

Cyprus implementation of the Anti-Tax Avoidance Directive

On 25/4/2019, further to the publication of Law 63(I)/2019, the provisions of the EU Anti-Tax Avoidance Directive (ATAD EU 2016/1164) of July 2016 were transposed into the Cypriot law. The Law transposes three ATAD measures in the Cypriot law, with effect as of 01 January 2019:

- interest limitation (earnings stripping rule)
- a general anti-abuse rule (GAAR)
- rules concerning controlled foreign companies (CFC).

The remaining ATAD provisions will be transposed gradually as per the timeframe set in the Directive.

These rules apply to all companies as well as other entities that are subject to tax in Cyprus in the same manner as companies, including entities that are not Cyprus tax residents but that have a Cypriot permanent establishment.

Interest Limitation Rule

Under the ATAD, interest limitation rule as transposed in the Cyprus Income Tax Law, exceeding borrowing costs shall be deductible in the tax period in which they are incurred only up to 30% of the taxpayer's earnings before interest, tax, depreciation and amortisation (EBITDA) as adjusted in accordance with the rules concerned.

Exceeding borrowing costs refer to net interest expense (broadly interest income less interest expense on all forms of debt and other costs economically equivalent to interest and expenses incurred in connection with the raising of finance).

The legal provisions transposed include opt outs in relation to a de minimis threshold (exceeding borrowing costs up to EUR 3 million can be deducted), a standalone entity exemption (not being part of a group of companies), grandfathering of loans concluded before 17 June 2016 and an exclusion from scope of long-term infrastructure projects which are considered to be in the general public interest. This limitation will also not apply to financial undertakings (credit institutions, insurance / reinsurance companies, occupational retirement pension funds, EU social security pension schemes, Investment Firms, AIFs and AIFMs, UCITs funds and UCITs management companies, OTC derivative counterparties – "CCPs"; central securities depositories-"CSDs"; and securitisation special purpose entities-"SPEs").

The implementing law also provides for a group equity ratio carve-out in that, where the taxpayer is a member of a consolidated group for financial accounting purposes, the taxpayer may be given the right to fully deduct its exceeding borrowing costs if it can demonstrate that the ratio of its equity over its total assets is equal to or higher than the equivalent ratio of the group and subject to the following conditions:

- the ratio of the taxpayer's equity over its total assets is considered to be equal to the equivalent ratio of the group if the ratio of the taxpayer's equity over its total assets is lower by up to two percentage points (2%); and
- all assets and liabilities are valued using the same method as in the consolidated financial statements prepared in accordance with acceptable accounting standards;

Taxpayers may carry forward exceeding borrowing costs and unused interest capacity which cannot be deducted in the current tax period, for a maximum of five years.

Under the option provided by the Directive, Cyprus has opted to allow the interest limitation rule to apply cumulatively at the level of a Cyprus group as this is defined for group-relief purposes.



Controlled Foreign Company Rule

Under the provisions of the CFC rules as these have been transposed in the Cyprus tax legislation, income derived by subsidiaries or attributed to PEs may in certain circumstances be taxed in Cyprus, in the event of a Cyprus tax resident parent company. The formal cumulative conditions for the CFC rule to kick in are:

- (i) in the case of an entity, where the Cypriot company taxpayer itself or together with associated entities holds a direct or indirect participation of more than 50% of the voting rights, or of the capital or is entitled to receive more than 50% of the profits of such entity; and
- (ii) the corporate income tax (CIT) paid by the non-resident entity / PE is less than 50% of CIT payable if it were resident in Cyprus; and
- (iii) exceeding the minimum thresholds (non-resident entity / PE with accounting profits less than EUR 750K or with accounting profits <10% of its operating costs).

In the event that the abovementioned conditions are fulfilled, the non-distributed income of the CFC may be included in the tax base of the Cyprus parent or the Cypriot head office, if the income arises from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage.

It is clarified that non-distributed income is the income that has not been distributed within the year in question or within a period of seven(7) months after the year end.

There should be no CFC charge if there are no significant people functions in Cyprus that are instrumental in generating the income of the CFC. A Transfer Pricing Study will be required in this respect.

General Anti-Abuse Rule

The Cyprus Income Tax Law has been amended introducing the ATAD GAAR in the Cyprus tax legislation under which Cyprus shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine (i.e. are not put into place for valid commercial reasons which reflect economic reality) having regard to all relevant facts and circumstances. The GAAR will therefore target all non-genuine transactions performed in a domestic or a cross-border situation.

Let us help you

The new rules could have a significant impact on your business. For example, the new interest deduction limitations or CFC rules could become applicable to your company. We are more than happy to advise you on the consequences of the new rules.

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