



Cyprus Tax News

FAQs issued by the Cyprus Tax Department with respect to Interpretative Circular 3 on intra-group back-to-back financing activities

On 24 January 2022, the Cyprus Tax Department (CTD) uploaded a new "[Frequently Asked Questions](#) (FAQs)" section on its website with respect to Transfer Pricing. The FAQs relate to [Interpretative Circular 3](#) ("the Circular") which was issued in 2017 in respect of intra-group financing activities of a back-to-back nature. The Circular provides for the application of TP methodology to such activities based on the arm's length principle as advocated by the OECD.

As a reminder, the Circular applies to intra-group financing activities where loans or cash advances are granted by a Cypriot tax resident company (or Cypriot permanent establishment of a non-resident company) to related parties, financed by financial means and instruments, such as debentures, private loans, cash advances, or bank loans.

The Circular sets out the requirements for a Transfer Pricing Analysis ("TP Study") to be prepared for such activities. In addition, it provides for a simplification measure (effectively a safe harbour remuneration of 2% after-tax on assets) for companies that do not intend to undertake a TP Study. This simplification measure can be opted for in cases where the relevant criteria are met and the company pursues a purely intermediary activity within the financing arrangements, borrowing from related parties and on-lending to related parties.

It should be noted that opting for the simplification measure is subject to exchange of information (included in DAC6 reporting following the subsequent introduction of the relevant DAC6 provisions in Cyprus).

Further details on the contents of the Circular can be found in our [tax alert](#) dated 3 July 2017.

The key points that are included in the FAQs posted on the CTD website are summarised below:

- The answers to the FAQs are applicable to all transactions that fall within the scope of the Circular and relate to loan agreements concluded as at the date of the issue of the FAQs (i.e. 24 January 2022), as well as to those loan agreements which were concluded prior to that date and have not been examined by the CTD by that date.
- Transfer Pricing documentation prepared is not filed with the CTD as part of the annual tax filing process but should only be submitted to the CTD upon request.
- The TP expert who prepares the TP Study is someone who possesses sufficient practical experience, competence and technical knowledge to prepare a TP study in accordance with the OECD TP Guidelines and the provisions of the Cyprus Tax Legislation. A TP expert is qualified by sufficient evidence of his/her technical expertise, training and knowledge in TP matters.
- If a company opts for the simplification measure (2% margin after tax) because it is functionally reduced as it is purely an intermediary financing entity should only prepare a functional analysis.
- In case the company does not have a TP study in place (and does not come under the simplification measure), the CTD may assess the company's taxable profits on the basis of the available information and at its own discretion.
- A TP study should be prepared when an intra group loan is initiated and updated when:
 - (i) new loans are provided or received by the company, or
 - (ii) significant terms of the existing loans change or amended, or
 - (iii) the functional profile of the company changes, or
 - (iv) the market and economic conditions change significantly (if applicable).

The above list is indicative and it is not exhaustive.

- “Specialised personnel” as mentioned in paragraph 19 of the Circular should have sufficient knowledge, possess competence and experience to perform decision making functions and to control the risks of a controlled transaction under consideration. Reference is made to relevant parts of the OECD TP Guidelines with respect to what is meant by “control over risk”.

It is clarified that there is no requirement for a company to hire specialised personnel provided that its board of directors has sufficient knowledge, possesses competence and experience to perform the decision-making functions and to control the risks of the transactions under consideration.

- Contributions from shareholders who are physical persons fall within the scope of the Circular regardless of whether these are interest bearing or not, and are therefore considered as funding back-to-back financing arrangements. However, contributions which are considered equity do not fall under the definition of financial means and instruments as described in paragraph 2 of the Circular and thus do not fall within the scope of the Circular.
- Paragraph 25 of the Circular states that in cases where the simplification measure is used, the minimum margin of 2% after tax is applied on the value of the company's assets.

The term "company's assets" is interpreted as the assets relating to the intra group back-to-back financing transactions (i.e. loan receivables) only. Moreover, the value of the loan receivables means their principal amount.

Accrued interest could also be included in the value of the company's assets under specific facts and circumstances (e.g. if a loan agreement includes provisions for capitalisation of the interest or if as per the actual conduct of the parties accrued interest could be considered as additional financing).

- A company that carries out back-to-back intra-group financing activities and also carries out other activities still falls within the scope of the provisions of the Circular in respect of its back-to-back financing transactions.
- The Circular applies to both cross-border transactions and domestic transactions between related companies.

How can we help?

Deloitte can assist clients with understanding the potential impact of the newly issued FAQs relating to the Circular on their financing arrangements, and where appropriate assist with the preparation and submission of the relevant transfer pricing work and analysis.

Our team of TP experts are also at hand to support clients with respect to other types of intercompany transactions at a time of increasing changes in the international and local TP landscape, and within the context of the newly updated version of the [OECD TP Guidelines](#) which were published on 20 January 2022.

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