

CYPRUS INTEREST INCOME AND HOW TO TAX IT



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Interest income plays a significant role in the financial landscape of businesses; therefore understanding its classification is crucial for taxation purposes. In Cyprus, interest income is categorized into two main types: active and passive; and taxed accordingly.

Active interest income refers to income earned through the regular operations of a business or closely associated activities. When a Cyprus entity earns active interest income, such is treated as trading income and is subject to a corporate tax rate of 12.5%. Notably, such income is not subject to the Special Defence Contribution (SDC). SDC is imposed on dividend income, passive interest income and rental income earned by Cyprus tax resident entities and by Cyprus tax resident and domiciled individuals. Passive interest income, derived from sources not linked to the ordinary business operations of a Cyprus company, is subject to SDC, currently at the rate of 17% (recently decreased by the Cyprus Parliament from 30% to 17%).

Interest received by Cyprus tax resident and domiciled individuals or legal entities from savings certificates and development bonds of the Republic of Cyprus, corporate bonds listed on a recognised stock exchange, as well as of bonds listed on a recognised stock exchange that are issued by a local authority or a state organisation, or from an approved provident fund or social insurance fund, continue to be subject to the SDC reduced rate of 3%.



When considering the taxation of interest income, received by a Cyprus entity, derived from an investment portfolio, comprising securities and bonds, the important question is whether the Cyprus company is deemed to engage in the trading of such bonds and securities. This may be assessed based on a number of considerations. For example, if such Cyprus company is actively involved in the decision making process, relating to the relevant investments, this shall be considered to be a trading activity and the relevant interest income will be subject to corporation tax, currently at the rate of 12.5%.

Conversely, if the entity is not considered as trading in bonds and securities, any interest received will be classified as passive income and be subject to SDC. Also, if the relevant bonds are listed, it needs to be examined whether the reduced SDC of 3% is applicable.

It's crucial to properly identify the classification of interest income to ensure accurate tax treatment; and while active interest income enjoys a taxation to the lower corporate tax rate without the burden of SDC, passive interest income is now subjected to a reduced SDC rate SDC of 17% in Cyprus.





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