RELEVANT TO ACCA QUALIFICATION PAPER P6 (CYP)

Understanding the benefit arising from debit balances

Following a number of amendments to Cyprus tax legislation, there have been significant changes to the *Study Guide*. The amendments to legislation are a result of measures to combat tax evasion and to increase government revenue, as well as new incentives to make the tax system more attractive. In a previous article, '[Amendments to the Paper P6 (CYP) syllabus]', I listed the main changes and gave a brief description of each. In certain cases, I stated that a technical article will be issued to help explain the change.

This article is the first of a series of articles written for this purpose, and expands on point A1 of the aforementioned article. It explains the tax treatment of the benefit, arising from debit balances maintained with Cyprus tax-resident companies, for relevant recipients. Candidates will be expected to be familiar with the provisions stated within this technical article, although no references to sections of tax legislation are required.

Introduction

From 1 January 2012, Article 5 of the Income Tax Law 118(I)/2002, was amended to include a new 'type' of income that is subject to tax, which applies only to physical persons. This is the 'benefit' that arises from maintaining a debit balance with a company.

Application and calculation of the benefit

Specifically, from 1 January 2012, on the amount of any loan or other financial facility, or on any drawings, granted by a Cyprus tax-resident company to:

- a director who is a physical person, or
- a shareholder of that company who is a physical person, or
- the spouse of a director or shareholder, or
- a relative of up to second degree of a director or shareholder,

that persons who receives the benefit of the loan/drawings/financial facility (referred to as the 'recipient') is deemed to have a benefit, which is calculated **monthly**, at a rate of 9% per annum, on the debit balance amount. This *benefit* is included in the taxable income of that person. The benefit includes debit balances created before 1 January 2012.

As of 1 January 2012, the provisions in the tax legislation (Article 39), which imposed deemed interest income on the company itself, equal to 9% on such debit balances, were abolished.

The *benefit* is a separate source of income and increases a person's taxable income. If the benefit is less than the tax free amount of €19.500, and there are no other sources of income, then no tax arises. In cases where tax arises, then the company must calculate the tax and pay it through the Pay-As-You-Earn (PAYE) system.

Scope of the benefit

A *recipient* person **cannot** be an employee of the company who is **not** also a director or a shareholder, or a spouse of either or a relative of up to second degree of either.

Furthermore, the benefit does **not** apply to debit balances arising out of trading transactions between the company and the recipient.

The tax practice for persons who are not Cyprus tax-residents is that the benefit will be further reduced pro-rata by the number of days that the person was physically **outside** of the Republic of Cyprus. This will minimise significantly the tax for Cyprus non-resident persons (see example 2 below).

In case the company charges interest to the recipient on the debit balance, then that amount of interest reduces the value of the benefit.

Examples

Example 1

A recipient, who is employed by Company A, has a fixed debit balance of €150.000 during a tax year with the company. She has no other income from the company and has not declared any other forms of income to the company through form IR59.

The benefit is calculated at 9% x €150.000 = €13.500, and will form part of her emoluments. This amount is less than the tax free amount of €19.500. Company A does <u>not</u> have an obligation to withhold any tax.

Example 2

A non-Cyprus tax-resident person is a shareholder of Company B. During 2012, he was in Cyprus for a total of 10 days. In 2011, he received an interest free loan from the company amounting to €5.000.000. The amount remained unpaid throughout the whole of 2012.

The benefit for 2012 is calculated at 9% x €5.000.000 = €450.000, and is reduced by the number of days that the recipient was **not** in Cyprus – ie by (356/366) x €450.000 = €437.705. This leaves a taxable benefit of €450.000 – €437.705 = €12.295. This amount is less than the tax free amount of €19.500. Company B does <u>not</u> have an obligation to withhold any tax.

Example 3
A recipient has a fixed debit balance amounting to €150.000 during the tax year with Company C. In addition, he receives a salary from the company equal to €14.000 for the year. He has no other income or personal allowances, except for social insurance.

The benefit is calculated as 9% x €150.000 = €13.500 and this is added to his salary of €14.000. Total remuneration thus amounts to €27.500. The benefit is **not** subject to social insurance contributions.

The tax that must be withheld by Company C, and paid to the Income Tax Office through the PAYE system during the tax year, is €1.409,60. This is calculated as follows:

	€
Income	
- salary	14.000
- benefit	13.500
	27.500
Social insurance: 6,8% x 14.000 (on salary only)	(952)
Taxable income	**26.548**
Calculation of tax	
From €0 – €19.500 @ 0%	Nil
From €19.501 – €26.548 @ 20%	1.409,60
Tax payable	**1.409,60**

Example 4
A recipient has a fixed debit balance of €150.000 during the tax year with Company D, which in turn charges her interest on her debit balance at a rate of 6%. The recipient also receives a salary from the company equal to €14.000 in the tax year, and has no other income.

The benefit for the tax year amounts to €4.500 and is calculated as follows:

	€
9% x €150.000	13.500
Less: interest charged by the company on the debit balance [6% x €150.000)	(9.000)
Benefit	**4.500**

The benefit is added to the salary of €14.000. Total remuneration amounts to €18.500. This amount is less than the tax free amount of €19.500. Company C does *not* have an obligation to withhold any tax.

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