The purpose of this bulletin is to shed some light on the use of unilateral safe harbour rules in Cyprus and specifically as to when an arrangement becomes reportable for DAC6 purposes for meeting the requirements of Hallmark E1.

Hallmark E1

According to the provisions of the sixth amendment of the Directive for Administrative Cooperation in the field of Taxation (DAC6) and the implementing Cyprus legislation, any cross-border arrangement taking place from 25thJune 2018 and onwards, which meets the specific characteristics and requirements of a Hallmark will be considered as a reportable transaction.

A reportable cross-border arrangement is considered to be put into effect at the date:

- which it is made available for implementation; or
- when is ready for implementation; or
- when the first step of implementation has taken place,

whichever occurs first.

Hallmark E1 is met when arrangements make use of unilateral safe harbour rules. The most common safe harbour rule in Cyprus, is the use of the minimum acceptable gross margin of 2.29% by intermediary companies involved in back-to-back financing transactions with related parties.

Before the introduction of the DAC6 requirements, any company making use of the safe harbour rule had to make a relevant declaration in its annual tax return. With the introduction of the DAC6 requirements and specifically Hallmark E1, there is an additional obligation to report any cross-border arrangement that makes use of the safe harbour rule in the DAC6 reporting channels.

It is therefore essential for the information presented in a company's tax return to be in line with what is reported under DAC6, and if there are differences, to be able to justify why a company that declared in its tax returns the use of the safe harbour rates did not proceed with the respective report under DAC6.

The key element is to identify when the decision to make use of the safe harbour rule was taken- the timing of which may in many cases not be easily identifiable, and depending on the timing of the above decision, to adopt the correct approach under DAC6 and decide whether the arrangement falls withing the reporting period or not.

Our View

In our view, if the intermediary or the taxpayer can demonstrate to the tax authorities that the decision to use the safe harbour rule was taken before 25th June 2018, then the arrangement is not reportable under DAC6, even if the Company continues to make use of the safe harbour in every subsequent tax year and irrespective of the fact that in the company's tax return a relevant declaration for the use of the safe harbour rate is made, provided of course that no substantial changes have taken place in the conditions of the relevant arrangement.

If the decision to make use of safe harbour rule was taken after 25 June 2018, then the relevant cross-border arrangement should be reported under DAC6. Further guidance will be needed however, as to whether such arrangements will continue to be reportable in every subsequent tax year that the safe harbour is used.

In the process of determining the timing of such decision, various indicators can be reviewed. Primarily, one must look at whether there is a documented decision taken by the board of the directors of the company to use the safe harbour rate that can provide sufficient evidence as to the timing of that decision (i.e. a certified board resolution).

In the absence of such resolution, one must look for other corroborative evidence that can prove the timing of such a decision.

Such evidence may include the use of the safe harbour rate in 2017 (i.e. the first year in which the safe harbour rate was in force) which will be a strong indication that the decision to use the safe harbour rate was taken well before 25th June 2018.

In addition, the payment of temporary taxation and/or payment of tax under self-assessment made before 25th June 2018 and estimated based on the safe harbour rate can be another indication of the timing of the decision. A Company who made temporary tax payments before 25 June 2018, basing its estimate on the 2.29% margin, most probably took the decision to use the safe harbour rule before that date. If no temporary tax payment was made and the use of the 2.29% was made during the preparation of the tax return then someone can reasonably conclude that the decision was made after 25th June 2018 and during the preparation of the annual tax return.

Scenario Analysis

1. Company A is involved in back-to-back loans. The Company's 2017 tax computation included the use of the safe harbour

and was submitted before the 25th of June 2018. The Company is using the safe harbour rate every year and thus the relevant

declarations were also made in the Company's returns for the subsequent years (i.e. 2018,2019 and so on).

> **Q1: Is the use of safe harbour which is indicated in the 2018 tax return considered a new arrangement and therefore reportable?**
>
> Since decision to use the safe harbour rate was taken before 25 June 2018 and the intention was to use it in every tax year, then the arrangement is considered to be ready for implementation prior to 25 June 2018 and hence not regarded as a reportable cross-border arrangement.
>
> **Q2: Is the use of the safe harbour rate in subsequent years considered a new arrangement and therefore reportable every year?**
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> Since decision to use the safe harbour rate was taken before 25 June 2018 and the intention was to use it in every tax year, then the arrangement is considered to be ready for implementation prior to 25 June 2018 and hence not regarded as a reportable cross-border arrangement. However, the whole arrangement will need to be re-evaluated if during the subsequent years a substantial change in the relevant arrangement is incurred.

2. Company B is involved in back-to-back loans. The Company's 2018 tax return included a declaration of using the safe harbour rate and there are indications that the decision to use the safe harbour rate was taken after 25 June 2018. The Company is using the safe harbour rate every year and thus the

relevant declarations were also made in the Company's returns for the subsequent years (i.e., 2019, 2020 and so on).

Q1: Is the use of safe harbour rate indicated in the 2018 tax return reportable?

Since decision to use the safe harbour rule was taken after 25th June 2018, then the arrangement is reportable under DAC6 in 2018.

Q2: Is the use of the safe harbour rate in subsequent years considered a new arrangement and therefore reportable every year?

It remains unclear whether the arrangement must be reported in every subsequent year. Our view is that if there are no substantial changes in the cross-border arrangement then there is no need for a new report under DAC6 to be submitted.

We expect that further guidance on the matter will be provided by the Tax Department .

3. Company C has receivables and payables from related parties. The company did not take any prior decision to use of safe harbour rates. However, the use of safe harbour rate was indicated in its 2018 tax return, for tax compliance purposes only (φορολογικής συμμόρφωσης). The Company continues following the above treatment in every subsequent year, making the relevant declaration in its annual tax returns.

Q1: Is the use of safe harbour indicated in the 2018 tax return reportable?

Irrespective of the fact that the use of the safe harbour rate was used only for tax compliance purposes, the obligation to report the cross-border arrangement under DAC6 remains and cannot be circumvented.

Q2: Since this treatment is followed in subsequent years, is every year considered a new arrangement and therefore reportable every year?

It remains unclear whether the arrangement must be reported in every subsequent year. Our view is that if there are no substantial changes in the cross-border arrangement then there is no need for a new report under DAC6 to be submitted. It is expected that the Tax Department will provide further guidance on the matter.

The above are some general views on how DAC6 will apply for Hallmark E1 and does not constitute a tax opinion or tax guidance.