

Cyprus introduces TP documentation, reduces tax on some ‘passive’ interest income, considers NID grandfathering

July 28, 2022

In brief

The Cyprus Parliament on June 30 approved the long-awaited amendments to the Cyprus Income Tax Law and new Regulations to introduce Transfer Pricing (TP) documentation compliance obligations (Master File, Cyprus Local File, Summary Table) for Cyprus tax resident persons, and permanent establishments of non-Cyprus tax resident persons situated in Cyprus, that engage in transactions with related parties (Controlled Transactions). A formal Advance Pricing Agreement (APA) procedure has also been introduced. Specific penalties for non-compliance with the new obligations are now in place by an amendment to the Assessment and Collection of Taxes Law. The law amendments and Regulations are effective from the tax year 2022 onwards.

Regarding the reduction of some ‘passive’ interest income, the Cyprus Parliament, on May 26, voted to amend the relevant law governing the taxation of corporate and government bonds, reducing the rate to 3% (previously 30%). The amendment became effective on June 8, 2022.

Finally, Cyprus is considering grandfathering the Cyprus Notional Interest Deduction (NID) regime for taxpayers already benefiting from it as of the cut-off date of January 1, 2024, and delaying implementation of the European Commission’s EU Debt-Equity Bias Reduction (DEBRA) proposal.

Actions to consider: Updating of the Income Tax Law on TP matters, and the introduction – from tax year 2022 onward – of wider TP documentation obligations and a formal APA process, will have an impact on most of the (local or multinational) groups and companies having presence in Cyprus that engage in transactions with related parties. Businesses therefore should act proactively so as to understand the impact of the new rules on their operations and invoicing flows, and identify the TP-related implications and risks to which they may be exposed, in order to take any necessary steps designed to mitigate risks and achieve compliance with the new requirements in the most efficient and effective way.

Existing and potential Cyprus corporate taxpayers should consider their portfolio allocations in light of the reduced taxation on ‘passive’ interest income from listed corporate bonds.

MNEs with or without Cyprus presence should consider the Cyprus NID grandfathering provided under DEBRA before the cut-off date of January 1, 2024.

In detail

Introduction of TP documentation compliance obligations

Amendments to the Income Tax Law

The Income Tax Law amendment clarifies that the arm's-length principle (as per Article 33 of the Law) may be applied and interpreted in accordance with the TP Guidelines issued by the OECD (as amended from time to time).

In addition, the Income Tax Law amendment introduces new TP documentation compliance obligations and a formal procedure for obtaining an APA (details of which are provided in the relevant Regulations). These new requirements are described below in more detail.

The Income Tax Law also has been amended to update the definition of related parties and introduce a minimum 25% relationship threshold relevant for companies.

In summary, two companies are considered as related if the same person (and its related persons) or group(s) of persons (under certain conditions) directly or indirectly:

- hold 25% of the voting rights or share capital of both companies, or
- have the right to at least 25% of both companies' income.

A company also is considered related to a person (and its related persons) that directly or indirectly:

- holds 25% of its voting rights or share capital, or
- has the right to at least 25% of its income.

Two or more persons are considered related if they act together (or take directions) to directly or indirectly:

- hold 25% of the voting rights or share capital, or
- have the right to at least 25% of the profit of a company.

TP documentation compliance obligations and APA procedure

The new TP Documentation File obligation

As from the tax year 2022 onwards, Cyprus tax resident persons and permanent establishments of non-Cyprus tax resident persons situated in Cyprus that engage in domestic and/or cross-border Controlled Transactions, subject to exemptions mentioned below, are required to prepare on an annual basis a TP Documentation File, which consists of the "Master File" and the "Cyprus Local File."

The Cyprus Tax Department (CTD) is issuing a relevant Notification to announce (among others) the required detailed contents of the Master File and Cyprus Local File.

Contents: The required contents of the Master File and Cyprus Local File closely follow the definition and suggested contents of Master File and Local File as per the OECD TP Guidelines and BEPS Action 13 Report.

Exemptions: The following exemptions apply:

- Master File: Only Cyprus tax resident entities that are the ultimate parent or surrogate parent entity of an MNE group falling under the scope of Country-by-Country reporting have an obligation to prepare and maintain a Master File. All other persons are exempt from this obligation.

- **Local File:** Persons that engage in Controlled Transactions with arm’s-length value less than EUR 750,000 p.a. in aggregate per transaction category (e.g., sale/purchase of goods, provision/receipt of services, financing transactions, receipt/payment of IP licensing/royalties, others) are exempt from the obligation to prepare a Cyprus Local File.

Quality review: A person who holds a Practicing Certificate from the Institute of Certified Public Accountants of Cyprus (ICPAC) or another approved by the Council of Ministers body of certified auditors in Cyprus is expected to perform a Quality Review of the Cyprus Local File.

Format and language: The TP Documentation File should be maintained by the taxpayer in electronic or paper format and may be prepared in a generally acceptable language, preferably in English; however, the CTD may request its translation in Greek if necessary.

Deadlines: The TP Documentation File must be prepared and be subject to Quality Review (to the extent applicable as mentioned above) on an annual basis, by the deadline of filing the Income Tax Return for the relevant tax year.

The TP Documentation File needs to be retained in compliance with the general document retention obligations for tax purposes; however, it should be submitted to the CTD upon request by the CTD (e.g., for the purpose of tax audit) and specifically within 60 days from the notification of such request. Penalties shall be imposed for late or nonfiling of the TP Documentation File (as described below).

TP Documentation File updates: The TP Documentation File must be updated on an annual basis and include details regarding the impact of market fluctuations or other events on the information and analyses included therein.

The Summary Table disclosure requirement

A Summary Table must be prepared by all taxpayers that engage in Controlled Transactions on an annual basis, disclosing details regarding such transactions, including the names and tax identification codes of the related counterparties, and the respective values per transaction category (sale/purchase of goods, provision/receipt of services, financing transactions, receipt/payment of IP licenses/royalties, others).

The Summary Table must be submitted electronically together with the Income Tax return for the relevant tax year.

Administrative Penalties

As per the amendment to the Assessment and Collection of Taxes Law, the following new administrative penalties are introduced:

- In the case of late submission of the TP Documentation File following the notification by the CTD to the taxpayer of a request for submission, the following penalties will apply:

EUR 5,000	If the TP Documentation File is filed after the 60th day but before the 91st day from the notification of the submission request
EUR 10,000	If the TP Documentation File is filed after the 90th day but before the 121st day from the notification of the submission request
EUR 20,000	If the TP Documentation File is filed after the 120th day from the notification of the submission request

- In the case of nonsubmission of the TP Documentation File following the notification by the CTD of a request for submission, a penalty of EUR 20,000 will apply.
- In the case of nonsubmission of the Summary Table, a penalty of EUR 500 will apply.

Services Advance Pricing Agreement (APA) procedure

Cyprus tax resident persons and non-Cyprus tax resident persons that have a permanent establishment situated in Cyprus may submit to the CTD an APA Request with respect to current or future domestic or cross-border Controlled Transactions. The detailed framework of the APA procedure and other relevant matters are described in the new Regulations that have been issued, as summarized below.

The APA request may cover the various conditions and assumptions relevant for determining the arm's-length pricing of the Controlled Transactions for a specified period, including:

- the critical assumptions on the functional and risk profile of the parties involved,
- the relevant market conditions,
- the applicable TP method to be followed,
- the identified uncontrolled comparable transactions and any necessary adjustments made to determine the arm's-length price range, and
- any other specialized matter relating to the pricing of the Controlled Transactions.

The CTD examines the APA request and approves or rejects it.

Timelines: The CTD should issue the APA decision within 10 months (the CTD may notify extension of this deadline up to 24 months) from the date of submission of the APA request by the taxpayer.

The APA decision may be applicable for a maximum term of four years; however, it cannot apply for any tax year prior to the tax year in which the request is submitted.

Bilateral and Multilateral APAs: The APA request for cross-border Controlled Transactions may be bilateral or multilateral, involving the tax authorities in other jurisdiction(s) with which Cyprus has concluded a Double Tax Treaty. In such cases, a corresponding request needs to be filed by the taxpayer with the authorities in the other jurisdiction(s). The CTD may consult in writing with such authorities under the relevant mutual agreement and exchange of information procedures and applicable EU legal framework, for the purpose of issuing the APA decision.

Validity of APA decision: The prices of the Controlled Transactions covered by an APA decision will be considered as arm's length, provided that any conditions included in the APA decision are met, and that the critical assumptions on which the APA was based continue to be valid and applicable.

An approved APA decision is considered binding; however, it can be revised during its agreed term upon request of the taxpayer or at the discretion of the CTA, only if:

- the critical assumptions on which the APA decision was based are proven incorrect; or
- the conditions or critical assumptions on which the APA decision was based have substantially changed so that it is impossible to apply the APA decision; or
- if an arbitration process is followed for transactions covered by the APA decision, under an effective Double Tax Treaty or the EU Arbitration Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises.

Revised APA decisions issued by the CTD shall apply for the remainder of the term of the original APA decision.

Reduction of tax on 'passive' interest income from listed corporate bonds

The Cyprus Parliament voted on May 26 to amend the relevant law governing the taxation of corporate and government bonds. The amendment is effective as of June 8, 2022. Under the amended law, a Cyprus tax-resident company that earns 'passive' interest (i.e., interest not arising from a business or closely connected thereto) from Cypriot and non-Cypriot corporate bonds listed on a recognized stock exchange, as well as from certain other types of bonds such as Cyprus government bonds, will be subject to tax at the reduced rate of 3%. Prior to the amendments such passive interest income would have been subject to tax at the rate of 30%.

Observation: The amendments enhance the competitiveness of Cyprus companies as vehicles for holding listed corporate bonds.

DEBRA

As part of the EU Directive proposal for DEBRA put forth by the European Commission (see [PwC's Tax Policy Alert](#) for more details), EU Member States that already apply an allowance on equity (AoE) under their national law may postpone application of the proposal (for a period of up to 10 years, and in no case for a period longer than the duration of the benefit under national law) for taxpayers already benefiting from the national AoE on January 1, 2024. Cyprus will consider retaining its own national AoE (i.e., the Cyprus NID regime) for taxpayers already benefiting from it as of January 1, 2024.

Observation: MNECs with or without Cyprus presence currently should consider the Cyprus NID grandfathering provided under DEBRA before the cut-off date of January 1, 2024.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

Transfer Pricing, Cyprus

Ioanna Stylianidou

Director Head of Transfer Pricing

+357 22 55 36 72

ioanna.stylianidou@pwc.com

International Tax Services, Cyprus

Christos S. Charalambides

+357 22 55 36 17

christos.charalambides@pwc.com

Stelios A Violaris

+357 22 555 300

stelios.violaris@pwc.com

Eftychios G Eftychiou

+357 22 555 277

eftychios.eftychiou@pwc.com

International Tax Services, United States

Jovanna Tannousis, New York

+1 646 471 2879

jovanna.m.tannousis@pwc.com

Transfer Pricing, United States

Horacio Peña, *New York*
Global Transfer Pricing Leader
+1 917 478 5817
horacio.pena@pwc.com

Paige Hill, *New York*
US Transfer Pricing Leader
+1 917 923 841
paige.hill@pwc.com