

## Anti Tax Avoidance Directive (ATAD) Controlled Foreign Company Rule (CFC)

On 5 April 2019, the House of Representatives adopted the law implementing the provisions of the EU ATAD. The provisions of the Law apply as of 1 January 2019 (from 2019 tax year onwards).

The Law introduces the below:

- Controlled Foreign Company rule (CFC);
- Interest limitation rule;
- General anti-abuse rule (GAAR).

The remaining ATAD provisions (i.e. Exit taxation provisions and Hybrid mismatch rules) will be implemented into Cyprus Law by the 1 January 2020.

In this article we are going to elaborate on the Controlled Foreign Company (CFC) rule.

### **Controlled Foreign Company Rule (CFC)**

The controlled foreign companies (CFC) rule has the effect of re-attributing the income of a low-taxed controlled foreign subsidiary to its parent and controlling company. The aim is to prevent revenue diversion to subsidiaries which are tax resident in jurisdictions with preferential tax regimes.

The ATAD provides Member States with two options and Cyprus has adopted the **Option 2**.

### **Option 1:**

CFC rules to apply on certain predefined categories of non-distributed passive incomes provided that the CFC under examination cannot demonstrate “substantial economic activity”. Substantial economic activity being linked to core and real facts and merits (staff, assets, functions).

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### **Option 2:**

CFC rules to apply on non-distributed incomes of the CFC arising from “non-genuine arrangements which have been put in place for the essential purposes of obtaining a tax advantage”.

The CFC rules apply to both (a) Cypriot tax resident companies and (b) non-Cyprus tax resident companies which have a permanent establishment (PE) in Cyprus.

A Non-Cyprus tax resident company or a foreign PE of a Cyprus tax resident company will be defined and treated as a CFC if the below tests are met:

#### (a) Holding Test:

A Cyprus tax resident company, by itself or together with its associated enterprises holds a direct or indirect participation of more than 50% of the voting rights or of capital, or is entitled to receive more than 50% of the profits of that company, and;

#### (b) Tax Paid Test:

A non-Cyprus tax resident company (or an exempt foreign PE) is considered as low-taxed if the actual foreign corporate tax paid by it on its profits is lower than 50% of the corporate income tax charge that would have been payable in Cyprus under the Cyprus corporate income tax rules had it been a Cyprus tax resident company.

#### **Income to be included:**

When a non-Cyprus tax resident company meets the definition criteria of CFC, the tax base of the Cypriot controlling taxpayer shall include any non-distributed income arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage.

The term “non-genuine arrangement” means the CFC would not own the assets or would not have undertaken the risks which generate all or part of its income if it were

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not controlled by the Cyprus Company which carries out the significant people functions which are relevant to those assets and risks that substantially contribute to the generation of the income of the CFC.

The revenue to be included in the Cypriot tax base shall be computed in proportion to the company's actual participation in the CFC.

### Exceptions from the CFC rule:

The CFC rule is not applied where the company or the foreign permanent establishment has:

- Accounting profits of no more than €750.000, and non-trading income of no more than €75.000; or
- Accounting profits of no more than 10% of its operating costs for the tax period.

### Avoidance of double taxation on CFC income:

Cyprus shall grant a tax credit against the Cyprus corporate income tax payable for certain taxes paid abroad on the CFC income. The Law does not limit the credit to the tax imposed in the jurisdiction of the CFC.

*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](mailto:solutions@oxfordcy.com).