



September 2017

## NEW RULES FOR TAXATION OF INTRA-GROUP FINANCING ARRANGEMENTS

Cyprus Tax Department has issued on 30 June 2017 a Circular with respect to the new rules for the taxation of intra-group financial arrangements, which became effective from 1 July 2017.

The Circular covers all existing and future transactions and is applicable to companies that carry out group financial transactions and are Cypriot tax resident or non-Cypriot tax resident companies with a permanent establishment in Cyprus.

The Circular introduces transfer pricing methodology to such activities, based on the arm's length principle as described in the OECD's Transfer Pricing Guidelines.

Below we analyse the main provisions of the Circular:

### **1. Applicability**

'Intra-group financing transactions' refer to any activity of granting of loans or cash advances remunerated by interest, or should be remunerated by interest, to related companies, financed by financial means and instruments (debentures, private loans, cash advances, bank loans).

Related companies are defined by Section 33 of the Cyprus Income Tax Law.

### **2. Transfer pricing requirements – Controlled transaction/arm's length remuneration**

The remuneration of intra-group financing transactions shall correspond to the price that would have been implemented

in transactions with independent entities in comparable circumstances. In order to be able to determine if the transaction is on an arm's length basis it is necessary to compare the transaction with comparable transactions in the open market.

To achieve such a comparison, the company would need to identify commercial and financial relationship with related parties ("controlled transactions") and determine the economic significant conditions connecting to such a relationship. It would also need to compare the conditions and economic substance of each controlled transaction with any similar transactions between independent entities.

To determine the characteristics of the controlled transactions successfully the entities shall examine and analyse underlying

purpose of the transactions (substance over form), the roles of the parties involved (the actual activities of those parties and their responsibilities), the assets used (and risks assumed (a company that wishes to facilitate by financing a related party is considered to assume the risk if it has the financial capacity to face the financial consequences in case such risk materialises).

### 3. Substance requirements

The Circular stipulates that the financing companies must have an actual presence in Cyprus and must control the risks and transaction which entered into.

To justify presence in Cyprus factors like the number of members of the board of directors of the company that are Cyprus tax residents, the board of directors' and shareholders' meetings taking place in Cyprus are taken into consideration.

The daily activities of risk mitigation may be outsourced as long as the company has the capability to take, and actually to make, key decisions with respect to the outsourcing.

### 4. Simplification regime

A financing company that satisfies the aforementioned substance requirements, and which is engaged purely in intermediary financing activities (i.e. borrowing from related entities and then lending to related entities), shall comply with the arm's length principle if it receives in relation to its intra-group financing transactions ("IGFT") a minimum return of 2% after-tax on assets. Entities adopting this regime shall specify it in their tax returns and will be reviewed by the Tax Department on a regular basis.

### 5. Minimum Requirements for transfer pricing analysis

The following are the minimum requirements for a transfer pricing analysis, as specified by the Circular, which must be prepared by a transfer pricing specialist (e.g. a licensed auditor):

- Explanation of the computation of equity allocation required to assume the risks
- a description of the group and the inter-linkages between the functions performed by the entities participating in the

controlled transactions and the rest of the group, together with a description of the value creation within the group by the entities participating in the transactions

- the precise scope of the transactions under review
- list of the potentially comparable transactions
- a rejection matrix for rejected potentially comparable transactions with justifications
- the final list of comparable transactions which have been selected and used to determine the arm's length price applied to the intra-group transactions
- a brief description explanation of market conditions
- list of all previous agreements on transfer pricing concluded with other countries in relation to the transactions in question
- a list of all the previous agreements concluded with entities under analysis which are still in effect at the time of the submission of the request
- a projection of the income statements for the years covered by the request

### 6. Entry into force

The Circular is applicable as from the 1st of July 2017, for all existing and future transactions.

### 7. Way forward

All affected companies will need to proceed with undertaking the required transfer pricing analysis for each IGFT or alternatively, and subject to conditions, the affected entities may opt to use the simplification regime.

Oneworld Ltd is furnished to provide a full service to assist clients both with identifying any potential implications from the above new rules and undertaking the required transfer analysis by our experts. If you wish to know more about the taxation of intra-group financing arrangements and how it may affect you, please contact our director, Savvas Shiatis at SShiatis@oneworldweb.net for a complimentary consultation.

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