



**K. TREPPIDES
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**Direct Taxation
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Adoption of EU ATAD Exit Taxation and Hybrid Mismatch Rules

We would like to inform you that the Cyprus Parliament has voted into law the following anti-tax avoidance measures under the European Union (EU) Anti-Tax Avoidance Directive (ATAD):

1. Exit taxation rules
2. Hybrid mismatch rules

The introduction of these measures completes the transposition of the EU ATAD I and II into the Cyprus tax legislation.

1. Exit Taxation

The exit taxation rules are designed to prevent tax avoidance when a taxpayer transfers assets or its tax residence out of the tax jurisdiction in which the economic value was created. Under these rules, Cyprus will be able to tax the economic value of any capital gain created in its territory even though that gain has not yet been realized at the time of exit.

Scope

Where a Cyprus Corporate Taxpayer moves assets or its tax residence outside Cyprus, the taxpayer will be subject to corporate tax on the difference between the market value of the transferred assets at the time of exit and their value for tax purposes, in any of the following circumstances:

- a. Transfer of assets from the taxpayer's Head Office (HO) in Cyprus to a permanent establishment (PE) outside Cyprus, in so far as Cyprus no longer has the right to tax the transferred assets due to the transfer;
- b. Transfer of assets from the taxpayer's PE in Cyprus to its HO or another PE outside Cyprus, in so far as Cyprus no longer has the right to tax the transferred assets due to the transfer;
- c. Transfer of the taxpayer's tax residence outside Cyprus, except for those assets which remain effectively connected with a PE which may be created in Cyprus following the change in the tax residence and for which Cyprus has the right to tax;
- d. Transfer of the taxpayer's business carried on by a Cyprus PE to another jurisdiction, in so far as Cyprus no longer has the right to tax the transferred assets due to the transfer.

Where a taxpayer transfers assets or its tax residence or the business of a PE into Cyprus from another EU Member State, the starting value of the assets for tax purposes shall be the value established by the EU Member State, unless this does not reflect the market value of the transferred assets.

In certain cases involving temporary transfer of assets which are set to return to Cyprus within a 12-month period, the above provisions shall not be applicable.

It is noted that the amount which shall be subject to corporation tax under the above-mentioned provisions, shall be calculated in accordance with the provisions of the Cyprus Income Tax Law. In this respect, any exemptions or deductions provided by the Income Tax Law (such as the exemption on transfer of qualifying titles), shall be granted on any gains arising under the above-mentioned provisions.

Under certain conditions, the taxpayer shall be given the right to defer the payment of the exit tax by paying it in installments over five years. In such case, the exit tax will be collected together with interest.

Entry into force

The exit taxation rules are applicable as from **1 January 2020**.

2. Hybrid Mismatches

The hybrid mismatch rules are designed to prevent tax avoidance by neutralizing the effects of hybrid mismatch arrangements. Such arrangements are used to exploit differences in the tax treatment of an entity or instrument under the laws of two or more jurisdictions in order to achieve “*double deduction*” (i.e. deduction in two tax jurisdictions) or “*deduction without inclusion*” (i.e. deduction of the payment in one tax jurisdiction without inclusion in the tax base in the other tax jurisdiction).

Types of hybrid mismatch arrangements

The hybrid mismatch rules address the following situations:

- a. A payment under a financial instrument that gives rise to a deduction without inclusion outcome and:
 - i. Such payment is not included in the income within a reasonable period of time, and
 - ii. The mismatch outcome is attributable to differences in the characterization of the instrument or the payment made under it.
2. A payment to a hybrid entity that gives rise to a deduction without inclusion 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 and the jurisdiction of any person with a participation in that hybrid entity.
3. A payment to an entity with one or more PEs that gives rise to a deduction without inclusion and that mismatch outcome is the result of differences in the allocation of payments between the HO and PE or between two or more PEs of the same entity under the laws of the jurisdictions where the entity operates.

4. A payment that gives rise to a deduction without inclusion as a result of a payment to a disregarded PE. A disregarded PE refers to an arrangement that is treated as a PE under the laws of the HO jurisdiction but is not treated as a PE under the laws of the other jurisdiction.
5. A payment by a hybrid entity that 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.
6. A deemed payment between the HO and PE or between two or more PEs that 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.
7. A double deduction outcome occurs.

It is noted that the above provisions apply only on mismatch outcomes arising in the following cases:

- i. Between associated enterprises
- ii. Between a taxpayer and an associated enterprise
- iii. Between the HO and PE
- iv. Between two or more PEs of the same entity
- v. Under a structured arrangement (i.e. 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).

It is further noted that the Notional Interest Deduction granted on new equity under the provisions of the Cyprus Income Tax Law, as well as other similar deductions granted by other jurisdictions, do not fall within the scope of the hybrid mismatch rules.

Double Deduction

To the extent that a hybrid mismatch results in a double deduction, the following shall apply:

- i. If Cyprus is the investor jurisdiction, the investor shall be denied the tax deduction in Cyprus.

- ii. If Cyprus is the payer jurisdiction, the tax deduction shall be denied in Cyprus if the investor jurisdiction has not denied the tax deduction.
- iii. In case where the deduction is denied in Cyprus, such deduction may be set off against any dual inclusion income arising in the current or a subsequent tax year (“dual inclusion income” refers to any income which is taxable both in Cyprus and in the other jurisdiction).

Deduction without Inclusion

To the extent that a hybrid mismatch results in a deduction without inclusion, the following shall apply:

- i. If Cyprus is the payer jurisdiction, the payer shall be denied the deduction in Cyprus.
- ii. If Cyprus is the recipient jurisdiction and the deduction is not denied in the payer jurisdiction, the amount of the payment which would create a mismatch outcome shall be included in the taxable income of the recipient in Cyprus. This provision shall not apply in cases (b), (c), (d) and (f) mentioned above in “Types of hybrid mismatch arrangements”.

Under certain conditions, hybrid mismatches arising from the payment of interest under a financial instrument to an associated entity issued with the purpose of absorbing losses, shall be excluded from these provisions until 31 December 2022.

Imported mismatch

No deduction shall be granted in Cyprus for any payment made by a Cyprus tax resident company to the extent that such payment finances either directly or indirectly a deductible expenditure giving rise to a hybrid mismatch through a transaction between associated enterprises or as part of a structured arrangement, unless one of the jurisdictions involved has made an equivalent adjustment regarding the hybrid mismatch.

Disregarded PE

To the extent that a hybrid mismatch involves income of an overseas PE which is disregarded in the other jurisdiction, the Cyprus HO must include in its taxable profits the income of the disregarded PE, unless the income from the PE is exempt from tax in Cyprus

under a double tax treaty concluded between Cyprus and a third country.

Hybrid transfer

Where a hybrid transfer (i.e. an arrangement to transfer a financial instrument where the underlying return of the financial instrument is treated as deriving simultaneously by more than one of the parties in the arrangement) has been designed with the purpose of producing a withholding tax relief on a payment derived from a transferred financial instrument to more than one of the parties involved, Cyprus shall limit the benefit of such relief in proportion to the net taxable income regarding such payment.

Reverse hybrid entities

A reverse hybrid entity is an entity which is considered as a transparent entity in the jurisdiction where it is established while the jurisdiction of the investor treats the entity as a taxable entity / non-transparent.

Under the new provisions, where one or more associated non-Cyprus entities holding in aggregate a direct or indirect interest of 50% or more in a Cyprus hybrid entity, are located in a jurisdiction or jurisdictions that regard the Cyprus hybrid entity as a taxable / non-transparent person, the hybrid entity shall be regarded as a tax resident of Cyprus and shall be taxed on its income to the extent that that income is not otherwise taxed under the laws of Cyprus or any other jurisdiction.

These provisions do not apply to collective investment vehicles set up under the Open-Ended Undertakings for Collective Investment Law and the Alternative Investment Funds Law.

Tax residence mismatches

To the extent that a taxpayer is resident for tax purposes in two or more jurisdictions and this leads to a deduction of a payment, expenses or losses from the tax base of the taxpayer in both jurisdictions, Cyprus shall deny the deduction to the extent that the other jurisdiction allows the duplicate deduction to be set off against income that is not dual-inclusion income.

If the other jurisdiction is an EU Member State and according to the double taxation treaty between Cyprus and that other Member State the company is not deemed to be a Cyprus tax resident, the deduction shall be denied.

Entry into force

The hybrid mismatch rules are applicable as from **1 January 2020**.

The reverse hybrid mismatch rules are applicable as from **1 January 2022**



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