

## Cyprus: Notional Interest Deduction, BEPS and Tax Structuring

In 2015, Cyprus introduced the Notional Interest Deduction (NID) in its tax law. The NID is notional interest deduction on new equity which can be set against taxable income generated by the company as a result of the funds from the new equity.

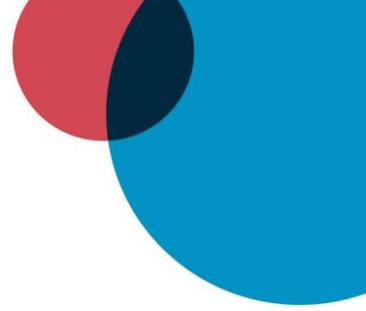
NID is equal to the interest yield of the 10 year government bond yield of the country in which the new equity is invested, increased by 3% (the minimum rate being the yield of the Cyprus 10-year government bond increased by 3 percentage points). The bond yield rates to be used are those valid on 31 December of the year preceding the assessment year.

On 17 February 2017, the Cyprus Tax Department issued an announcement informing on the bond yield rates as at 31 December 2016 for the below jurisdictions, which should be increased by 3 percentage points to determine the reference rates to be used for the NID of 2017.

Country	Rate (%)
Cyprus	3.489
Czech Republic	0.414
Germany	0.204
India	6.878
Latvia	0.894
Poland	3.627
Romania	3.748
Russia	8.380
(denominated in USD)	4.409
Ukraine	8.705
United Arab Emirates	3.326
United Kingdom	1.326

Having in mind the tax amendments resulting mainly from the BEPS Action Points, NID is an important tool which can be used in tax structuring.

As per BEPS Action Point 6 (preventing the granting of treaty benefits in inappropriate circumstances), one of the main issues under discussion is the beneficial ownership of income. An anti-avoidance measure in relation to this is the introduction of limitation of benefit clauses in double tax treaties. Even though Cyprus does not have a limitation of benefit clause in all its double tax treaties, all new treaties which have been signed or are currently being negotiated either do or will include such a clause. The beneficial ownership of income issue is also present with countries with which a limitation of benefit clause does not exist in the double tax treaties, like Russia, where the courts will often disregard intermediary companies if they were created with the purpose of avoiding tax.



The beneficial ownership of income is an issue which could be overcome by using NID, since by granting loans out of equity funds, there is no contractual obligation to pay interest income in other jurisdictions.

The use of NID in tax structures could also be viewed in combination with the expected changes in Cyprus tax law, since - as has already been announced - back-to-back loan arrangements' profit margins will be abolished by 1 July 2017 and will be replaced with transfer pricing.

It is evident that the structures used for Cyprus financing companies are being outdated and that immediate action is required for such structures to be revised in light of recent changes. Our team of skilled professionals can help you examine the potential effect of all existing and upcoming tax law changes on your structures and examine necessary changes in order to update them.

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