The Transfer Pricing Law Review

Seventh Edition

Editors

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The Law Reviews

Published in the United Kingdom
by Law Business Research Ltd
Holborn Gate, 330 High Holborn, London, WC1V 7QT, UK
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www.thelawreviews.co.uk

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ISBN 978-1-80449-178-2

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

ARENDT & MEDERNACH

BLAKE, CASSELS & GRAYDON LLP

DDTC

FLICK GOCKE SCHAUMBURG

GALICIA ABOGADOS SC

GIBSON, DUNN & CRUTCHER LLP

HERZOG FOX & NEEMAN LAW OFFICES

LENZ & STAEHELIN

MATHESON LLP

NAGASHIMA OHNO & TSUNEMATSU

PINHEIRO NETO

SCORDIS, PAPAPETROU & CO LLC

SLAUGHTER AND MAY

STUDIO LEGALE E TRIBUTARIO BISCOZZI NOBILI PIAZZA

PREFACE

It has been a great pleasure to edit this seventh edition of *The Transfer Pricing Law Review*. This publication aims to give readers a high-level overview of the principal transfer pricing rules in each country covered in the *Review*. Each chapter summarises the country's substantive transfer pricing rules, explains how a transfer pricing dispute is handled, from initial scrutiny through to litigation or settlement, and discusses the interaction between transfer pricing and other parts of the tax code (such as withholding taxes, customs duties and attempts to prevent double taxation).

Other than Brazil, all the countries covered in this *Review* apply an arm's-length standard and adhere, at least to some extent, to the Organisation for Economic Co-operation and Development Transfer Pricing Guidelines (the OECD Guidelines); and Brazil itself is moving towards greater alignment of its TP rules with the OECD norm. However, as the chapters make clear, there remains significant divergence, both in countries' interpretation of the arm's-length standard (e.g., the transactions it applies to, the pricing methods preferred and whether secondary adjustments are imposed) and in the administration of the rules (e.g., the documentation requirements imposed and the availability of APAs). Therefore, transfer pricing practitioners cannot simply assume that the OECD Guidelines contain all the answers, but must engage with their detailed application within each country.

Given their economic importance, transfer pricing rules will be high on the corporate tax agenda (and the broader political agenda) for many years to come, and they are continuing to evolve at a rapid pace. Over the next few years, we expect the following to be among the main areas of focus.

First, as many of the chapters make clear, litigation over transfer pricing disputes is becoming ever more common. Some countries have a long record of transfer pricing litigation and have resolved many of the procedural hurdles in asking a court to rule on exactly where value is created in a multinational; for example, the approach to handling (often conflicting) expert evidence and the challenge of developing factual evidence in a proportionate but comprehensive way. However, this clearly results in lengthy – and costly – hearings before the tax tribunals and many other countries will soon find themselves grappling with transfer pricing litigation for the first time.

Second, the fact-heavy nature of transfer pricing disputes means that they often take many years to reach resolution; for example, the US Tax Court judgment in *3M*, published in February 2023, involved an appeal lasting 10 years, and the UK authorities have confirmed that it now takes five years to agree an 'average' advance pricing agreement, compared to under three years in 2018/19. This can make it difficult to ensure that accurate evidence

is available – either because people have left the business or simply due to the vagaries of memory – and make it ever more important that high quality transfer pricing documentation is prepared in real time.

Third, in the *Fiat Chrysler* judgment, published in November 2022, the Court of Justice of the European Union appears to have rejected the European Commission's suggestion that there is an 'autonomous' EU arm's-length standard, holding instead that transfer pricing standards are set at the national level. (We are still waiting, however, for the Court of Justice to confirm whether this means that the €13 billion *Apple* case also needs to be decided against the Commission.) The *Fiat Chrysler* judgment reduces the ability of the European Commission to act as an additional transfer pricing watchdog, but also means that (pending any harmonisation through EU legislation) taxpayers will need to grapple with 27 separate transfer pricing regimes across the European Union.

Finally, the OECD/G20 project to address the tax consequences of digitalisation continues to progress. If it is ever implemented, which looks increasingly unlikely, Pillar One would mark a radical pivot away from the arm's-length standard for large and highly profitable multinationals, so that a portion of their profits (above a 10 per cent hurdle rate) would automatically be reallocated to market jurisdictions. The Pillar Two 'minimum tax' reforms are much more likely to be implemented; for example, the European Union has already adopted a Pillar Two Directive, and the first part of the UK Pillar Two rules is included in the Finance Bill currently before Parliament. Pillar Two, as merely a minimum tax measure, has a less radical impact on transfer pricing than the Pillar One proposals; nevertheless, there will be many issues to work through here in the future. For example, what happens if a transfer pricing adjustment in country A, after several years of debate, finally causes the group's effective tax rate in country A to increase above 15 per cent? Will any countries that have levied Pillar Two tax on the group, through the income inclusion or undertaxed payment rules, be obliged to reverse this Pillar Two charge?

We would like to thank the authors of each of the chapters for their comprehensive and illuminating analysis of each country's transfer pricing rules, and the publishing team at Law Business Research for their diligence and enthusiasm in commissioning, coordinating and compiling this *Review*.

Steve Edge and Dominic Robertson
Slaughter and May
London
May 2023

Chapter 3

CYPRUS

Kyriacos Scordis and Costas Michail[1]

I OVERVIEW

As an internationally recognised business centre, Cyprus is a jurisdiction largely compliant with Organisation for Economic Co-operation and Development (OECD) standards, as recognised in the latest OECD progress report,[2] and as such follows many of the OECD principles and practices, including the 'separate legal entity' approach, which is broadly accepted internationally (see the OECD definition of the international arm's-length principle).[3]

Cyprus generally applies the above-mentioned international arm's-length principle, which essentially requires that conditions and circumstances attached to a 'controlled transaction' are consistent with comparable transactions concluded in the open market.

The OECD has, over the years, produced the Transfer Pricing Guidelines (the OECD TPGs)[4] and several reports refining their application and broadening their scope. The most recent and comprehensive reports comprise the Final Reports on BEPS Actions 8–10,[5] which largely revise the previous Transfer Pricing Guidelines with the stated aim of taxing profits where economic activities take place and value is created, giving particular weight to the party undertaking and managing economically significant risks. In addition, the OECD issued for the first time additional Transfer Pricing Guidelines on financial transactions, in February 2020.

The OECD's work in this area (i.e., the OECD Transfer Pricing Guidelines and reports) underpins the arm's-length principle incorporated in the OECD Model Tax Convention[6] and forms the basis of an extensive network of bilateral double-tax treaties; therefore, several jurisdictions are already applying this principle and the underlying transfer pricing methodology to either domestic or cross-border transactions.

1 Kyriacos Scordis is the managing partner and Costas Michail is a director at Scordis, Papapetrou & Co LLC.
2 Cyprus was rated Largely Compliant in the Phase 2 Peer Review Report of the Global Forum on Transparency and Exchange of Information for Tax Purposes.
3 OECD Model Tax Convention, Article 9.
4 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (1995–2022).
5 OECD/G20 Base Erosion and Profit Shifting Project: Aligning Transfer Pricing Outcomes with Value Creation: Actions 8–10: 2015 Final Reports.
6 OECD Model Tax Convention, Article 9.

The OECD Model Tax Convention contains the arm's-length principle under the heading 'Associated Enterprises' (Article 9),[7] which states:

> *Where*
>
> *a. an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or*
>
> *b. the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,*
>
> *and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.*

The relevant Cyprus legal framework giving effect to this arm's-length principle is replicated below.

In particular, the Income Tax Law[8] provides the following:

> *(1) Where–*
>
> *(a) a business in the Republic participates directly or indirectly in the management, control or capital of a business of another person; or*
>
> *(b) the same persons participate directly or indirectly in the management, control or capital of two or more businesses;*
>
> *and in either case conditions are made or imposed between the two businesses in their commercial or financial relations which differ from those which would be made between independent businesses, then any profits which would, but for those conditions, have accrued to one of the business, but, by reason of those conditions, have not so accrued, may be included in the profits of that business and taxed accordingly.*
>
> *(2) The provisions of sub-section (1) apply also in connection with any transaction between connected persons.*

Recent amending legislation[9] introduced a threshold of 25 per cent, profit share, equity participation or voting rights, for determining 'connected persons'. Such threshold may apply directly or indirectly.

The above arm's-length principle as enshrined by the Income Tax Law covers both physical persons and companies (the definition of which is set out below but note that this definition includes what are described as 'corporations' in other jurisdictions).

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7 See footnotes 3 and 4.

8 Article 33, Income Tax Law of 2002, 118(I)/2002, as amended, CTR Publications Ltd.

9 Article 33(3)(c), Income Tax Law of 2002, 118(I)/2002, as amended.

Companies, pursuant to the Income Tax Law, are defined to include under Article 2:

> *anybody with or without legal personality, or public corporate body, as well as every company, fraternity or society of persons, with or without legal personality, including any comparable company incorporated or registered outside the Republic and a company listed in the First schedule [comprising a list of several companies registered in other EU Member States]; but it does not include a partnership.*[10]

In addition, the amendments introduced transfer pricing provisions (the Cyprus TP requirements or the new TP Law) into Income Tax Law No. 118(I)/2002 and Assessment and Collection Law No. 122(I)/2002 (collectively the 'national Tax Law'). As expected, the new TP Law is aligned with the OECD TPGs, by effectively[11] transposing these into the national Tax Law. The new TP Law came into effect on 1 January 2022. The new TP Law replaces the earlier Cypriot transfer pricing regulations that only governed financial back-to-back (BtB) controlled transactions (BtB Regulations)[12] (see Section III). These BtB Regulations only apply up to 31 December 2021.

This chapter delves into the new TP Law and provides insights on specific transactions and areas. The new TP Law has a wide scope covering a broad range of items and transactions. In brief, the Transfer Pricing methodology for applying the provisions of the new TP Law may be divided into two main areas:

a the delineation of the connected or controlled transaction and subsequent recognition of the delineated transaction; and

b the selection and application of the selected transfer pricing methodology.

II FILING REQUIREMENTS

The new TP Law creates specific filing and reporting requirements obligating the taxpayer to have proper documentation for its controlled transactions. The filing requirements apply for transactions that exceed the monetary threshold of €750,000. The Law introduces a three-tiered approach for documentation, namely the master file, the local file and a summary table briefly (cumulatively the TP documentation) describing the controlled transactions.

The obligation for preparing the master file applies only to Cypriot companies that operate as the ultimate holding entity or surrogate parent entity in a multinational group (the MNE). The obligation should only apply if the MNE has consolidated revenues exceeding the monetary threshold of €750 million. This is aligned with the country-by-country reporting (CbCR) requirements.[13] In brief, the master file lays out a blueprint of the MNE and relevant information in relation to the organisational structure, description of the business, intangibles, intercompany financial activities and tax positions.

Regarding the local file, the obligation applies to all taxpayers not falling within the *de minimis* monetary threshold of €750,000. The threshold is determined by reference to the class of transactions (all activity of a particular type is aggregated). The local file reveals detailed information on the controlled transaction entered into by the local entity.

10 Article 2, Income Tax Law of 2002, 118(I)/2002, as amended, CTR Publications Ltd.

11 Article 33(6), Income Tax Law of 2002, 118 (I)/2002, as amended.

12 Cyprus Tax Department Circular EE 3.

13 Decree on Country-by-Country Reporting, 401/2016.

Finally, the summary table lays out a brief overview of the controlled transactions entered by the taxpayer. The master file and local file should be prepared by the deadline of filing the income tax return. However, the new Tax Law does not lay down the obligation to submit these together with the tax return. These should be submitted upon request by the authorities. The summary table must be prepared and submitted along with the annual tax return.

III PRESENTING THE CASE

Pricing methods

The new TP Law incorporates the OECD approved five pricing methods (the OECD recognised methods) into the national Tax Law. These are split into two categories: the traditional transaction methods and the transactional profit methods. The traditional transaction methods comprise the comparable uncontrolled price method (CUP), resale price method (RPM) and the cost-plus method (CPM). The transactional profit methods comprise the transactional net margin method (TNMM) and the transactional profit split method (TPSM). RPM, CPM and TNMM are one-sided methods with the tested party selected as having the less complex functionality profile. The remaining methods are two-sided because they apply to both parties of the transaction.

Aligned with the OECD TPGs,[14] the taxpayer has the freedom to employ a method that differs from the OECD recognised methods for pricing a transaction. In this situation, the taxpayer should excuse the use of different method. The different methods should not supersede the OECD recognised methods when the latter are more appropriate.

Financing arrangements (provision of loans to related parties)

The incorporation of the OECD TPGs into the national Tax Law, suggests that Chapter X of the OECD TPGs should have full effect. In brief, Chapter X requires a two-step pricing, covering both the amount of the loan and the size of the interest rate. Chapter X lays down several considerations for accurately delineating an outlay of funds and whether this should be regarded as a loan for tax purposes or not (e.g., quasi equity). The debt capacity of the debtor forms a useful indicator in examining the underlying nature of the advancement of funds with the debt coverage ratios providing useful metrics.

In general, financing arrangements such as the provision of loans to related parties mainly make use of the comparable uncontrolled pricing methodology, as comparables are generally available by reference to their economically relevant characteristics. This pricing methodology may be used in conjunction with the business or commercial sense underpinning a particular financing arrangement.

14 OECD TPGs, Paragraph 2.9.

A transfer pricing report is expected to cover the following.

Functional, circumstantial and contractual analysis

This entails a delineation of the transaction by examining the contractual relations, the functional profile and general circumstances pertaining to the relationship between the debtor and creditor. A clear understanding should be provided concerning the transaction in question that will (1) support that a genuine loan has been granted and (2) provide an economic analysis or substantiation for the transaction.

Economic analysis

The economic analysis will begin with credit scoring the debtor using available tools. The credit scoring will consider both quantitative and qualitative factors (e.g., country and industry risk).

The credit scoring will be used along with other key elements or characteristics extracted from the loan agreement to carry out a comparative analysis of those elements or characteristics (loans or bonds featuring similar elements or characteristics). Commercial databases may be used for compiling the comparable data. It is likely that comparability adjustments such as foreign exchange currency or term of maturity will be necessary.

As a result, the emerging table of data will consist of comparables or near comparables, featuring similar credit rating, the maturity of the loan and the currency of the loan, among other data. The arm's-length interest rate will be determined using these comparables or near comparables.

Occasionally, the lender company may only undertake limited functions and risks. In such a case, determining the credit scoring of the debtor should not be requisite for assessing the arm's-length pricing element of the interest rate. The lender should only be remunerated with a risk-free return. Chapter I of the OECD TPGs[15] elaborates on the determination of a risk-free rate of return.

BtB controlled transactions

Preceding the new TP Law, BtB regulations governed the BtB transactions. The BtB regulations came into effect as of July 2017 covering situations where a company in Cyprus obtained borrowed funds for providing loans to related parties. The BtB regulations required that a transfer pricing study should be prepared. The following analyses lie at the core of this study:

a functionality analysis, concentrating on the functions, assets and risks that the Cyprus company undertakes to perform its financial business; and

b comparability analysis, by way of which the conditions and circumstances of the BtB arrangement should be consistent with the comparable conditions of a BtB transaction in an uncontrolled transaction.

15 OECD TPGs, Paragraph 1.108.

Functionality analysis

The authorised OECD guidance on permanent establishments (PEs) of banks[16] may be used as a reference point when assessing the functionality of BtB financing of a Cyprus company. This guidance provides a variety of elements that can be used to assess the functions, risks and assets of a PE maintained by a bank, some of which can be applied by analogy to companies even if the object of the transfer pricing analysis is not a bank or a regulated financial institution.

Comparability analysis

Moving to the methodology that may be deployed to implement comparability, the trend is to establish the spread on an arm's-length basis that would have applied to the BtB company. In other words, 'rewarding' the BtB company for maintaining sufficient own capital to absorb the future expected loss. This in turn entails:

a determining the expected loss; and

b establishing a market return by using the Capital Asset Pricing Model.

Determining the expected loss inextricably leads to the determination of the own capital that the company should retain to absorb expected losses, and in this respect the BASEL framework may be applied by analogy. In addition, a key component for determining the expected loss is the use of probability of default. The probability of default may be measured by using the credit score models used by credit agencies such as S&Ps and Moody's.

Simplification measures also apply, whereby pure intermediary financing vehicles may opt in to these measures and be released from the requirement to perform a comparability analysis. Notwithstanding this, the intermediary financing company should still perform a functionality analysis demonstrating that it undertakes related functions, assets and risks.

Companies following the simplification route should have a minimum return on the BtB transaction of 2 per cent (after tax), calculated on the face value of the principal loan.

Simplification measures also apply to companies having a profile or outlook similar to financial institutions, as described in EU Regulation No. 575/2013. These companies would be required to produce at least 10 per cent (after tax) return on their equity.

Buying or selling of goods or services

The new TP Law covers the buying or selling of goods or services. Commonly the CPM or the TNMM may be deployed for pricing a service or transfer of property (finished or semi-finished products) in a controlled transaction. For the sale of goods, the RPM or TNMM would be more appropriate.

In brief, the CPM[17] determines an arm's-length markup after considering the cost of the service or property. The TNMM may instead apply computing an arm's-length net profit margin for a service or transfer of property. The availability of reliable information such as comparability of the gross profit margin will be an essential ingredient for determining the

16 OECD, *Report on the Attribution of Profits to Permanent Establishments* (2008, 2010), Part II: Special Considerations for Applying the Authorised OECD Approach to Permanent Establishments (PEs) of Banks.

17 OECD Transfer Pricing Guidelines 2022, Part II: Traditional transaction methods.

most appropriate method. In the absence of reliable information on gross profit margins, the TNMM may be the most appropriate method. TNMM will compute a net profit margin in relation to costs.

Regarding the RPM, the requisite is to compute a gross profit margin out of which the reseller will recoup its marginal cost, that is covering the selling and other expense and earn an adequate profit. To compute a net profit margin in relation to sales, TNMM may apply instead. Similarly, the availability of information should be the essential ingredient for deciding the most appropriate method.

All three methodologies – CPM, RPM and TNMM – require screening tools and data mining techniques. Ultimately, a reliable sample of observations should be assembled that is near the covered scenario. Relevant considerations for compiling a sample include the nature of services or product and industry, functionality profile, covered years, the operational capacity (start-up phase or not) or persistently being in a loss position or insolvency, availability of relevant financial and other information. Databases that may be used include Amadeus and Orbis.

Chapter VII[18] introduces a safe harbour of 5 per cent markup on low value activities. The incorporation of the OECD TPGs into the national Tax Law hints that a taxpayer may find resort to this safe harbour when pricing low-value activities. In brief, low-value services encompass supportive or auxiliary nature services unrelated with taking key risks or requiring unique and valuable intangibles. Chapter VII explicitly excludes a list of services from the definition, such as sales, marketing or distribution activities, and lays down a list of support activities that may fall within the definition, such as human resource activities.

Transactions involving non-business assets that produce exempt income in Cyprus

Although the new TP Law has broad scope covering several transactions and arrangements, we may be posit that transactions or arrangements unrelated to 'business assets' (pursuant to the national Tax Law) should be excluded from the Transfer pricing reporting obligation. The reasoning for the suggested exclusion rests on their very nature – non-business assets for the national Tax Law. Non-business assets mainly comprise corporate titles (such as shares in corporate entities or units in investment funds).

That being said, transactions that involve non business assets may confront secondary adjustments (see Section VIII), especially if they lack commerciality. Business and commercial rationale underlying a transaction is very important in relation to the tax impact (and treatment).

In this respect, it is advisable that transactions involving non-business assets that produce exempt income in Cyprus, such as foreign dividend income[19] or capital gains on sale of corporate titles,[20] are underpinned by a sound business and commercial rationale relative to the overall context in which they occur. It may also be advisable for the taxpayer to obtain an advance tax ruling: an application that sets out the specific facts and circumstances underlying the transaction and seeks the opinion of the tax authorities.

18 OECD Transfer pricing Guidelines 2022, Chapter VII: Special considerations for intra group services, Section D.

19 Article 3, Special Contribution for the Defence of the Republic Law of 2002, 117(I)/02, as amended (easily met participation exemption) and Article 8(20), Income Tax Law of 2002, 118(I)/2002, as amended.

20 Article 8(22), Income Tax Law of 2002, 118(I)/2002, as amended.

IV INTANGIBLE ASSETS

The new TP Law has also incorporated Chapter VI on special considerations for intangibles.[21] Chapter VI introduces the DEMPE[22] activities principle, which lies at the heart of this Chapter. DEMPE forms an essential ingredient in the delineation of a transaction or arrangement that relates to the ownership or exploitation, or both, of intangible assets. It delimits the functions and tasks that each party undertakes in the research, development, enhancement, protection and commercial exploitation of the intellectual property (IP). It also defines the relevant commercial, market, operational and market risk that each party assumes. Ultimately, it aids in rewarding each party by reference to the relevant functions and risk, capabilities and authority.

An IP owner may outsource the R&D to the group's R&D company, while retaining all relevant key risks and functions and having the capability and authority to own and operate the developed intangible property. To price this, the R&D company may earn a cost-plus markup rewarding it only for the R&D tasks performed.

Arm's-length pricing of a licence or royalty fee will require scrutiny of specific features relevant to intangible assets. These include exclusivity, the extent and duration of legal protection, limitation and geographic scope, and useful life. Databases such as Royalty Stat and Royalty Source may be employed.

Cypriot companies that hold intangible assets (trademarks and industrial designs) may, for the purposes of determining the transfer price on the contemplated income streams, expect to employ a variety of commonly used valuation techniques, such as discounted valuations. Such valuation techniques are used in particular for hard-to-value intangibles for which comparable transactions do not exist. It should be noted that discounted valuation techniques should be based on reasonable forecasts and assumptions.

V SETTLEMENTS

General rules on handling a dispute[23] with the tax administration are applicable. In this regard, a settlement may be reached amid a tax audit after negotiations with the tax administration and provision of relevant evidentiary documentation underpinning, inter alia, the historical treatment of the taxpayer's affairs (including any transfer pricing issues that may arise). In this regard, any settlement reached on a transfer pricing issue would generally be of an *ex post* nature (applying to historical transactions) and not *ex ante*.

The new TP Law has introduced an advance pricing arrangement (APA) mechanism via separate regulations.[24] The regulations lay out the process for instituting an APA application request and the prescription of the content and object of the request. It also sets a 10-month time limit for the tax administration to opine on the APA requests and constrains the validity of the APA for a time horizon not exceeding four years. Generally, the Cyprus APA mechanism is aligned with the APA mechanism as enshrined in the OECD TPGs Chapter IV.[25]

21 OECD TPGs 2022, Chapter VI: Special considerations for Intangibles.

22 Development, enhancement, maintenance, protection and exploitation of intangibles.

23 The Tax Disputes and Litigation Review, in *The Law Reviews*, Cyprus Chapter, 11th edition.

24 Transfer Pricing Regulations elaborating on Transfer Pricing Documentations, ΚΔΠ 314/2022.

25 OECD TPGs 2022, Chapter IV: Administrative approaches, F. Advance pricing arrangements.

VI INVESTIGATIONS

The law generally grants the right to the tax authorities to assess a taxpayer's tax return after the applicable submission deadline[26] and to issue a notice of assessment to the taxpayer stating the tax authorities' agreement or disagreement with the tax return submitted.[27]

Similarly, the law provides the taxpayer with the right to dispute an assessment, in which case the objection should be filed by end of the next month, specifying the reason for the objection.[28] Following submission of an objection, the tax authorities and the taxpayer usually exchange views (at meetings or by correspondence), which invariably involves the taxpayer providing additional documentation to support his or her case.

In the absence of detailed or specific provisions governing transfer pricing investigations, the general provisions of the law also apply to those disputes regarding a set 'transfer price' in which the tax authorities, upon issuing an assessment, potentially challenge the underlying terms of a controlled transaction; the taxpayer should be able to demonstrate to the satisfaction of the tax authorities that the controlled transaction reflects the fair market terms.

In this respect, and as already mentioned above, the taxpayer should have satisfactory evidentiary documentation in place underpinning the method of determination of the price and the economic and commercial rationale underlying the controlled transactions, and should furnish the tax authorities with these. The tax authorities generally review the documentary evidence provided by the taxpayer detailing the determined transfer price, and they will accept it if it is reasonable and justifiable in light of the specific economic circumstances or in accordance with the OECD reports and Transfer Pricing Guidelines. The tax authorities generally accept near comparables that illustrate that the determined transfer price is within a reasonable range.

It should also be noted that the tax authorities, on examining the evidentiary documentation, will cancel their original assessments and issue revised or final ones, or a final assessment will be issued without the agreement of the taxpayer, in which case the taxpayer may seek recourse to the Tax Tribunal or to the Supreme Court (see below).

Finally, as of July 2017, the taxpayer should have a transfer pricing study in place supporting financial BtB transactions, and similarly, if opting for the simplification measures, the taxpayer should have a functionality analysis prepared.

VII LITIGATION

In the event that a taxpayer wishes to challenge the findings, position or tax assessment of the tax authorities on a specific matter, he or she may apply to the Tax Tribunal[29] or the Supreme Court,[30] or both.

In this respect, the taxpayer, on receiving the final notice of assessment as issued by the Commissioner without reaching an agreement, should file his or her application to the Tax Tribunal within 45 days of the date of notification of the disagreement with the tax authorities (from the issue of the final notice of assessment).

26 Article 13(1), Assessment and Collection of Taxes Law of 1978, 4/78, as amended.
27 Article 19, Assessment and Collection of Taxes Law of 1978, 4/78, as amended.
28 Article 20(3), Assessment and Collection of Taxes Law of 1978, 4/78, as amended.
29 Article 20A, Assessment and Collection of Taxes Law of 1978, 4/78, as amended.
30 Article 21, Assessment and Collection of Taxes Law of 1978, 4/78, as amended.

The Tax Tribunal will examine the application of the claimant and request a report from the tax authorities documenting the facts of the case and their position. At a later stage, the Tax Tribunal will set a hearing with the two sides and decide on the case. The burden of proof falls on the taxpayer.

Should any of the parties disagree with the decision of the Tax Tribunal, they may seek recourse to the Supreme Court. If the taxpayer disagrees with the decision, the taxpayer must pursue this action within 75 days of either final notification of the assessment or the issue of the Tax Tribunal decision. The burden of the proof should lie with the taxpayer. Recourse to the Supreme Court is brought under Article 146 of the Cyprus Constitution. The Supreme Court will assess the validity of the Commissioner's decision, but if this is found to be reasonable, the Court will not quash the decision.

The following is taken from a relevant ruling of the Supreme Court on its power to quash the Commissioner's decision under Article 146:

> *The Supreme Court has no jurisdiction to go into the merits of the taxation and substitute, where necessary, its own decision. The power of the Supreme Court is limited, as indicated, to the scrutiny of the legality of the action, and to ascertain whether the administration has exceeded the outer limits of its powers. Provided they confine their action within the ambit of their power, an organ of public administration remains the arbiter of the decision necessary to give effect to the law; and so long as they make a correct assessment of the factual background and act in accordance with the notions of sound administration, their decision will not be faulted. In the end, the courts must sustain their decision if it was reasonably open to them . . . The approach of the court to the validity of a taxing decision is no different from its approach in respect of any other administrative decision liable to review under Article 146.*[31]

Transfer pricing matters are also governed by the above rules; therefore, if the taxpayer and the tax authorities cannot reach an agreement on a controlled transaction, the taxpayer may find recourse to either the Tax Tribunal or the courts, or both.

VIII SECONDARY ADJUSTMENTS AND PENALTIES

Currently, the Cyprus arm's-length principle does not explicitly provide for secondary adjustments, although in the absence of wording to forbid these, the tax authorities may apply such adjustments. Such secondary adjustments may take the form of a deemed:

a dividend distribution (if it involves Cyprus tax-residents and domiciled physical persons);

b receivable equal to the difference between the actual transfer price and the fair market price on which the market interest rate will be imputed; or

c operating income.

Secondary adjustments may be invoked in response to primary transactions involving tax-exempt assets and could take any of the forms mentioned above. In the event of such a secondary adjustment, a primary controlled transaction that should not have any Cyprus direct tax implications may ultimately be subject to taxation, especially if it lacks a commercial or business rationale.

31 *Costas M Pikis v. The Republic* (1965) 3 CLR. 131, at 149.

IX BROADER TAXATION ISSUES

i Diverted profits tax

The arm's-length principle in Cyprus law does not apply to transactions where no controlled relation exists between the parties or to certain transactions that constitute capital transactions.

Although there is no specific diverted profits tax provision, the law enshrines the following general anti-avoidance tax provisions (from the Assessment and Collection of Taxes Law and the Capital Gains Tax Law respectively), which govern applicable situations and complement the arm's-length principle.

> *Where the Director is of the opinion that in respect of any year of assessment the object of the tax of any person is reduced by any transaction which in his opinion was artificial or fictitious, he may disregard any such transaction and assess the persons concerned on the proper object of the tax.*[32]

> *In case of a disposal between related persons, as such term is interpreted by the Income Tax Law in force, where the disposal proceeds declared is an amount which is less than the market value of the property, there shall be deemed as disposal proceeds the amount of the market value of the property at the date of its disposal, as this is ascertained by the Director.*[33]

In addition, the general anti-abuse rule (the GAAR)[34] may be employed to deny a tax benefit or recharacterise transactions in the event that 'an arrangement or a series of arrangements' is intended, exclusively or mainly, to exploit tax incentives.[35] The GAAR has been incorporated into the national Tax Law through the transposition of the EU Anti-Tax Avoidance Directive (effective from 1 January 2019).

ii Double taxation

Cyprus has a very broad tax treaty network and generally applies the mutual agreement procedure (MAP) in response to its obligations under its bilateral double-tax treaties (which are mainly based on the OECD Model Convention – therefore giving effect to the specific OECD MAP Article 25, where applicable) or the EU Arbitration Convention[36] pursuing the elimination of double taxation.

Prima facie, the MAP procedure may also be invoked in the context of primary adjustments under transfer pricing for the corresponding adjustment to apply, thereby eliminating or mitigating the possibility of double taxation.

Currently, there is limited practical experience of invoking a MAP for transfer pricing. In addition, the Income Tax Law[37] provides that if the tax authorities make an upward adjustment to a taxpayer's tax calculation during their audit, a corresponding downward adjustment should also be made in the books of a connected controlled party. The resulting

32 Article 33, Assessment and Collection of Taxes Law of 1978, 4/78, as amended, CTR Publications Ltd.

33 Article 9(4), Capital Gains Tax Law, CTR Publications Ltd.

34 Article 33.A. (1), Income Tax Law of 2002, 118(I)/2002, as amended.

35 Article 6, EU Directive, 2016/1164.

36 Convention 90/436/EEC; CRS decree 161/2016 implemented the automatic exchange of financial account information for Cyprus financial institutions.

37 Article 33(5), Article 9(1)(e), Income Tax Law of 2002, 118(I)/2002, as amended.

corresponding adjustment may be allowed as a deduction for the purposes of determining the connected controlled party's tax calculation if, under the normal rules, the subject matter of the corresponding adjustment would have qualified for deduction.

In providing for such a corresponding downward adjustment to be made, the law provides a framework for mitigating cases of double taxation, at least within Cyprus.

X OUTLOOK AND CONCLUSIONS

Notably, the arm's-length principle in Cyprus law is in line with the international arm's-length principle as envisaged in the relevant OECD Model Convention and Transfer Pricing Guidelines, and it governs controlled transactions in Cyprus. The new TP Law builds on the arm's-length principle and comes at the forefront for pricing-controlled transactions.

In conclusion, the new TP Law effectively incorporates the OECD TPGs into national law and creates a reporting and filing obligation for the preparation and maintenance of TP documentation. In this regard, the OECD TPGs provide a toolbox for interpreting and applying the new TP Law and at the same time draw experience from other jurisdictions that implement the OECD TPGs. This new area is expected to give rise to potential disputes amid a tax audit with some cases choosing to resort to the courts.