CYPRUS TRANSFER PRICING GUIDELINES

On 30 June 2017, the Cyprus Tax Department (CTD) issued a Circular revising the transfer pricing framework for companies carrying out intra-group financing activities in Cyprus. The Circular provides additional guidance in terms of substance and transfer pricing requirements in line with the Organization for Economic Co-operation and Development (OECD) Guidelines, as well as guidance as to the required content of a Transfer Pricing study. The Circular is effective from 1 July 2017 and replaces the Minimum Margin Scheme regime applicable until 30 June 2017 (of 0.125% to 0.35% for "back to back loans").

According to the Circular, the term intra-group financing transactions refers as all activities of granting loans or cash advances remunerated by interest (or deemed to be remunerated by interest) to related entities, and funding them through public debt issuance, private loans, advances, or bank loans, among others.

It is required that all intra-group transactions be conducted in compliance with the arm's length principle. Arm's length transactions are defined as the transactions that should be valued as they had been carried out between unrelated parties.

Moreover, an appropriate comparability analysis (transfer pricing report) must be carried out in order to determine whether transactions between independent entities are comparable to transactions between related entities. The comparability analysis should consist of two parts:

1. Identification of commercial or financial relationship between related entities and determination of the conditions and economically relevant circumstances attaching to those relations.
2. Comparison of the as accurately delineated conditions and economically relevant circumstances of the controlled transaction with those of comparable transactions between independent entities.

<u>Part 1 - Identification of commercial or financial relationship between related entities and determination of the conditions and economically relevant circumstances attaching to those relations</u>

A full description of the role of each of the entities participating in the controlled transaction is required and also a group structure which shows the relationships and how those affect the functioning of the group.

CYPRUS TRANSFER PRICING GUIDELINES

Functional analysis:

An analysis is required of the functions performed, assets used and risks assumed by the financing company. These will need to be compared with similar transactions between unrelated companies. An underlying principle of the risk analysis is that a financing company bearing risk must have the financial capacity to manage those risks and bear the financial consequences if the risks assumed actually materialize.

Substance requirements:

In order to justify the risk control and to further validate that the management and control are exercised in Cyprus it is imperative that the group financing company must have an actual presence in Cyprus. In this regard the following will be taken into account:

1. The majority of the board of Directors should be Cyprus tax residents
2. The majority of the board of Director meetings must be held in Cyprus and the main management decisions must be made in Cyprus
3. The majority of the shareholders meetings must be held in Cyprus
4. The financing company must have qualified personnel controlling and managing the financing transactions

Part 2 - Comparison of the as accurately delineated conditions and economically relevant circumstances of the controlled transaction with those of comparable transactions between independent entities:

Comparable transactions must be identified in order to assess the arm's length remuneration. The identification process must be transparent, verifiable and systematic.

Simplification measures:

A Cyprus Company which meets the substance requirements above and is engaged in purely intermediary financing activities, grants loans or advances to related companies, which are refinanced by loans or advances obtained from related companies, will be deemed for the sake of simplification to comply with the arm's length principle, if the company receives a minimum after tax return of 2% on the assets (i.e. 2.3% on assets). This percentage will be regularly reviewed by the Tax Department, based on relevant market analyses. In such case no transfer pricing study will be required.

CYPRUS TRANSFER PRICING GUIDELINES

A minimum return percentage cannot be used, without a transfer pricing analysis, to determine arm's length remuneration for intra-group financing transactions different from those covered by the Circular.

Minimum requirements for transfer pricing analysis:

The Circular provides the below minimum requirements for transfer pricing analysis:

- A description of the computation of equity allocation required to assume risks
- A description of the group and the inter-linkages between the functions performed by the entities
- The precise scope of the transactions analyzed
- A complete list of the potentially comparable transactions searched
- A rejection matrix for the aforementioned transactions (with rejection justification)
- The final list of comparable transactions selected
- A general description of the market conditions
- A list of all previous transfer pricing agreements concluded with other countries in relation to the transactions
- A list of all previous agreements concluded and being still valid with the entity or entities under analysis
- Projected income statements for the years covered by the request

Preparation of Transfer Pricing Analysis:

The Transfer Pricing Analysis should be prepared by a Transfer Pricing Expert. Also, it must be submitted to the Cyprus Tax Department by a person who has license to act as auditor of a company in Cyprus, who is required to carry an assurance control of the transfer pricing analysis.

The Transfer Pricing Analysis will only be submitted to the Tax Authorities only upon request or in the case of applying for an advance tax ruling.

Reasons for Transfer Pricing Preparation

CYPRUS TRANSFER PRICING GUIDELINES

The below are a few of the reasons that forced OECD to impose transfer pricing guidelines:

- Increasing integration of national economies;
- Growth of Multinational Enterprises (MNEs);
- Countries right to tax profits where the income and expense arises.

It is strongly recommended that such existing intra-group financing arrangements are carefully reviewed in order to assess the potential impact of the upcoming changes and to take corrective action, if required. For new transactions of this type, companies should consider having a transfer pricing study in place.

The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained.

For professional assistance please contact us at solutions@oxfordcy.com .