

Simplified Transfer Pricing Rules CYPRUS

Introduction

On 6 July 2023 the Cyprus Tax Department issued a circular (6/2023) that introduces simplification measures for taxpayers that are exempted from the obligation of preparing a TP Local file (i.e., their transactions with related parties, are below €750.000 per category of transactions).

The simplification measures apply as from 1 January 2022.

These simplification measures relate to:

- a. Simplified transfer pricing documentation requirements
- b. Introducing safe harbor rates for certain types of transactions

A. Simplified transfer pricing documentation requirements

The minimum documentation requirements apply in cases where the transactions between related parties do not exceed the €750,000 threshold per category of transactions. The minimum documentation requirements to support the arm's length nature/pricing of such transactions are as follows:

- a. A brief functional analysis of the Cypriot entity (functions performed, assets used, risks undertaken).
- b. A characterization of the entity based on its functional profile (i.e., limited risk service provider, fully fledged distributor, principal etc.)
- c. A provision of arguments/reasons why the selected pricing method is the most appropriate.
- d. A transfer pricing benchmarking study using internal or external comparables (or any other method as per OECD TP guidelines) to support the pricing used.

The minimum TP Documentation should be submitted to the Cyprus Tax Department upon request (within 60 days).

In case that a taxpayer opts to apply for the TP simplification documentation requirements and at the same time opts for safe harbor rates for the certain types of transaction then need only to prepare (a) and (b) from the documentation requirements plus the documentation requirements for the specific type of transaction.

B. Safe harbor rates for certain types of transactions

The Cyprus tax department introduced minimum/maximum acceptable profit margins (safe harbors) for the categories of transactions as below. These apply if the transactions are below the €750,000 threshold per category of transactions.

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These profit margins will be revised from time to time based on market changes and other factors deemed appropriate.

No deviation is acceptable from the safe harbors. In addition, the Cyprus tax department will not accept any downward adjustment if the accounting profit is higher from the profit resulting from application of a TP benchmark study or the simplification measures.

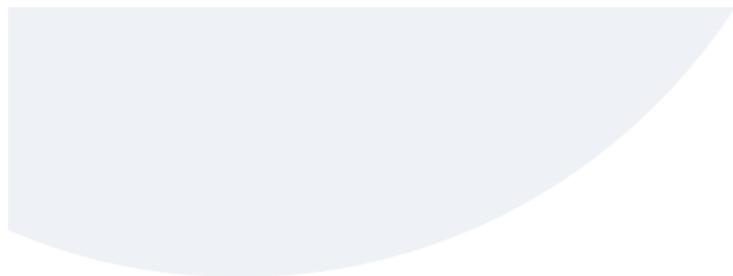
Opting for safe harbors for the selected transactions is reportable under DAC 6 reporting requirements.

The persons elect to apply for any of the safe harbors described below needs to disclose such election to the Cyprus Tax department through the completion of the relevant part in the Summary Information table each tax year.

It is important to note that Simplification Measures cannot be applied if reliable internal comparables (i.e. comparable transactions with unrelated parties) exist and hence can be used to determine the arm's length price of the related parties' transactions.

Analysis of transactions where safe harbor rates apply:

Transactions	Safe Harbor rate	Documentation requirements in addition to A (a) and A (b)
<p>Providing finance to related parties through debt (back-to-back financing) Debt includes borrowings from related parties, credit institutions, shareholders current accounts etc.</p>	<p>Minimum return of 2,5% before taxes. The return is after the deduction of allowable expenses and is estimated on the average loan receivable during the year and includes interest accrued but not received.</p>	<p>The Company should provide: An analysis of loans receivables under simplification rules Justification for the classification of the loans receivables as back-to-back Workings and reconciliations on how the simplification measure applied on the tax computations.</p>
<p>Providing finance to related parties through equity. Equity includes the proceeds from issue of share capital, share premium, non-reciprocal capital contributions and funds out of the profits of the Company (retained earnings).</p>	<p>Minimum return is the 10-year government bond yield (as of 31 December of the previous year) of the country that the loan recipient (borrower) operates increased by 3,5%. The return is estimated on the average loan receivable during the year and includes interest accrued but not received. In case the 10-year government bond yield is negative, then only the 3,5% margin will apply.</p>	<p>The Company should provide: An analysis of loans receivables under simplification rules Justification to support that the loans receivables are financed through equity. Workings and reconciliations on how the simplification measure applied on the tax computations.</p>
<p>Borrowings obtained and the funds are used in the business. These relate to borrowings, bonds or other instruments obtained from related parties and carry interest.</p>	<p>The maximum allowable interest expense is the Cyprus 10-year government bond yield (as of 31 December of the previous year) + 1,5%. The return is estimated on average borrowings during the year and includes interest accrued but not paid.</p>	<p>The Company should provide: An analysis of borrowings under simplification rules Justification to support that the borrowings are obtained from related parties and are used in the business. Workings and reconciliations on how the simplification measure applied on the tax computations.</p>



Transactions	Safe Harbor rate	Documentation requirements in addition to A (a) and A (b)
<p>Provision and Receipt of Low Value adding services. Low Value adding services as per the definition provided in the OECD TP Guidelines Chapter VII, part D, par. 7.43-7.65. As per paragraph 7.45, Low Value adding services for the purposes of the simplified approach are services performed by one member or more than one member of a Group on behalf of one or more other group members which: are of a supportive nature, are not part of the core business of the Group (i.e. not creating the profit-earning activities or contributing to economically significant activities of the Group), do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles, and do not involve the assumption or control of substantial or significant risk by the service provider and do not give rise to the creation of significant risk for the service provider.</p>	<p>If the Cypriot company is the provider of the Low Value adding services, the minimum return is 5% mark up on total costs. If the Cypriot company is the recipient of the Low Value adding services, the maximum return is 5% mark up on total costs.</p>	<p>The Company should provide: Description of low value-added services provided. Identity of the recipients of the services. Justification for each category of service classified as low value-added nature. Description of the selected cost allocation keys. Determination of costs pool, and application of the selected allocation keys with the margin. Workings and reconciliations on how the simplification measure applied on the tax computations.</p>

Overview

Taxpayers that have transactions with related parties below €750,000 per category of transactions should still prepare simplified transfer pricing documentation to support the arm's length nature of these transactions.

For certain types of transactions, falling below €750,000, taxpayers can opt for the minimum/maximum acceptable profit margins (safe harbors), however it is highly recommended that taxpayers should examine carefully whether the application of those will actually save tax/administrative cost, or it would be more beneficial to opt for having a full transfer pricing study to support the arm's length pricing.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.