



Cyprus Tax News

Circular issued by the Cyprus Tax Department with respect to Financing Transactions of a “Back-to-Back” Nature

On 7 July 2023, the Cyprus Tax Department (“CTD”) issued Circular 7/2023, which is effective from the tax year 2023 onwards, clarifying the method which it considers appropriate for determining the arm’s length pricing for financing transactions, including those of a “back-to-back” nature.

In accordance with the Circular, the CTD considers that the most appropriate Transfer Pricing (“TP”) method for financing transactions is the Comparable Uncontrolled Price (“CUP”) method, with interest rates being the comparables to be used in applying the CUP method.

The Circular also notes that the CUP method, based on arm’s length interest rates, is applicable to any taxpayer which:

- (a) engages in back-to-back financing provided that the transactions are accurately delineated as loans; and
- (b) in accordance with the conclusions of the functional and risk analysis (i.e., assessment of the functions, assets and risks assumed), is characterised as a financing business which has the financial capacity to assume the risks involved as well as having the functional capability to control the relevant risks and actually exercises such control over those risks. The taxpayer should have sufficient capital to absorb potential losses, should any of the risks associated with the financing transactions crystallise.

The Circular also states that the use of any other method by taxpayers which have the above profile will only be permitted in exceptional cases. In order to secure the use of an alternative method, this will need to be pre-approved by the CTD via the rulings process. In such cases, the following additional information should be provided to the CTD:

- The reasons why the CUP method is less suitable or cannot be applied under the specific circumstances. Taxpayers will still need to undertake and present a comparability analysis for interest rates to support their position that the CUP method based on interest rates leads to inappropriate results.
- Detailed analysis supporting the position that the proposed alternative method aligns with the arm's length principle, as defined in the OECD TP Guidelines, and leads to results which satisfy this principle.
- Conclusion as to why the alternative method proposed is considered to be more appropriate than the CUP method.

How can we help?

Deloitte can assist clients with understanding the potential impact of the newly issued Circular on their financing transactions and any adjustments that need to be made to their TP methods and policies to be compliant with the Circular. In addition, Deloitte can assist with the preparation of the relevant TP analysis, Local Files and other documentation in connection with the above.

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