



## Cyprus Tax News

# New Transfer Pricing Circular issued by the Cyprus Tax Department with respect to Simplification Measures for Low Value Transactions

On 6 July 2023, the Cyprus Tax Department (“CTD”) issued a [Circular](#) with respect to transactions that fall below the Local File threshold.

The Circular applies to all taxpayers with related party transactions (“Controlled Transactions”) which are exempted from the obligation to be documented in a Cyprus Local File. As a reminder, per the provisions of Article 33 of the Income Tax Law (the “arm’s length principle”), such exemption applies when the aggregate value of Controlled Transactions per particular category (e.g. goods, services, IP related income, financial transactions<sup>[1]</sup>) total, or should total had the Controlled Transactions been executed based on the arm’s length principle, an amount which does not exceed €750.000 per tax year.

The new Circular provides for simplified documentation to be prepared for Controlled Transactions that do not exceed the threshold (regardless of category).

Furthermore, the Circular also provides for the use of safe harbours for certain types of financing activity, as well as for low value-adding services, again assuming that the Local File threshold is not exceeded.

<sup>[1]</sup> As a reminder the threshold for financing transactions is determined by the principal amount of the loan including interest charged but not paid. Furthermore, at the time of writing this Tax Alert, it is understood that there are ongoing developments in terms of a possible increase in the threshold for financial transactions, but this needs to follow a parliamentary process. Consequently, currently the new threshold amount for financing transactions and the timing of its introduction are uncertain.

The main provisions of the Circular are outlined below:

### **1. Simplified Transfer Pricing documentation requirements**

Taxpayers falling under the provisions of the Circular, who are eligible to maintain simplified Transfer Pricing (“TP”) documentation based on the above, will be required to include the following minimum contents in such documentation, which should be kept on file to support their compliance with the arm’s length principle for their Controlled Transactions:

- a. Brief description of the functional analysis (functions undertaken, assets used and risks assumed);
- b. A description of the characterisation of the entity, based on the results of the functional analysis;
- c. The reasons for the chosen TP method being considered the most appropriate one;
- d. Determination of the arm’s length price/remuneration based on the benchmarking analysis undertaken, using either external or internal comparables. The benchmarking approach may also include any other appropriate method whose use is warranted under the circumstances described in the OECD TP Guidelines for Tax Administrations and Multinational Enterprises (the “OECD TP Guidelines”).

### **2. Safe harbours for certain types of transaction**

The Circular also introduces safe harbours for the following four types of sub-categories of Controlled Transactions:

- I. Financing transactions such as loans or cash advances granted to related parties which are funded out of financial means (such as bonds, loans from related parties, interest free loans from the shareholders, cash advances and bank loans). The safe harbour applies regardless of whether the taxpayer assumes the risks of the financing activity.
- II. Loans or cash advances receivable from related parties which have been funded out of own capital (e.g. issued share capital and share premium, non-return capital contributions, and retained earnings).
- III. Funding received from related parties (through interest bearing loans, bond issuance, or cash advances) to the extent that the funds borrowed are used in the business.
- IV. Low value-adding services.

The Circular emphasises that in order to be able to use a safe harbour, the total aggregate value of Controlled Transactions within the particular sub-category for which the safe harbour will be used, together with the value of the remaining Controlled Transactions which belong to the same main category to which the sub-category belongs, should not exceed, or should not have exceeded had the Controlled Transactions been executed based on the arm’s length principle, the threshold of €750.000 for the tax year.

Taxpayers engaged in the related party transactions which fall under the following subcategories are assumed to comply with the arm’s length principle if the Controlled Transactions fall within the safe harbours. The safe harbours covered by the Circular relate to certain sub-categories of financing activity as well as to low value adding services, and they are as follows:

	Transactions eligible for safe harbours	Safe harbour provision
I.	Loans or cash advances to related parties which are funded out of financial means.	Minimum return of 2.5% (after the deduction of allowable expenses).
II.	Loans or cash advances receivable from related parties which are funded out of own capital.	Minimum return should be equal to the yield rate (as at 31 December of the prior tax year) of the 10 year government bond of the country in which the borrower operates, increased by 3.5%.
III.	Loans payable to related parties to the extent that the funds obtained are used in the business.	Cost of borrowing must not exceed the yield rate (as at 31 December of the prior tax year) of the ten-year government bond of the Republic of Cyprus, increased by 1.5%.
IV.	Low value-adding services	5% mark-up on the relevant costs.

*The safe harbour amounts stated above are before the deduction of taxes.*

*In the case where the yield rate of the ten-year government bond is negative, the safe harbour rates for transactions described under II and III should amount to 3.5% and 1.5%, respectively. Also for I, II, and III, in addition to the principal amount, the relevant safe harbour should also be applied to any interest charged but not paid.*

*The safe harbours are subject to review and may be amended from time to time depending on the prevailing market conditions or other factors.*

### **3. Additional conditions and requirements with respect to use of the safe harbours**

The use of the safe harbours for the above sub-categories of transactions will still need to be supported by some minimum documentation. Such documentation will include the items under points (a) and (b) above, i.e:

- a. Brief description of the functional analysis (functions undertaken, assets used and risks assumed);
- b. A description of the characterisation of the entity, based on the results of the functional analysis.

Furthermore, additional information will be required to be included in the minimum documentation supporting the use of the safe harbour. For example, with respect to the financing transactions described above, such information must include a list of the relevant loans and certain details relating to those loans, the reasons why they meet the required criteria for using the safe harbour and numerical analyses and reconciliations for the purposes of arriving at the taxable income.

The requirements for using the safe harbour of a 5% mark-up on relevant costs (referred to as the “simplified approach” in the OECD TP Guidelines) for low value-adding services closely follow those in Chapter VII of the OECD TP Guidelines with some slight variations. Broadly speaking, services falling under the definition of low value-adding services are those which have a supportive character, are not part of the core activities of the group, do not involve unique and valuable intangibles and do not involve significant risk for the service provider. Specific examples of services that would or would not fall within the category of low value-adding services are described in Section D of Chapter VII of the OECD TP Guidelines. Under the simplified approach for low value-adding

services, documentation and information must be prepared which include justifications as to why the services are eligible for the simplified methodology of a 5% mark-up on relevant costs and should also include certain analyses and calculations.

The Circular also states that a taxpayer choosing to benefit from a safe harbour, must declare the use of that safe harbour to the CTD electronically by completing the relevant section in the annual income tax return/summary information table.

It is noted that if the taxpayer has reliable internal comparables at its disposal, then the use of the safe harbour is not permitted.

Furthermore, in case the accounting profit from the Controlled Transactions is higher than that resulting from a TP Study or the amount resulting from application of the safe harbour, the CTD will not proceed with any downward adjustments to taxable profits.

#### **4. Reporting and Mandatory Disclosure Rules**

The simplified TP documentation for Controlled Transactions covered by the Circular should be made available within 60 days of the receipt of the CTD's request by the taxpayer or by a person authorised to act as a representative of the taxpayer.

In addition, the use of the above safe harbours will be subject to the DAC6 provisions of the Administrative Cooperation in The Field of Taxation Law and accompanying Regulations, under the automatic hallmark (E1) on the use of unilateral safe harbours.

The Circular does however state that the use of the simplified methodology of a 5% mark-up on relevant costs for low value-adding services may be exempted from DAC6 reporting if the taxpayer fully complies with the guidance on how to apply the relevant methodology as set out in Chapter VII of the OECD TP Guidelines and the information and documentation prepared strictly follow the contents set out in those OECD Guidelines.

#### **How can we help?**

Deloitte can assist clients with understanding the potential impact of the newly issued Circular on their TP affairs and policies and support with the compliance obligations that arise. Deloitte can also assist with the preparation of the relevant TP analysis and documentation, as well as reporting where appropriate

**Get in touch**

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