

Cyprus implementation of the Anti-Tax Avoidance Directive

On 04/07/2020, the law implementing the remaining provisions of the EU Anti-Tax Avoidance Directive (ATAD EU 2016/1164) of July 2016 was published in the Official Gazette. The Law transposes the remaining ATAD measures in the Cypriot law, namely:

- Exit taxation
- Hybrid mismatches (including reverse hybrid mismatches and tax residency mismatches)

The law is entered into force with effect as of 01 January 2020 as regards exit taxation, hybrid mismatches and tax residency mismatches and 01 January 2022 as regards reverse hybrid mismatches.

Exit taxation

Scope

Under the provisions of the Cyprus Income Tax Law as amended, a Cypriot corporate taxpayer (i.e. a Cyprus tax resident company or a Cyprus permanent establishment of a non-Cyprus tax resident company) shall be subject to tax as per the provisions of the Cyprus Income Tax Law at an amount equal to the market value of the transferred assets, at the time of exit of the assets, less their value for tax purposes, in any of the following circumstances:

- A Cyprus tax resident company transfers assets from its head office in Cyprus to its permanent establishment in another Member State or in a third country in so far Cyprus no longer has the right to tax the transferred assets due to the transfer;
- The Cypriot permanent establishment of a non-tax resident company transfers assets from the Cypriot permanent establishment to its head office or another permanent establishment in another Member State or in a third country in so far Cyprus no longer has the right to tax the transferred assets due to the transfer;

(c) A Cyprus company transfers its tax residence to another Member State or to a third country, except for those assets which remain effectively connected with a Cypriot permanent establishment;

(d) The Cypriot permanent establishment of a non-tax resident company transfers the business carried on by the permanent establishment to another Member State or to a third country in so far as Cyprus no longer has the right to tax the transferred assets due to the transfer.



In the event where a company or a Permanent Establishment tax resident in another Member State transfers its assets, residency, or business to Cyprus, the starting value of the transferred items for tax purposes, shall be equal to the value accepted by the Member State unless this does not reflect the market value.

'Market value' is defined as the amount for which an asset can be exchanged, or mutual obligations can be settled between willing unrelated buyers and sellers in a direct transaction.

By way of exemption, exit taxes shall not be imposed in outbound transfers related to the financing of securities, assets posted as collateral or where the asset transfer takes place in order to meet prudential capital requirements or for the

purpose of liquidity management, in the event where such assets are set to revert to Cyprus within a period of 12 months.

Deferral of exit tax payments

In the event of intra-EU transfers (including transfers within the European Economic Area where a mutual understanding for tax recovery is in place), an option for deferral of the tax by paying it in installments over a period of five years is introduced in the Cyprus Assessment and Collection of taxes law. Such deferral is subject to interest and the provision of guarantees to leverage non-recovery risks where appropriate and may be discontinued immediately with the tax being deemed recoverable if the provisions of the income tax law are not met.

Hybrid mismatches

General Principles

Hybrid mismatches result from the discrepancies in the tax treatment, of two or more jurisdictions. Such hybrid mismatches have been considered as abusive by the European Union and are hence included in the provisions of the EU Anti-Tax Avoidance Directive to the extent where they arise:

- between associated enterprises;
- between a taxpayer and an associated enterprise;
- between a head office and its PE or two or more PEs of the same company; or
- under a structured arrangement (an arrangement involving a hybrid mismatch where the mismatch outcome is priced into the terms of the arrangement or an arrangement that has been designed to produce a hybrid mismatch outcome, unless the taxpayer or an associated enterprise could not reasonably have been expected to be aware of the hybrid mismatch and did not share in the value of the tax benefit resulting from the hybrid mismatch).

For a hybrid arrangement to be caught by the rules, a mismatch outcome needs to result, namely:

- A Deduction Without Inclusion (DWI);
- A Double Deduction (DD).

In the event where a hybrid mismatch has been identified, any deduction provided in Cyprus as a result of the hybrid mismatch shall be denied under the hybrid rules introduced whereas if Cyprus is the recipient of a payment in a

hybrid mismatch, Cyprus shall tax the payment accordingly (thus neutralising the hybridity).

Scope

Under the rules introduced, a hybrid mismatch shall be assessed on both Cyprus tax resident companies and Cypriot PEs of non-resident companies in the event of the following hybrid mismatch arrangements:

- (a) a payment under a financial instrument gives rise to a deduction without inclusion outcome and:
 - (i) such payment is not included to the income within a reasonable period of time; and
 - (ii) the mismatch outcome is attributable to differences in the characterisation of the instrument or the payment made under it.
- b) a payment to a hybrid entity gives rise to a deduction without inclusion to the income and that mismatch outcome is the result of differences in the allocation of payments made to the hybrid entity under the laws of the jurisdiction where the hybrid entity is established or registered and the jurisdiction of any person with a participation in that hybrid entity;
- (c) a payment to an entity with one or more permanent establishments gives rise to a deduction without inclusion and that mismatch outcome is the result of differences in the allocation of payments between the head office and permanent establishment or between two or more permanent establishments of the same entity under the laws of the jurisdictions where the entity operates;
- (d) a payment gives rise to a deduction without inclusion as a result of a payment to a disregarded permanent establishment;
- (e) a payment by a hybrid entity gives rise to a deduction without inclusion and that mismatch is the result of the fact that the payment is disregarded under the laws of the payee jurisdiction;
- (f) a deemed payment between the head office and permanent establishment or between two or more permanent establishments gives rise to a deduction without inclusion and that mismatch is the result of the fact that the payment is disregarded under the laws of the payee jurisdiction; or
- (g) a double deduction outcome occurs.

Application

Hybrid mismatch rules are applied with the aim to neutralise hybridity as follows:

- Double deduction

Double deduction due to hybridity is neutralized by Cyprus denying the deduction of any payment, expense or loss in Cyprus in the event Cyprus is the investor jurisdiction. If Cyprus is not the investor jurisdiction but rather is the payer jurisdiction, then the deduction is allowed but only in the case where the investor jurisdiction denied the deduction.



Nevertheless, any deduction shall be eligible for off-setting against current or future dual inclusion income whether arising in a current or subsequent tax period.

In the event of payments by a hybrid entity or permanent establishment, the payer jurisdiction is the jurisdiction where the hybrid entity or permanent establishment is established or situated.

- Deduction without inclusion

Deduction without inclusion due to hybridity is neutralized by Cyprus denying the deduction of a payment or deemed payment between a head office and a permanent establishment or between two or more permanent establishments of the same entity, if Cyprus is the payer jurisdiction. If Cyprus is the recipient jurisdiction, Cyprus will include the income in its taxable base unless an exception applies.

In adopting the ATAD provisions Cyprus has opted to adopt the available exemptions where Cyprus is the recipient jurisdiction and the deduction is not denied by the payer jurisdiction (e.g. because its source is in a third country). In this respect, Cyprus will not include in the tax computation of the recipient taxpayer the income deriving from the following payments:

- (i) A payment to a hybrid entity when the mismatch outcome is the result of differences in the allocation of payments made to the hybrid entity;
- (ii) A payment to an entity with one or more PE when the mismatch outcome is the result of differences in the allocation of payments;
- (iii) A payment to a disregarded PE;
- (iv) A deemed payment between the head office and PE or between two or more PEs when the mismatch outcome is the result of the fact that the payment is disregarded under the laws of the payee jurisdiction.

Exceptions/Disapplications

A grandfathering provision up to 31st December 2022 is available with regard to hybrid mismatches resulting from a payment of interest under a financial instrument to an associated enterprise where certain conditions are met.

As per the provisions of the implementing law, the deduction available under the Notional Interest Deduction (NID) rule does not raise hybridity issues.

Imported mismatches

Imported mismatches are also caught by hybrid rules under which the deduction for any payment shall be denied to the extent that such payment directly or indirectly funds deductible expenditure giving rise to a hybrid mismatch through a transaction between associated enterprises or entered into as part of a structured arrangement and unless one of the jurisdictions involved in the transaction has made an equivalent adjustment in respect of such hybrid mismatch.

Disregarded PE income

A disregarded PE is defined as any arrangement which is treated as giving rise to a permanent establishment under the laws of the head office jurisdiction but not under the laws of the other jurisdiction.

To the extent that a hybrid mismatch involves disregarded PE income, which is not subject to tax in Cyprus, the Cyprus taxpayer will have to include the income that would otherwise be attributed to the disregarded PE to its taxable base unless such income is exempt from tax under a double taxation treaty entered into by Cyprus with a third country.

Hybrid transfer

A hybrid transfer is defined as any arrangement to transfer a financial instrument where the underlying return on that instrument is treated for tax purposes to be derived simultaneously by more than one party in the arrangement.

To the extent a hybrid transfer is designed to produce withholding tax relief for more than one of the parties involved, then Cyprus shall limit the relief it grants to the Cyprus taxpayer in proportion to the net taxable income in Cyprus.



Tax Residency mismatches

The rules target tax residency mismatches whereby payments, expenses or losses are deductible in multiple jurisdictions due to the taxpayer being considered a tax resident of those jurisdictions. In the event where such deduction is allowed from the taxable base of the taxpayer in Cyprus and is also allowed as a deduction in the other jurisdiction(s), Cyprus will deny the deduction to the extent that the other jurisdiction(s) allows the duplicate deduction to be set off against income that is not dual inclusion income. Even so, the deduction will not be granted in Cyprus in the event where all jurisdictions concerned are EU

member states and a double tax treaty is in force between Cyprus and the Member state concerned according to which the taxpayer is not considered to be a Cyprus tax resident.

Reverse hybrid mismatches

A reverse hybrid entity is an entity that is treated as transparent in its jurisdiction of incorporation or establishment (e.g. a partnership where income is considered to flow-through to the partners) but is considered as a taxable entity under the laws of the investor's jurisdiction.

Reverse hybrid entities may give rise to deductions with no inclusions as their income may be exempt in the jurisdiction where they are established as well as in the state of the investor (since the entity is not treated as transparent and there is no flow-through approach).

To the extent where the income of a reverse hybrid entity is not otherwise taxed in Cyprus or in any other jurisdiction, the reverse hybrid entity shall, under conditions, be regarded as a Cypriot taxpayer and a Cyprus taxpayer and shall be subject to tax accordingly.

This rule shall not apply to collective investment vehicles that adhere to certain conditions.

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