

Notional Interest Deduction

Outline - Notional Interest Deduction

Notional Interest Deduction (NID) is considered a useful tool for both domestic and international businesses. The NID helps businesses reduce leverage and achieve a tax efficient return regarding new equity. The return is obtained by deducting a notional interest expense from the business' taxable income.

Purpose of NID

The Reasons NID was introduced in Cyprus Legislation:

- To align the tax treatment of debt finance to equity finance. Before the NID was implemented, equity financing was not tax deductible whereas debt financing was tax deductible.
- To enhance Cyprus capital investments. Due to the implementation of the NID, international corporations and groups are able to use Cyprus companies as factoring, financing and procurement centres.
- To support and boost small and medium-sized companies.

Who Benefits from the Introduction of NID?

- Cyprus Tax Resident Companies
- Non-Cyprus Tax Resident Companies with permanent establishments in Cyprus

General – The NID

A reduction in tax is permitted after the NID rate is applied to the amount of New Equity inserted to both a Cyprus company and/or a permanent establishment of a non-Cyprus tax resident company.

The NID is reduced similarly to the manner actual interest expense is deducted, that is, only when it was used to fund the majority assets of a business.

The NID is deducted after the taxable profit of a company is determined. The deduction cannot be more than 80% of the company's or permanent establishment's taxable profit.

Since the NID is considered a notional deduction, no exchange of funds or booked expense must take place to apply the NID.

What is New Equity?

New equity is defined as the equity (share premium or share capital) inserted from the 1st January 2015 onwards, in either cash or in kind. In case where the new equity is contributed in assets, the amount

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should not be more than the market value of the asset. Any reserves that existed on the 31st December 2014 may be viewed as New Equity only when used to fund new business operations and activities.

The NID Rate

Basically, the NID rate is the return on the 10-year state bonds, as it appeared on the 31st December before the tax year the NID is applied, of the jurisdiction where the funds are inserted within a business plus a premium rate of 3%.

Example:

In the example below, it is supposed that New Equity amounts to EUR 100.000 & that the NID rate is 8%.

	Before NID	After NID
Profit Before Deductions	10.000	10.000
Notional Interest Deduction		8.000
Taxable Profit	10.000	2.000
Tax	1.250	250
Effective Tax Rate	12,5%	2,5%

The Advantages of NID:

- The NID can apply to numerous incentives included in the Cyprus Legislation like, the Intellectual Property Regime.
- The NID provides similar advantages as debt financing.
- A company can benefit from tax while simultaneously strengthen financially.

The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained.