Anti Tax Avoidance Directive (ATAD)

Controlled Foreign Company Rule (CFC)

The Republic of Cyprus has implemented the EU Anti-Tax Avoidance Directive (ATAD), aligning its tax framework with broader anti-avoidance standards established by the European Union.

The ATAD provisions, including Controlled Foreign Company (CFC) rules, interest limitation rules, and a general anti-abuse rule (GAAR), were transposed into Cypriot tax law with effect from the 2019 tax year.

Subsequent provisions such as exit taxation and hybrid mismatch rules have also since been incorporated and are now fully operational within the Cypriot tax regime.

This article provides an overview of the Cyprus CFC framework as it currently applies.

Controlled Foreign Company Rule (CFC)

The CFC regime is part of Cyprus's anti-tax avoidance framework and is designed to prevent the artificial diversion of profits to low-tax jurisdictions.

Under the CFC rules, certain undistributed income of a low-taxed foreign subsidiary or permanent establishment may be attributed to its Cyprus-based controlling company and taxed accordingly.

The objective is to ensure that profits arising from arrangements lacking genuine economic substance are taxed where value is actually created.

ATAD Approach and Cyprus Implementation

The ATAD provides Member States with two implementation options. Cyprus has adopted Option 2, which focuses on the concept of non-genuine arrangements rather than predefined categories of passive income.

Option 1 (not adopted by Cyprus)

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CFC rules apply to specified categories of passive income unless the taxpayer can demonstrate that the entity carries out substantial economic activity supported by personnel, assets, and functions.

Option 2 (adopted by Cyprus)
CFC rules apply to non-distributed income arising from arrangements that are considered non-genuine and have been put in place for the essential purpose of obtaining a tax advantage.

The CFC rules apply to:

- Cyprus tax resident companies; and
- Non-Cyprus tax resident companies or foreign permanent establishments (PEs) controlled by Cyprus tax residents.

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) <u>Holding Test:</u>

A Cyprus tax resident company, alone or together with its associated enterprises, holds:

- More than 50% of voting rights, or
- More than 50% of capital, or
- Entitlement to more than 50% of profits.

b) <u>Low-Taxation Test</u>

A foreign entity is considered low-taxed if:

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- The actual corporate tax paid abroad is lower than 50% of the Cyprus corporate income tax that would have been payable had the entity been tax resident in Cyprus.

Income Attribution Rule

Where an entity qualifies as a CFC, the Cyprus tax resident shareholder may be taxed on undistributed income derived from non-genuine arrangements.

An arrangement is considered non-genuine where:

- The CFC would not own the assets or assume the risks generating its income; and
- These functions are effectively performed by the Cyprus controlling company through its key personnel or decision-making functions.

Only income attributable to the Cyprus entity's involvement (i.e., significant people functions) is included in the Cypriot tax base, proportionate to its level of 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.

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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 .

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