INFORMATION SHEET No.146

Introduction of Transfer Pricing legislation in Cyprus

February 2024

Introduction

On 30th June 2022 the Cyprus Parliament approved amendments to the Income Tax Law ("the Law"), introducing detailed Transfer Pricing (TP) requirements into the Cyprus tax legislation.

The provisions of the amended Law, which are in line with the recommendations of the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, have retroactive effect from 1st January 2022.

The new TP rules impose documentation requirements to Cypriot tax resident persons (both legal and physical) and to permanent establishments of non-tax resident entities for certain transactions undertaken with related parties ("controlled transactions").

Additionally, the Cyprus Tax Department issued a Circular in July 2023, with retroactive effect as of 1 January 2022, introducing simplified measures on TP documentation requirements regarding controlled transactions not exceeding certain thresholds, as well as simplification measures ('safe harbours') for certain categories of controlled transactions.

The introduction of TP requirements is expected to provide clarity as to the proper and adequate documentation of controlled transactions, so that taxpayers can demonstrate adherence to the arm's length principle.

What is "transfer pricing"

Transfer Pricing is concerned with the pricing of commercial relationships and the methods of allocation of income between related parties for tax purposes. The most accepted method of arriving at a transfer price for tax purposes is the "arm's length" approach, i.e. identification of the prices (or margins) that would be obtained in transactions between unrelated parties in the same commercial circumstances.

Prior to the introduction of detailed TP requirements, transfer pricing issues were addressed by Section 33 of the Law ("arm's length principle"). However, the Law provided no guidance as to how to apply the arm's length principle in practice.

Moreover, from June 2017 and up to now, the only type of arrangements that were subject to TP requirements in Cyprus were intercompany financing arrangements between related parties. With the introduction of detailed TP requirements, virtually all types of transactions between related parties now come within scope, such as sale of goods, provision of services, licensing (royalties), financial services, etc.

Transfer pricing requirements

Section 33 of the Law has been amended to provide for the following:

- Introduction of a 25% threshold in defining the relationship/ connection of a Cypriot company with another person for TP purposes (refer to **Appendix** for more details).
- TP documentation requirements in case where taxpayers meet the conditions under the 25% relationship test, subject to minimum thresholds.
- Stipulation that the arm's length principle shall be applied and interpreted in accordance with the OECD's TP Guidelines.
- Introduction of the option to apply for an Advance Pricing Agreement (APA).

Moreover, the Council of Ministers reserves the right to issue Regulations regarding the framework of implementation of the TP requirements and regarding the procedure for APAs.

Documentation requirements

From tax year 2022 and onwards, Cypriot tax resident persons and permanent establishments of non-Cypriot tax resident persons situated in Cyprus that engage in domestic and/or cross-border controlled transactions are obliged to prepare TP documentation on an annual basis, comprising of a Cyprus Local File, a Master File (in limited cases), and a Summary Information Table.

Master file

The obligation to prepare a master file arises only for taxpayers who act as the ultimate parent entity or surrogate parent entity for Country-by-Country Reporting (CbCR) purposes (i.e. with consolidated revenue exceeding €750 million).

The master file contains standardized information relating to all group companies of a multinational enterprise (MNE), and is intended to provide a high-level overview of the MNE group business, nature of business operations, and overall transfer pricing policies.

The deadline for preparation of the file is the same as the due date for submission of the company Income Tax Return (i.e. 15 months from the end of the tax year). Upon request by the Tax Department, the file should be made available within 60 days from receipt of the relevant request.

Finally, the file needs to be updated on an annual basis regarding any significant changes in the market conditions that may impact the information included in the file.

Local File

Unlike the master file which contains a high-level overview, the local file contains detailed information relating to specific intercompany transactions, including financial information relevant to such transactions, a comparability analysis, and the selection of the most appropriate transfer pricing method.

Simplified measures

An **exemption** from the obligation to prepare a local file is granted to taxpayers engaging in controlled transactions with value below €5,000,000 in the category of financing transactions and below €1,000,000 in all other categories (i.e. trade of goods/services/intellectual property/other) per year in aggregate per transaction category. Up to 31 December 2023 this exemption was granted below the threshold of €750,000 for all categories per year in aggregate per transaction category. For such transactions, the Cyprus Tax Department issued a Circular in July 2023, introducing simplified minimum documentation requirements for controlled transactions falling below the above thresholds, and also introducing optional simplification measures ('safe harbours') for certain categories of controlled transactions. More details on the simplification measures can be found on our relevant Information Sheet 146A by clicking here.

The deadlines for preparation and submission of the local file, as well as the obligation for annual updating of the file, are the same as for the master file (described above).

Finally, the local file is subject to a quality review from a person holding a Practicing Certificate from the Institute of Certified Public Accountants of Cyprus (ICPAC) or from another body of certified auditors approved by the Council of Ministers. The deadline for preparation of the quality review is again the same as for the submission of the company Income Tax Return.

Summary Information Table

All taxpayers engaged in controlled transactions (with no reporting materiality threshold) need to prepare a Summary Information Table (SIT) on an annual basis, which contains high-level information regarding transactions with related parties. Such information include the identification of the related counterparties, their countries of tax residence, and the values of the transactions. The categories of transactions as per the SIT are Goods, Services, Transactions involving Intangibles, Financial Transactions, and 'others' (capturing transactions not falling in any of the other four categories).

The SIT needs to be submitted to the Tax Department electronically, together with the Income Tax Return for the relevant tax year.

Advance Pricing Agreement

The amended Law provides for the option to taxpayers to request for an Advance Pricing Agreement (APA) from the Cyprus Tax Department, with respect to current or future controlled transactions.

In essence, an APA is a voluntary agreement between the taxpayer and one or more tax authorities that determines, in advance of the controlled transactions, an appropriate set of criteria for determining the transfer pricing of the controlled transactions in question, with such criteria including critical assumptions, relevant market conditions, appropriate TP method to be used, comparable transactions and appropriate adjustments thereto.

Upon receipt of the request for an APA, the Tax Department has 10 months from the date of application in which to reach a decision and communicate it to the taxpayer (the Commissioner reserves the right to extend the deadline up to 24 months). The APA decision will be valid for a maximum of 4 years. The Tax Department has the authority to revise, revoke or cancel an APA, under certain circumstances.

Penalties

In case of non-compliance with the aforementioned documentation requirements, penalties are applicable.

Specifically, in the event of non-submission of the SIT by the due date, a penalty of €500 is imposed.

Moreover, in case where a taxpayer receives a notice form the Tax Department for provision of TP documentation (local file or master file), and the taxpayer fails to comply within the statutory 60-day deadline, penalties apply as follows:

- €5,000 if submitted between the 61st and 90th day
- €10,000 if submitted between the 91st and 120th day
- €20,000 if submitted after the 120th day or if not submitted at all

What needs to be done

Both local and multinational groups having presence on Cyprus and engaged in controlled transactions with related parties will be affected by the new TP regulations.

In this respect, a proactive stance needs to be adopted in order to understand and assess the impact of the amended Law, to plan ahead and have in place appropriate TP policies and procedures, and to determine the steps that need to be taken to ensure compliance with the TP documentation requirements.

APPENDIX: Definition of "related parties" for TP purposes

The amended Section 33 of the Cyprus Income Tax Law provides a definition of what constitutes "related parties" for Transfer Pricing purposes, by introducing a minimum 25% threshold relevant to companies.

Specifically, a company is connected with another company if:

- The same person holds, directly or indirectly, at least 25% of the voting rights or share capital or has a right to a share of at least 25% of the income of both companies;
- The same person and persons connected with that person hold, directly or indirectly, at least 25% of the voting rights or share capital or have a right to a share of at least 25% of the income of both companies;
- A group of two or more persons hold, directly or indirectly, at least 25% of the voting rights or share capital or have a right to a share of at least 25% of the income of each company, and the groups either consist of the same persons or could be regarded as consisting of the same persons by treating (in one or more cases) a member of either group as replaced by a person with whom they are connected;

Moreover, a company is connected with another person if that person holds, directly or indirectly, at least 25% of the voting rights or share capital or has a right to a share of at least 25% of the income of that company or, that person and persons connected with him hold directly or indirectly a participation in at least 25% of the voting rights or share capital or have a right in at least 25% of the income of that company.

Finally, any two or more persons acting together to secure, directly or indirectly, at least 25% of the voting rights or share capital or a right to a share of at least 25% of the income of a company, shall be treated in relation to that company as connected with one another and with any person acting on the directions of any of them to secure directly or indirectly 25% of the voting rights or share capital or a right to a share of at least 25% of the income of that company.

NOTES

The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained. Totalserve Management Ltd will be glad to assist you in this respect. Please do not hesitate to contact us.