

Cyprus implements the legislation of the EU Anti-Tax Avoidance Directive

Introduction

On the 5th of April 2019, the House of Representatives approved the proposed legislation (the Law) implementing the provisions of the European Union Anti-Tax Avoidance Directive (ATAD or Directive). The new Law will come into force once it is published in the *Official Gazette of the Republic*. The provisions of the Law shall be effective as of 1 January 2019 (i.e. from the tax year 2019 onwards).

The Law introduces the below:

- Interest limitation rules
- CFC rules
- General Anti-abuse rule (GAAR).

The second phase of the implementation of the Directive concerning the exit taxation provisions and the Hybrid mismatch rules will be effective as of 1 January 2020.

The first implementation of the ATAD Law impacts only Cyprus Corporate Income Tax payers and more specifically Cyprus Tax Resident Companies and Cyprus Permanent Establishments (PEs) of non-Cyprus Tax Resident Companies.

1. Interest Limitation rule

Outside of the scope of the application of the ATAD are the below:

- Stand-alone Companies – Companies that on a worldwide basis are not part of a Group/have no associate/no PEs
- Financial Undertakings – as defined by the Law include inter alia, credit institutions, investment firms, alternative investment fund managers (AIFMs) and management companies of undertakings for collective investment in transferable securities (UCITS), insurance and reinsurance undertakings, alternative investment funds (AIF) managed by an AIFM, UCITS and others.

In the case that a Cyprus Tax payer is part of a Cyprus Group, the interest limitation rule applies on an aggregate level of the Cyprus Group, otherwise it applies per company or per Cyprus PE.

(a) Application of the rule

The Law introduces the interest limitation rule that limits the deductibility of the taxpayers' Exceeding Borrowing Costs (EBC) to 30% of the taxable EBITDA (earnings before interest, taxes, depreciation and amortization). The Law provides that any EBC up to €3 million per tax year (de minimis rule) are not subject to the limitation. In the case that the Cyprus taxpayer is a member of a group then the €3 million de minimis exception of the rule is applied on an aggregate level of the Group's borrowing costs.

As defined in the Law, "*Exceeding Borrowing Costs*" is defined as the excess of borrowing costs over interest income and other economically equivalent taxable revenues.

As per the provisions of the ATAD, "*Borrowing costs*" are interest expenses on all forms of debt, other costs economically equivalent to interest, as well as expenses incurred in relation with the raising of finance.

"*Taxable EBITDA*" is defined as the total taxable income increased by the EBC, the depreciation and amortization of fixed assets and intangibles and the notional interest deduction of 80% on the gross profit as a result of the Intellectual property (IP) Box Regime. Losses brought forward are not taken into consideration when determining the EBITDA. Therefore, exempt income for tax purposes such as dividends, capital gains and their relating costs are neither taken into consideration.

(b) Exclusion of certain borrowing costs from the rule

In the Law there is a grandfathering clause as per which the interest on the below loans is excluded:

- Loans that concluded before 17 June 2016 – the grandfathering clause will not apply to any subsequent modifications of such loans (further circulars will be published to clarify the understanding of *subsequent modifications*).
- Loans used to fund long-term public infrastructure projects where the operator, borrowing costs, assets and income are all located in the EU.
 - Long-term public infrastructure projects are defined as projects to include, upgrade, operate and/or maintain a large-scale asset that is considered in the general public interest. Income earned from such projects are also excluded from the definition of taxable EBITDA.

(c) Group equity exception

In the case that the taxpayer is a member of a consolidated group for financial accounting purposes, they may upon request, deduct the entire amount of their EBC only if they can demonstrate that the equity over total assets ratio is higher or at least equal (with a tolerance of 2%) than the equivalent ratio of the group.

For the above to exception to apply all assets and liabilities must be valued using the same method used at the consolidated level.

(d) Carry forward of EBC

Any EBC not deductible in a tax year are eligible to be carried forward for a period of 5 years under certain conditions.

Furthermore, the unused interest capacity that has not been utilized in the tax year can be carried forward to be used in the following 5 years period. Unused interest capacity exists where the amount of 30% of the Company's taxable EBITDA exceeds the Company's EBC.

2. Controlled Foreign Company (CFC) rule

A CFC is a low taxed non-Cyprus tax resident Company in which the Cyprus taxpayer company (alone or aggregately with its associated companies, has a direct or indirect interest of more than 50%).

Adding to the above, a CFC is a low taxed foreign PE of a Cyprus tax resident Company that is exempt from tax in Cyprus.

A non-Cyprus tax resident company or an exempt Foreign PE is considered as low taxed in the case that the actual foreign corporation tax paid on its profits is lower than 50% of the equivalent tax that would have been paid in Cyprus had it been a Cyprus tax resident Company.

(a) Exceptions from the rule

The CFC rule should not be applied to non-Cyprus tax resident Companies or exempt Foreign PEs that:

- their accounting profits does not exceed €750,000 and non-trading income does not exceed €75,000; or
- their accounting profits does not exceed the 10% of their operational costs. For the purposes of this exception, costs of goods sold outside the country where the non-Cyprus tax resident Company is tax resident and payments to its associated enterprises.

(b) Income within the scope

The non-distributed income of a CFC must be included in the tax base of the Cypriot taxpayer Company. This applies for income that derived from non-genuine arrangements that have been put in place solely for obtaining a tax advantage.

The income to be included in the tax base can only be decreased with dividends that were distributed by the CFC during the same tax year or within the 7 months following the year end.

(c) Non-genuine arrangements

An arrangement or series thereof shall be regarded as non-genuine to the extent that the CFC would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it were not controlled by the Cyprus taxpayer where the significant people functions (SPFs) which are relevant to those assets and risks, are carried out and are instrumental in generating the CFC's income.

(d) Income to be included

The amount of the CFC's non-distributed income to be included in the Cyprus taxpayer's tax base is limited to the amounts that the Cyprus taxpayer is entitled out of the CFC's profits.

The same provisions apply in the cases that the CFC generates losses instead of profits.

(e) CFC income – double taxation avoidance

Cyprus grants a tax credit against the Cyprus corporate income tax payable for certain taxes paid abroad concerning the CFC income included in the tax base.

In addition, rules have been put in place to prevent double taxation in Cyprus for income that was previously included in Cyprus under the CFC rule and is subsequently distributed or realized through the disposal of a CFC.

3. General Anti-Abuse Rule (GAAR)

According to the ATAD, for the purpose of calculating the Cyprus corporate income tax liability of the Cyprus taxpayer, an arrangement or a series of arrangements that have been put in place solely for obtaining a tax advantage should be ignored.

4. Implications and Implementation

The first implementation of the ATAD in the form of a Law is a clear indication of Cyprus towards the full compliance with EU tax initiatives.

Further circulars are expected to be issued by the Cyprus Tax Authorities in the coming months to provide more practical guidance as to the application of the law and also to clarify any grey areas that might exist within the context of the ATAD Law.

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