not apply if:

- a. more than 50% of the paying company's activities result directly or indirectly in investment income, and
- b. the foreign tax is significantly lower than the tax burden in Cyprus. The tax authorities have clarified through a circular that "significantly lower" means an effective tax rate of less than 6,25% on the profit distributed (i.e. less than 50% of the Cyprus tax rate of 12,5%).

When the exemption does not apply, the dividend income is subject to special Contribution for Defence at the rate of 17%.

4. Such interest income is subject to personal Income Tax/ Corporation Tax.
5. The Special Contribution for Defence rate on interest income of 30% is effective for interest received or credited on or after 29 April 2013.

Interest income earned by individuals from Cyprus government savings bonds and development bonds as well as all interest earned by a provident fund is subject to Special Contribution for Defence at the rate of 3% (instead of 30%).

In the case where the total income of an individual (including interest) does not exceed €12.000 in a tax year, then the rate on interest income is reduced to 3% (instead of 30%).

For Cyprus-sourced rental income where the tenant is a Cyprus company, partnership, the state or local authority, Special Contribution for Defence on rental income is withheld at source and is payable at the end of the month following the month in which it was withheld. In all other cases, the Special Contribution for Defence on rental income is payable by the landlord in 6 monthly intervals on 30 June and 31 December each year.

For Cyprus-sourced interest and dividends, Special Contribution for Defence due is withheld at source and is payable at the end of the month following the month in which they were paid.

However, for foreign sourced dividends, interest and rental income, Special Contribution for Defence is payable in 6 month intervals on 30 June and 31 December each year.

6. Rental income is also subject to personal income tax/ corporation tax.

Foreign taxes paid can also be credited against the Special Contribution for Defence liability.

Deemed dividend distribution

A Cyprus tax resident company is deemed to distribute as a dividend 70% of its accounting profits (as adjusted for Special Contribution for Defence purposes and net of Corporation Tax, Special Contribution for Defence on company incomes, Capital Gains Tax and unrelieved foreign taxes) two years from the end of the tax year in which the profits were generated.

Such a deemed dividend distribution is reduced with payments of actual dividends paid during the year the profits were generated and/ or the following two years.

On the remaining net amount (if any) of deemed dividend, 17% Special Contribution for Defence is imposed to the extent that the ultimate direct/ indirect shareholders of the company are individuals who are both Cyprus tax resident and Cyprus domiciled (see page 26). Prior to 16 July 2015, the imposition applied to the extent the ultimate direct/indirect shareholders of the company were Cyprus tax resident individuals. Instead of the rate of 17%, a rate of 3% is applicable on deemed dividend distribution of Collective Investment Schemes.

When an actual dividend is paid after the deemed dividend distribution date, then if Special Contribution for Defence is due on such a dividend, the tax is imposed only on the amount of the actual dividend paid which is over and above the dividend that was previously deemed to have been distributed and previously suffered Special Contribution for Defence.

Disposal of assets to shareholder at less than market value

When a company disposes of an asset to an individual shareholder or a relative of his up to second degree or his/ her spouse for a consideration less than its market value, the difference between the consideration and the market value will be deemed to have been distributed as a dividend to the shareholder. This provision, does not apply for assets originally gifted to the company by an individual shareholder or a relative of his/ hers up to second degree or his/ her spouse.

Company dissolution

The cumulative profits of the last five years prior to the company's dissolution, which have not been distributed or deemed to have been distributed, will be considered as distributed on dissolution and will be subject to Special contribution for defence at the rate of 17% (3% for Collective Investment Schemes).

This provision does not apply in the case of dissolution under a Reorganisation.

Reduction of capital

In the case of a reduction of capital of a company, any amounts paid or due to the shareholders over and above the previously paid-in equity will be considered as dividends distributed subject to special defence contribution at the rate of 17% after deducting any amounts which have been deemed as distributable profits.

The redemption of units or shares in a Collective Investment Scheme is not subject to the above provisions.

Prior to 16 July 2015, the above three provisions applied only to the extent that the ultimate shareholders (direct or indirect) are Cyprus tax resident individuals. As from 16 July 2015, the above provisions apply only to the extent that the ultimate shareholders (direct or indirect) are individuals who are both Cyprus tax resident and Cyprus domiciled.