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Tax Newsletter – Cyprus' DAC 6 Guidelines

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Dear Clients, Associates, and Friends

The Cyprus Tax Authorities have recently issued and circulated their administrative Guidelines ('**the Guidelines**') on the Cyprus Law implementing the amended EU Directive on Administrative Cooperation, DAC 6, (henceforth '**Cyprus DAC 6'**) further to the incorporation of DAC 6 in Cypriot tax legislation. In brief (see our January Tax Newsletter), DAC 6 introduces a mandatory disclosure of cross border arrangements/transactions to Cypriot tax Authorities.

The Guidelines elaborate on key areas and interpret key terms found in the Cyprus DAC 6. Additionally, the Guidelines provide non-conclusive examples illustrating the application of Hallmarks.

A. Key Considerations and highlights

The starting point is that the Cyprus DAC 6 mandatory disclosure requirement (hereinafter '**MDR**') should **not** be equated to disclosure of tax abuse or tax evasion. It is merely a disclosure requirement of certain actions. Additionally, it should be mentioned that not all transactions/ arrangements should be reported.

Broadly, the MDR addresses transactions that feature:

(a) a **cross border element**. At least one of the participants must have a nexus to an EU Member State and at least one other participant must have a nexus to another EU Member State or a third country;

(b) it should be a **new** transaction/arrangement for the purposes of Cyprus DAC 6. New encompasses all transactions/arrangements taking place after June 25, 2018 and/or pre-existing transaction/arrangements that have been extended or amended after June 25th, 2018;

(c) one of the **Hallmarks**; and

(d) one of the main purposes underpinning the transaction/arrangement is to obtain a tax benefit ('**Main Benefit Test'**). The Main Benefit Test is a prerequisite to MDR in a number of Hallmarks. **The Main Benefit Test is an objective test**.

If the Main Benefit Test is interpreted too broadly, it will result in over-reporting. Over-reporting is counterproductive and will effectively derail the purpose of introducing the mandatory reporting system or even lead it to a breaking point. The purpose of the reporting system should not be to create a flood of MDRs.

It may be suggested that transactions/arrangements mainly pursuing genuine and commercial purposes, are likely not to fulfil the Main Benefit Test. Assessing whether the main purposes are genuine and commercial, Cyprus DAC 6 appears to incorporate the "reasonable man" test, namely whether a reasonable man could have *ex ante* considered that the said transaction/arrangement mainly pursues genuine and commercial purposes. In this respect, first it must be determined if a tax advantage exist (tax loss, lower or no taxable income etc) and then evaluate if the tax advantage outweighs other advantages. The comparison should employ both qualitative and quantitative criteria.

B. Summary of the Guidelines

In the context below we summarise key terms defined and/or further explained in the Guidelines:

- **Intermediaries:**

The intermediaries are split into two groups, (i) primary and (b) secondary.

Primary intermediaries include people that actually design, organise or promote the mandatory reportable transaction**.** The primary intermediary is expected to have a complete understanding and full knowledge of the details of the cross-border arrangement.

Secondary intermediaries include people participating in the design, promotion, implementation of a mandatory reportable transaction. However, they are not the primary intermediaries. Secondary intermediary services may include tax services in relation to components of the cross-border transaction. Secondary intermediary services do not include services rendered *ex post* the design and formulation of the cross-border transaction. As such, tax compliance or audit services rendered after the cross-border transaction do not commonly constitute secondary intermediary services for Cyprus DAC 6 purposes. Secondary intermediaries are not expected to conduct a comprehensive check for determining if their services activate a reporting obligation under the Cyprus DAC 6 or exceed their normal duties in the ordinary course.

Cyprus DAC 6 provides for an **escape rule** discharging secondary intermediaries from MDR in the form of the "reasonableness benchmark". Relevant indicators include, relevant circumstances, available information and relevant expertise and capability that ordinarily a professional person in the shoes of the respective secondary intermediary should have possessed.

- **Hallmarks (see also Appendix I for a snapshot of the Hallmarks):**

The Guidelines deal with the following:

Standardised Documentation- A.3: Indications hinting when the arrangement should be considered as standardised. The indications generally rest upon the use of documentation of general application that are not subject to negotiations and they are of relatively uniform implementation.

Acquiring of a loss-making company- B.1: The hallmark should only apply if the loss-making company ceases its core activity. The Guidelines also suggest that the acquirer entity must obtain a tax advantage by utilising the tax losses of the loss-making company.

Conversion of an income into another form or other income charged to lower taxation- B.2: Provision for a calculation of the taxation *ex ante* and *ex post* the conversion for determining the application of this Hallmark. The regulations explicitly exclude the use or award of share options to employees from the scope of this Hallmark if they do not exceed the 25% of their remuneration package. In parallel, the Guidelines seem to hint that contrived arrangements or not executed in the context of normal business or contain artificial elements should fall within the scope of this Hallmark.

Circular transactions involving roundtripping- B.3: Set preconditions to triggering this Hallmark. These include: (a) the interposed entities serve no trade purpose or (b) the transaction offset or cancel each other out. It may be suggested that if it can be demonstrated that the interposed entities serve a genuine business purpose/ trade operations (eg asset protection) this Hallmark may be deactivated.

Outbound payment to recipients located in NIL tax or almost Nil Tax jurisdictions- C.1: Explicit exclusion of notional deduction unrelated to real payments from scope of this Hallmark. In this regard notional deductions under the Tax Laws of the Republic of Cyprus should be excluded. Equally payment for the purchase of assets affording tax depreciation should be excluded also. The Guidelines define the almost Nil tax jurisdictions those that apply a headline corporate tax rate of less than 1%.

The recipient is on the list of non-cooperative jurisdictions or not tax resident in any jurisdiction- C.1 (No MBT): It precludes situations where the jurisdiction hosting a company does not define tax residency in its Laws. The Hallmark covers jurisdiction listed in the non-cooperative list of EU or OECD.

The payment benefits from a preferential tax regime- C.2 (No MBT): Notional deduction or patent boxes have been assessed and verified by the EU. In this regard they should not constitute preferential tax regimes.

Material difference in the amount being treated as payable regarding assets transferred - C.2 (No MBT): Clarification that the Hallmark addressed the tax value. In this regard if the asset to be transferred has no tax value (because it is discharged for tax purposes), then this Hallmark should not be relevant. They also exclude the tax migration from the scope of this Hallmark.

By passing of the Common Reporting Standard- D.1: Introduction of the reasonable conclusion threshold. This should be objectively applied in the light of the prevailing circumstances. A jurisdiction which has not introduced relevant Laws enacting CRS or automatic exchange of information, falls within this Hallmark.

Use of artificial cross border chain of ownership which conceals Bo- D.2: The application of the EU Directive 2015/849, Anti money Laundering, should disable this Hallmark.

Use of Safe Harbour- E.1: Explicitly stipulation that the safe harbour of 2,29% on back-to-back financial loans should be reported. No deminimis applies.

Transfer of Hard to Value Intangibles- E.2: Non-exclusive definition of HTVI, encompassing (a) partially developed intangibles, (b) commercial exploitation will occur subsequently, (c) the exploitation will happen in a new way.

- **MDR and intermediaries**

The primary intermediary should complete and submit the necessary report within 30 days as from the day the first step implemented. The secondary intermediary has to submit the necessary report within 30 days as from the day he provided assistance. For MDR taking place within the period June 25th-October 2021, necessary reports should be submitted by **November 30th**.

Intermediary is discharged from the obligation to file a report if another intermediary or the taxpayer submits such report. The intermediary may provide (a) either a copy of the report submitted with the Tax Department, (b) the reference number of the electronic submission.

- **Obligation of a taxpayer to submit a report**

The circumstances necessitating reporting by a taxpayer include cases where (a) there is no intermediary, (b) the intermediary is not liable under Cyprus DAC 6, (c) the intermediary invokes legal privilege.

To sum up

Cyprus **DAC 6 has already come into effect**. As from **November 30th**, intermediaries and taxpayers (when applicable) **have the obligation to report** relevant transactions/arrangements. **Failure** to report may lead to substantial monetary **penalties** up to **Eur 20,000**.

Our team of lawyers, advisors and consultants is at your disposal to evaluation transactions/ arrangements for determining if reportable and if reportable to arrange for reporting this.

APPENDIX I- Hallmarks