



**K. TREPPIDES  
& CO LTD**

**Direct Taxation**

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***Transfer Pricing – Cyprus Tax Authorities are increasing the thresholds of Local File requirements***

We would like to inform you that the Tax Commissioner, on 1 February 2024, confirms via a letter to interested parties, the intention to increase the threshold per category of transaction which will be subject to Local File documentation requirements.

Particularly, the Tax Commissioner expressed the consensus among the interested parties, in an attempt to provide legal certainty, that the thresholds will change (subject to the relevant amendments to the ITL<sup>1</sup>).

The new thresholds will be increased from €750.000 to €5.000.000 for the financing transactions category, and to €1.000.000 per category for all other categories of

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<sup>1</sup> (“Income Tax Law N.118(I)/2022” or the “ITL”)

transactions. The proposed changes should apply retrospectively from 1 January 2022.

## Local File Requirements and Simplification Measures

As the ITL currently stands taxpayers in Cyprus are required to maintain a Local File for their transactions with connected parties, on the basis that these transactions exceed the threshold, as determined based on the arm's length principle, of €750.000 per tax year and per category of transaction.<sup>2</sup>

To streamline the compliance process, the Tax Department has also issued a Circular (2023/06) clarifying the treatment of transactions per category that do not exceed the documentation threshold. The Circular is effective from 1 January 2022 and includes, inter alia, the following based on each specific case:

Category	Simplification Measure <sup>3</sup>
Loans or Advances (of a financing nature <sup>4</sup> ) Funded by Debt	A minimum return (i.e. interest spread) equal to 2.5% before taxes, based on the outstanding balance <sup>5</sup> of financial aid provided (which is directly financed by debt).
Loans or Advances (of a financing nature) Funded by Equity	A minimum return equal to the yield of the 10-year government bond of the jurisdiction that the funds were invested, plus a rate of 3.5% before taxes, based on the outstanding balance of financial aid provided (which is directly financed by equity).
Provision of Financing from Connected Parties	In case the interest expense is treated as tax deductible under the provisions of the ITL, the taxpayer would be allowed to deduct an interest equal to the

<sup>2</sup> The categories are separated in 5 groups, namely; Financial transactions, Goods, Services, Intangible assets and any other transaction not falling under the previous groups.

<sup>3</sup> Irrespective of category, and whether a simplification return is explicitly mentioned, a minimum documentation requirement still applies, i.e. Brief functional analysis, functional characterization of the entity and justifications for the most appropriate TP method (where the simplification price is not determined directly in the Circular).

<sup>4</sup> Including receivables (i.e. trade receivables) accurately delineated as of a financing nature, irrespective of their contractual form.

<sup>5</sup> Including accrued interest which remains outstanding.

	yield of the 10-year government bond of Cyprus increased by 1.5% before taxes.
Any Other Category (Apart from Low-Value Added Services, subject to the 5% mark-up)	Comparability Search Study based on OECD TPG

## Implications for Taxpayers

Taxpayers should carefully consider the implications arising from the new threshold requirements. Businesses are advised to carefully assess the advantages and disadvantages of implementing the simplification measures versus maintaining a Local File.

The following points should serve as a guide to aid in this decision-making process:

- **DAC6 (MDR) Reporting Requirement**

Utilizing simplification measures is classified as a reportable (cross-border) arrangement under Hallmark E1. Therefore, taxpayers opting for these measures must ensure compliance with their reporting obligations.

- **Cost Arising from the Application of Simplification Measures**

While simplification measures offer convenience, they might result in higher tax expenses compared to maintaining a Local File, especially if the arm's length remuneration under a Local File may yield lower tax expenses.

We recommend reviewing these updates closely and assessing their impact on your business operations and transfer pricing strategies.

For any further information and/or clarifications required please do not hesitate to contact us.



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