

Tax Newsletter – Introduction of Simplification Measures for Low Value Transactions and Summary Information Table

Dear Clients, Associates, and Friends

The Tax Administration released a Circular (‘Circular’ or ‘Guidelines’) on the implementation of **safe harbours** introducing **simplified rules** for the application of the arm’s length standard. Safe harbours (i.e. a set of set exemptions or criteria to satisfy a condition) are commonplace in many jurisdictions and generally foster administrative simplicity and reduction of compliance costs while increasing predictability for the taxpayers (by adhering to these they avoid future disputes and know ex ante their tax base). They generally target low transfer risk taxpayers and they are typically unilateral in nature (therefore only binding the jurisdiction implementing these).

The said safe harbour rules apply to a **specific category** of taxpayers (‘qualifying taxpayers’), namely those below the monetary threshold of Eur €750.000¹. This monetary threshold **is a prerequisite** to be considered as a qualifying taxpayer and thus enjoy the benefit of applying the safe harbour (ie less onerous general Transfer Pricing rules).

Safe harbour categories:

- a) Administrative simplification measures which have a broad scope covering all transactions,
- b) Financial safe harbours that involve the application of predetermined rates for lenders and/or borrower and/or intermediary back-to-back loans.
- c) Low Value Activities which replicate the Low Value adding intra group services as set out in Chapter VII of the OECD Transfer Pricing Guidelines.

¹ It has been announced that the monetary threshold will rise to €1,000,000 and €5,000,000 for Financial Transactions

A. Administrative Simplification Measures

Qualifying taxpayers are not obliged to prepare the Cyprus Local File otherwise required pursuant to the relevant Cypriot TP Law provisions and regulations. Nevertheless, they continue to be subject to the arm's length principle ('ALP'), therefore the need for demonstrating that the said controlled transaction abides with the ALP persists. The Circular lays down simplified TP documentation that qualifying taxpayers should prepare for supporting their controlled transactions. This includes:

- A. Brief functional analysis (functions, assets, risks)
- B. Description of the functional profile of the entity;
- C. Explaining the selection of the most appropriate TP method
- D. Determination of the arm's length price(s) using as comparability search result by reference to internal or external comparables and/or other economic analysis compliant with the OECD TP Guidelines.

B. Financial & Low Value Safe harbours

The Circular introduces the below Safe harbours (primarily to address related party transactions and ancillary services):

- I. Applying debt capital (may be bonds, loans etc) for extending loans to related parties.
- II. Applying own capital (share capital, retained earnings etc) for extending loans to related parties.
- III. Applying lending from related parties to own business.
- IV. Low value-adding services. The Circular implements the 'Low Value Services' definition and examples laid down by the OECD TPGs². Broadly speaking, services falling under the definition of low value-adding services are those which have a supportive character, are not part of the core activities of the group, do not involve unique and valuable intangibles and do not involve significant risk for the service provider

² Chapter VII: Intra Group Services, Section D

The table below shows the applicable safe harbours:

I. Loans or cash advances to related parties which are funded using debt capital	Minimum return of 2.5% (after the deduction of allowable expenses).
II. Loans or cash advances extended using own capital	Minimum return should be equal to the yield rate (as at 31 December of the prior tax year) of the 10-year government bond of the country in which the debtor operates, uplifted by 3.5%.
III. Borrowings obtained by related parties	Cost of borrowing must not exceed the yield rate (as at 31 December of the prior tax year) of the ten-year government bond of the Republic of Cyprus, uplifted by 1.5%.
IV. Low value adding services	5% mark up on the relevant costs.

The taxpayers that implement the foregoing safe harbours should still need to prepare:

- A. A brief description of the functional analysis;
- B. A description of the characterisation of the entity.

Furthermore, additional details/documentation for the financial transactions should be included in the tax file and provide when requested, such as, description and break down of the loans (details, amounts, repayments etc) and relevant reconciliations.

C. Reporting and Mandatory Disclosure Rules

The Circular stipulates that the TP simplified documentation should be made available within 60 days from the date of receiving the relevant request from the Tax Administration. The use of the safe harbour should be declared by the taxpayer on the face of its tax return. Finally, it should be highlighted that the application of the safe harbour should be viewed as reportable under the relevant DAC 6 rules.

D. Summary Information Table

Reiterating that qualifying taxpayers are relieved from the obligation to prepare the Cyprus Local File ('CLF'). In brief, the CLF obligation requires to show a thorough comparability analysis to (a) accurately delineate and recognise the transaction, and (b) perform economic analysis of the transaction. Relevant supporting documentation should be maintained. However, the Law does NOT waive the taxpayer's obligation to prepare a Summary Information Table ('SIT'). On the Summary Information Table requirement:

- It is a strict requirement and applies to all 'in scope' taxpayers (as defined by article 33(7) of the Income Tax Law (i.e. where direct or indirect 25% relation/association persists), irrespective of whether their controlled transactions fall within the de minimis threshold of EUR 750k.
- It should include details such as, tax residency, value in relation to goods, services, financial transactions (loan by loan), IP income streams and others.
- It should be prepared for each tax year and submitted along with the respective tax return.
- Is submitted electronically only through the TFA.
- Monetary penalties apply for delay submission and/or non- submission and/or inaccurate completion.

Concluding Remark

Qualifying taxpayers may use the foregoing safe harbours, as laid down by the Circular, therefore complying with the ALP with reduced reporting obligations. However, they must still prepare and submit annually the SIT (like all other in scope taxpayers).

Our team of lawyers, advisors and consultants is at your disposal to discuss and navigate the application of safe harbours and SIT requirement.