

# Tax Newsletter – Introduction of Transfer Pricing Law

July 2022

Dear Clients, Associates, and Friends

On 30 June 2022, the Cyprus Parliament voted into Cyprus Tax Laws the Transfer Pricing provisions (**‘Cyprus TP requirements’ or ‘new Law’**). The Council of Ministers also approved the Transfer Pricing Regulations (**‘Regulations’**), which lay out further guidance on the reporting obligations. The introduction of the TP requirements aligns the Cyprus Tax System with the OECD Inclusive Framework on BEPS Actions 8-10<sup>1</sup>.

The Cyprus TP Requirements build on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 1995-2022 (OECD TPG), as from time to time are amended or replaced, and create yearly obligation to taxpayers to (i) support their transactions/arrangements with ‘connected parties’ using the OECD TPG guidance and methodology and (ii) report to the Cyprus Tax Administration.

## A. Deconstructing the Cyprus TP requirements

The Cyprus TP requirements supplement the application of the Arm’s Length Principle (ALP) already part of the Cyprus Tax Law. The **comparability analysis** is at the heart of the ALP and the Cyprus TP requirements. In its essence it involves a comparison of the conditions pertaining to the ‘controlled’ transaction with the conditions applicable in a comparable uncontrolled transaction. Two key aspects are embedded in this comparability analysis:

- ❖ Delineation and recognition of the controlled transaction/arrangement using the comparability factors. This requires analysis of the contractual terms, economic and business circumstances, characteristics of the covered property and services, as well as a functional analysis.
- ❖ An economic analysis using comparable uncontrolled transactions as benchmarks. In this regard, a proper transfer pricing methodology should be selected and applied.

<sup>1</sup> OECD/G20 Base Erosion and Profit Shifting Project: Aligning Transfer Pricing Outcomes with Value Creation: Actions 8–10: 2015 Final Reports  
Nicosia (Cyprus) - Limassol (Cyprus) – Moscow (Russia) – Athens (Greece) – Valletta (Malta)

## **B. Summary of key features**

- ❖ **Effective date:** The new Law has retroactive effect, namely 1<sup>st</sup> January 2022.
- ❖ **Scope of the Cyprus TP requirements:** Its scope is broad, encompassing multiple transactions/arrangements between ‘connected parties’, such as distribution or manufacturing activities, provision of services, royalties, financing activities, and other type of activities.
- ❖ **Parties concerned:** They are tax residents in the Republic or they have a permanent establishment in the Republic.
- ❖ **25% participation threshold:** The new Law establishes a participation threshold of 25% or more. The 25% or more threshold may apply directly or indirectly and is determined by reference to voting rights or capital ownership or profit/revenue sharing. In more detail it applies when:
  - ✓ A company, resident or not, holds directly or indirectly a 25% participation or more in another company. Likewise, a company may be connected to a person.
  - ✓ A company, resident or not, holds (i) on its own or (ii) together with connected parties, directly or indirectly a 25% or more participation in both a taxpayer and one or more companies, in which case all the companies concerned, including the taxpayer, shall be regarded as connected parties. Likewise, a company may be connected to a person(s).
- ❖ **Documentation:** The new Law introduces a three-tier structure approach when it comes to documentation. A Master file and a Local file.
  - ✓ **Master file:** ‘Ultimate parent Companies’ or ‘Surrogate parent Companies’, having their tax residence in the Republic, have the obligation to prepare and keep such a file. Generally, the Master file lays out an overview of the Group, its business and value chain. The Master File must be updated **on annual** basis.
  - ✓ **Local File:** Every company having its tax residence in the Republic should prepare and keep a local file. The local file provides detailed information to a specific transaction between connected parties, focusing on information relevant to the transfer pricing analysis. The local file must also be updated on **an annual** basis.
  - ✓ **Summary table:** A summary table reflecting the controlled transactions must be prepared and submitted electronically on an annual basis along with the tax return.

- ❖ **Derogations:** The obligation to prepare a **Master file** lies **only** with Ultimate parent Companies or Surrogate parent Company as defined in the Administrative Cooperation Law, N 2015(I)/2012, Annex III, section I. The New Law also provides for a **deminimis rule** discharging companies from the obligation to prepare the **Local File** if their transactions/arrangements do not surpass the monetary threshold of Eur 750,000.

## C. Deconstructing the Regulations

The Regulations elaborate on the documentation requirements and introduce the concept of Advance Pricing Arrangements (APA).

- ❖ **Documentation requirements** aim to ensure that:
  - ✓ Taxpayers abide with their obligation to demonstrate that the conditions pertaining to controlled transactions are consistent with the conditions applicable in comparable uncontrolled transactions,
  - ✓ Provide Tax Administration with information necessary to primarily assess the Transfer Pricing risk and conduct a transfer pricing audit.
- ❖ **Advance Pricing Arrangements:** APAs allow the taxpayer to determine in advance a set of relevant criteria (method, comparability factors and critical assumptions) on which to base the transfer pricing for its controlled transactions. The taxpayer may commence the process by lodging an application for an APA request. The Tax Administration has 10 months as from the submission date to release its APA opinion.

## D. Summary of key features

- ❖ **Timing of Documentation:** Should be prepared by the deadline of submission of the tax return.
- ❖ **Audit of the Local File:** A Person having a practicing certificate by ICPAC, or other recognised body of independent auditors, should affirm the quality of the Local File.
- ❖ **Advance Pricing Arrangements:** The validity of APA opinion will span for four years affording assurance to the taxpayer that no Transfer Pricing adjustment will apply as long as the taxpayer abides with the terms of the APA. The APA process may involve foreign Tax Administrations.

## **E. Penalties**

The new Law introduces penalties aiming to provide disincentive for non-compliance. These include:

- ❖ Penalty for overdue submission or incomplete submission of the summary table. This is calculated as 1/1000 on the cumulative value of the controlled transactions. The penalty cannot be lower from the monetary threshold of €500 with the maximum monetary threshold being set at €2.000.
- ❖ Penalty for non-submission of a summary table. This is calculated as 1/1000 on the cumulative value of the controlled transactions. The penalty cannot be lower from the monetary threshold of €2.000 with the maximum monetary threshold being set at €10.000.
- ❖ Penalties also apply if the submission of Local / Master File is overdue. The penalty is on a progressive scale by reference to the number of days of delay, commencing from the day the Tax Administration requires submission through notification.

**31<sup>st</sup>- 60<sup>th</sup> day: Penalty of € 5.000**

**61<sup>st</sup>- 90<sup>th</sup> day: Penalty of € 10.000**

**Post 91<sup>st</sup> day: Penalty of € 20.000**

### **To sum up**

The Cyprus Tax System finally implements the OECD Transfer Pricing Guidelines. The scope of the new Law is broad covering all type of transactions/ arrangements taking place between connected parties. Reiterating, the New Law comes into effect as from January 1<sup>st</sup>, 2022.

The Local and Master File must be updated on an annual basis and relevant summary table reflecting all controlled transactions must be prepared and submitted along with the tax return. It is also noteworthy that legal documentation, such as contracts, agreements, remains the first line of defense amid a Transfer Pricing tax audit.

Our Transfer Pricing team of lawyers and consultants is at your disposal to navigate you through the new Law.