

Transfer Pricing rules adopted in Cyprus for intra-group back to back financing transactions

On 30 June 2017 the Cyprus tax authorities issued a Circular providing guidance for the implementation of Transfer Pricing rules of intra-group back to back financing transactions. In this respect, the minimum profit margins applicable for back to back financing (0,125% - 0,35%) are abolished as from 1 July 2017. No grandfathering provision is provided for existing intra-group back to back financing transactions. The new circular applies with effect as from 1 July 2017 for existing and future transactions, regardless of the date of entering into the relevant transactions and irrespective any tax rulings issued prior to the said date.

Definition of intra-group financing activity

The term “intra-group back to back financing transaction” refers to any activity of granting of loans including cash advances remunerated or not with interest to related companies, financed by financial means and instruments such as debentures, private loans, cash advances and bank loans.

Companies are considered to be related if they fall within the scope of Section 33 of the Cyprus Income Tax Law. Section 33 states that transactions between related parties should follow the arm’s length principle (as set out in Article 9 of the OECD Model Tax Convention on Income and on Capital) and allows Tax Authorities to adjust the reported profits in case the transfer prices differ from prices that would have been agreed between independent entities

Therefore, for the purposes of transactions falling with this circular, it is required that all intra-group transaction should be conducted in accordance with the arm’s length principle.

Comparability Analysis

An appropriate comparability analysis must be prepared in order to determine the enforcement of the Arm’s length principle and whether transactions between independent entities are comparable to transactions between related entities.

The comparability analysis should consist of two parts:

- a) Identification of commercial or financial relationship between related entities and determination of the conditions and economically relevant circumstances attaching to those relations in order to accurately delineate the controlled transaction.
- b) Comparison of the as accurately delineated conditions and economically relevant circumstances of the controlled transaction with those of comparable transactions between independent entities.

Part a: Identification of commercial or financial relationship between related entities and determination of the conditions and economically relevant circumstances

Functional Analysis

The Circular provides extensive guidance on the approach to be taken in conducting a functional analysis. The purpose of the functional analysis is to identify the economically significant activities, responsibilities and functions, the assets used or contributed, and the risks assumed by the parties in the context of the transaction.

The functional analysis focuses on actual activity of the parties and on the competences, they deploy. The functions analysed include decision-making, in particular in terms of corporate strategy and risks. In this context, to the extent possible, it is necessary to determine the legal rights and obligations of each party when performing said functions.

Examples of such functions (although not limited) include:

- Origination of the transaction
- Management of the transaction

Risks Analysis

A group financing company is generally considered to assume the risk if it has the financial capacity to manage the risk and to bear its financial consequences if the risk materialises. The financial capacity to assume the risk can be defined as the access to funding necessary in order to take on or avoid the risk, to pay for the risk mitigation actions, and to bear its consequences if the risk occurs.

The Circular mentions that when the comparability analysis reveals significant differences in the functional profile (the assets used and functions performed) of the group financing company as compared to a regulated financing entity, it is necessary to refer to other methods in order to assess the equity level required to assume the risks, in particular using other applicable credit risk analysis methods.

Substance requirements

A group financing company controls the risk if it has the decision-making power to enter into a risk bearing commercial relationship, if it has the ability to address such risks, and if it actually performs such decision-making functions.

The Circular mentions that it is imperative that a group financing company must have an actual presence in Cyprus and the qualified personnel to control the transactions performed. Nevertheless, the following actual presence criteria will be taken into account:

- The number of Cyprus tax resident directors
- The number of Board of Directors' meetings held in Cyprus

- The main management and commercial decisions taken in Cyprus
- The number of shareholders' meetings taking place in Cyprus

The group financing group may subcontract daily activities of risk mitigation provided that do not have a significant impact on risk control.

Part b: Comparison of the controlled transaction with comparable transactions between independent entities and determination of arm's length remuneration

In order to determine the arm's length principle, it is necessary to compare the accurately delineated controlled transaction with comparable transactions on the open market.

Simplification measures

When a group financing company pursues a purely intermediary activity, grants loans or advances to related entities which are refinanced by loans or advances granted by related entities, may opt for the simplification measure. As a result, the transactions are deemed to comply with the arm's length principle, if the entity receives in relation to its controlled transactions under analysis, a minimum return of 2% after tax on assets.

In order for a taxpayer to apply for the simplification measure, it is necessary that the substance requirements are met (as mentioned above). Furthermore, the entities should communicate to the Tax Department the use of the simplification measure, by filling the relevant field in the tax return of the corresponding fiscal year.

It should be noted that a deviation from the above 2% minimum return is acceptable when duly justified in a transfer pricing analysis.

The use of the simplification measure, whether applied following the issuance of a ruling or not, are subject to the exchange of information rules set under the Directive on Administrative Cooperation (Council Directive 2011/16/EU as amended by Council Directive Council Directive (EU) 2015/2376).

Minimum requirements for Transfer Pricing Analysis

- The Transfer Pricing Analysis should be prepared by a Transfer Pricing Expert.
- It must be submitted to the Cyprus Tax Department by a person who has a licence to act as auditor of a company in Cyprus, who is required to carry an assurance control of the transfer pricing analysis.
- The minimum requirements for the preparation of transfer pricing analysis are described in paragraph 29 of the Circular issued by the tax authorities.

For any further information and or clarification please feel free to contact us:

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