

New Transfer Pricing Circular on Simplification Measures for Transactions not exceeding the threshold for a Local File

A. INTRODUCTION

On 6 July 2023, the Cyprus Tax Authorities (“CTA”), published a new Transfer Pricing Circular addressed to the tax inspectors with reference to the simplification measures for low value transactions. *

B. BACKGROUND

On the 30th of July 2022, the Cyprus Parliament has voted for the introduction of the Transfer Pricing Regulations in Cyprus, effective as from 1 January 2022. The Transfer Pricing regulations require that all Cyprus taxpayers with related party transactions exceeding the aggregated amount of EUR 750.000 per category of transactions, will prepare for transfer pricing purposes a Local File.

C. BRIEF POINTS TO NOTE

In order to ensure that the entities not subject to the requirement of preparing a Local File comply with the arm’s length principle, in July 2023 the CTA published the new Transfer Pricing Circular, setting new requirements for the entities not exceeding the materiality threshold of EUR 750.000 with related party transactions.

The main points of the Circular are described below:

1. Preparation of a simplified transfer pricing documentation Entities exempted from the requirement of a Local File preparation must prepare a simplified transfer pricing documentation including the following minimum contents:

- Short description of functional analysis (functions, assets, risks);
- Characterisation of the entity, based on the functional analysis performed;
- Rationale of selection of the most appropriate Transfer Pricing method; and
- Determination of the arm’s length results, based on the benchmark analysis.

2. Use of unilateral **safe harbor rules**

Entities entering into cross border transactions can use the safe harbor rules. Safe harbor is only applicable for entities not exceeding (or should not exceeding) the total aggregate amount of EUR 750.000 of related party transactions in the relevant category.

* For the purposes of this Circular, low value transactions are the transactions that in aggregation per category do not exceed the EUR 750.000 threshold for the preparation of a Cyprus Local File.

The safe harbor rules apply on the below types of transaction:

- a) **Provision of financing** in the form of loans or cash advances to related parties, which are **funded out of financial means** (such as bonds, loans from related parties, interest free loans from the shareholders, cash advances and bank loans).

The applicable safe harbor will be 2.5% after the deduction of allowable expenses. The minimum return of 2.5% will be applicable on the average balance of loan receivable for the relevant tax year, including the interest accrued but not paid.

- b) **Provision of financing** in the form of loans or cash advances to related parties, which **are funded out of own capital** (such as issued share capital and share premium, non-refundable capital contributions, and retained earnings).

The applicable safe harbor will be the 10-year government bond of the borrower's country plus a 3.5%. The minimum return will be applicable on the average balance of loan receivable for the relevant tax year, including the interest accrued but not paid.

- c) **Receiving of financing** in the form of loans or bonds or cash advances from related parties, that carry an interest rate, to the extent that the funds borrowed **are used in the business**.

The applicable safe harbor shall not exceed the 10-year government bond of Cyprus plus a 1.5%. The minimum return will be applicable on the average balance of loan payable for the relevant tax year, including the interest accrued but not paid.

- d) Conducting of **low value-adding services**.

For the purposes of this Circular, low value-adding services are defined as the services of a supportive nature, which are not part of the core activities of the group, do not involve unique and valuable intangibles or a significant risk for the service provider.

The applicable safe harbor should be minimum 5% mark-up on the relevant costs. If the entity under examination is the recipient of low value-adding services, 5% shall be the maximum applicable mark-up.

The use of safe harbor rules on the above-mentioned types of transaction must be supported by an appropriate minimum documentation. Such documentation will include a short description of functional analysis and characterisation of the entity, based on the functional analysis performed. For the financing type transactions, (points a, b and c of the above) the documentation must also include analytical description of the loans, the criteria met for the use of safe harbor and the relevant numerical analyses that led to the taxable income. For the low value-adding services, the minimum documentation will consist of description of the low value-adding services, justification of the reasons the services considered eligible for the safe harbor and the relevant analyses and calculations.

The use of safe harbor shall be declared in the relevant section of the taxpayer's income tax return. In the availability of reliable internal comparables, the taxpayer is not permitted to use the safe harbor rules.

The simplified Transfer Pricing documentation must be made available within 60 days upon the CTA's request, by the taxpayer or a person authorised to act as a representative of the taxpayer.

3. DAC6 reportability

The provisions of unilateral safe harbor rules described above in cross-border transactions, will be reportable under the DAC6 legislation in Cyprus, under Hallmark E.1.

D. OUR CONCLUSION

The new Transfer Pricing Circular imposes additional documentation requirements to the Cyprus taxpayers, on top of the already strict transfer pricing legal framework for Cyprus purposes. Further compliance measures will lead to further burden for the taxpayers. Also, the taxpayers must be up to date with the ongoing tax developments in order to remain compliant and should be aware of the overall reporting obligations that may arise further to the publication of the new Transfer Pricing Circular.

E. HOW CAN WE ASSIST

- ✓ Assess if the intragroup transactions of an entity exceed the threshold;
- ✓ Categorize the transactions;
- ✓ Prepare and submit the Summary Information Table;
- ✓ Prepare the required documentation (Local File, Master File) and relevant Benchmark Analysis;
- ✓ Prepare the required simplified transfer pricing documentation;
- ✓ Perform and submit a transfer pricing study for your intragroup financing transactions before the tax year 2022;
- ✓ Prepare an APA and liaise with tax authorities to enable the client to secure a pricing in advance;
- ✓ Assist in the formation of the internal transfer pricing policy;
- ✓ Representation arrangements in a transfer pricing dispute with the tax authorities.

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