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REPORT

From:	General Secretariat of the Council
To:	Delegations
Subject:	Code of Conduct Group (Business Taxation) - Report to the Council

Annex 3: Cyprus – CY020 – Notional interest deduction [2020 CoCG decision]

I. Background

1. In 2020 the Code of Conduct Group agreed that the Cypriot NID regime was *Not harmful after the amendment in June 2020*, but that it should be *"further monitored, in order to establish if a high foreign use of the NID regime would appear under criterion 1b and 2b"*.
2. The 2023 annual monitoring exercise (covering data for tax year 2021) was the first monitoring exercise, but Cyprus was not able to provide the relevant data at that time. Beginning of December 2024, Cyprus provided the data for the tax years 2021 and 2022 (table below).
3. We recall that the Cypriot NID regime is an incremental regime, and is calculated as a percentage of a company's net equity increase, as follows: Reference interest rate x New Capital (NC). This is referred to as the "Basic Calculation".
4. Since the 2020 modifications to the NID regime, the reference interest rate – differently from similar regimes in other Member States where one single rate is applicable to all cases - is for the Cypriot NID the *"10-year government bonds yield of the state where the new capital is invested, increased by 5% on 31.12 of the year preceding the tax year."* In

case “the state where the new capital is invested has not issued any government bonds [...] reference rate is the yield of the government bonds of the Republic increased by 5% on 31.12 of the year preceding the tax year.”¹.

The First Step

5. *The regime requires that each asset financed by NC should be identified through a tracing/matching method. The CY NID deduction cannot exceed 80% of the taxable income from each asset as determined before the application of the NID provisions. The 80% cap is calculated based on the taxable income derived from each asset financed by NC separately. This cap is then compared to the NID calculated for each asset under the Basic calculation above. The deduction for each asset is then determined as the lower of these two amounts.*

The Second Step

6. *A second calculation is then made on the total taxable income from all assets financed by NC. If this amount is lower than the total deduction under the first step, this lower amount is used as the deduction. The lowest effective rate that may be achieved with the maximum deduction is 2.5% (12.5% CIT rate*(100% taxable – 80% taxable income/maximum NID deduction).*

II. Preliminary assessment

7. The CY NID applies as of January 2015. It was amended as of June 2020 and put under monitoring. The data provided and under analysis covers tax years 2021 and 2022.
8. So far, based on the data provided, and taking into account the effects of the changes in the NID rate, the Group can notice that the uptake has decreased between 2021 and 2022 from 1 400 taxpayers to 1 000 taxpayers. The overall amount of NID granted has also decreased almost proportionately. The same applies to the average amount of the NID deduction.
9. However, the data provided does not distinguish between the domestically- versus foreign-owned companies, in order to ensure the proper monitoring of criteria 1(b) of the

¹ The minimum reference rate is no longer the Cyprus interest rate as was the case before, and can hence be lower or higher than the Cyprus interest rate depending on the respective jurisdiction.

Code of Conduct. The Cypriot authorities informed that they were not able to extract such data from their system.

10. Despite the absence of data that breaks down per category of beneficiary, the available information indicates that the average amount of the NID deduction remained rather high but relatively comparable, with a slight decrease from EUR 1 615 000 to EUR 1 255 000. This corresponds to an average NID tax benefit per taxpayer (average NID deduction x CIT 12.5%) of approximately EUR 200 000 in 2021, and of EUR 156 000 in 2022. The amount of the tax benefit per company on a yearly basis is relatively high. Therefore, it remains important that the Cypriot authorities provide the Group with data on the numbers of domestically- and (directly or indirectly) foreign-owned taxpayers.
11. Based on the aforementioned information and the lack of data regarding the domestic or foreign ownership of the beneficiaries, the Commission Services cannot draw a final conclusion whether the measure affected in a significant way the business location amongst the Member States. However, the effect of a NID is in principle positive, as the amount of the NID deduction is linked to the increase in the equity during the relevant tax year. Furthermore, in this specific case the average NID tax benefit, although relatively high, has slightly decreased.
12. The Commission Services suggest that the Group continues monitoring the effects of the measure, to verify whether the trend regarding the amount of the NID allowance is maintained. Moreover, Cypriot authorities are invited to improve the data collection and endeavour to provide the Group with a breakdown of the numbers of domestically- and foreign-owned companies which benefit from the regime.

III. Follow-up

The Group supported the preliminary assessment that the monitoring should continue and that the Cypriot authorities were invited to improve the data collection and provide the relevant data.

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Cyprus – CY020	2021 (not provided previously)	2022
Total number of taxpayers benefitting from the measure	1 409	1 018
Out of which directly or indirectly foreign owned companies:	We cannot extract such information from our database	We cannot extract such information from our database
Global amount of NID granted	€2 276 000 000	€1 278 000 000
Total tax expenditure (<i>at 12.5% CIT rate</i>)	€285 000 000	€160 000 000
<i>Average amount of NID allowance</i>	€1 615 000	€1 255 000

Total tax expenditure attributable to directly or indirectly foreign owned	We cannot extract such information from our database	We cannot extract such information from our database
<i>Average NID tax expenditure attributable to directly or indirectly foreign owned</i>	We cannot extract such information from our database	We cannot extract such information from our database