



**K. TREPPIDES
& CO LTD**

Direct Taxation

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Transfer Pricing Simplification Measures

We would like to inform you that the Cyprus Tax Department has issued a Circular on the transfer pricing documentation requirements and simplification measures for transactions which are exempted from the obligation of being documented in a Cyprus Transfer Pricing ("TP") Local File.

The Circular is applicable for transactions with related parties ("controlled transactions") which cumulatively per category (i.e., goods, services, IP related, financial transactions, other), do not exceed, or would not have exceeded under the arm's length principle, the amount of €750,000 in a tax year, and are therefore exempted from the obligation of a TP Local File.

A. Minimum Transfer Pricing Documentation Requirements

The minimum TP documentation requirements for taxpayers that are exempted from the obligation to maintain a TP Local File are the following, irrespective of the category of the transaction:

1. Brief description of the functional analysis (functions performed, assets used, risks assumed),
2. Description of the characterization of the entity, based on the results of the functional analysis,
3. The reasons that the chosen transfer pricing method is considered the most appropriate,
4. Determination of the arm's length price(s) based on the comparability search results, using internal or external comparables (as applicable for each case), or any other relevant analysis which is in line with the recommendations of the Organization for Economic Co-operation and Development Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD TP Guidelines").

B. Simplification Measures for certain subcategories of controlled transactions

Taxpayers can choose to apply simplification measures for transactions that fall within the following subcategories:

- a) Provision of financing to related parties financed out of financial means.
- b) Provision of financing to related parties financed out of own equity.
- c) Funding obtained from related parties to the extent that the funds are used in the business of the taxpayer.
- d) Low Value Adding Services.

To be able to use any simplification measure, it is a requirement that the sum of the controlled transactions in the selected sub-category and of the remaining controlled transactions of the same main category, to not exceed, or to not have exceeded under the arm's length principle, the amount of €750,000 in a tax year.

It is noted that taxpayers cannot use any simplification measure if there is an obligation to maintain a TP Local File for the category in which the subcategory belongs.

In addition, taxpayers cannot use the simplification measures in a subcategory if there are reliable internal comparables which can be used to determine the arm's length price(s).

(a) Provision of financing to related parties financed out of financial means

This subcategory refers to the provision of loans or cash advances to related companies or related persons which carry interest (or should have carried interest), and which are financed out of financial means, such as bonds, loans from related companies or related persons, including interest-free loans from the shareholders, cash advances and bank loans.

Taxpayers shall be deemed to comply with the arm's length principle if they receive, in relation to the controlled transactions, **a minimum return of 2.5% before taxes.**

The 2.5% minimum return is calculated on the average value of the loans receivable (outstanding principal balance and unpaid accrued interest) during the tax year under review, to the extent that the loans are financed out of financial means.

(b) Provision of financing to related parties financed out of own equity

This subcategory refers to the provision of loans or cash advances to related companies or related persons which carry interest (or should have carried interest), and which are financed out of the company's own equity i.e., equity introduced in the company through issue of share capital, or issue of shares at premium, to the extent that these are paid, non-reciprocal capital contributions, or retained earnings.

Taxpayers shall be deemed to comply with the arm's length principle if they receive, in relation to the controlled transactions, **a minimum return equal to the 10-year government bond rate of the country in which the borrower operates as at 31/12 of the preceding tax year, increased by 3.5% before taxes.** In case the government bond rate is negative, the minimum return should be 3.5% before taxes.

The minimum return is calculated on the average value of the loans receivable (outstanding principal balance and unpaid accrued interest) during the tax year under review, to the extent that the loans are financed out of own equity.

(c) Funding obtained from related parties to the extent that the funds are used in the business of the taxpayer

This subcategory refers to the receipt of loans, bonds or cash advances from related companies or from related persons which carry interest, to the extent that the funds received are used in the taxable business activities of the taxpayer, and the interest expense on the loans is claimed as a tax deduction by the taxpayer.

Such transactions will be deemed to comply with the arm's length principle **if the cost of borrowing, in relation to the controlled transactions, does not exceed**

the 10-year government bond rate of Cyprus as at 31/12 of the preceding tax year, increased by 1.5% before taxes. In case the government bond rate is negative, the maximum interest rate should be 1.5% before taxes.

The above interest rate is applied on the average value of the loans payable (outstanding principal balance and unpaid accrued interest) during the tax year under review, to the extent that the loans are used in the taxable business activities of the taxpayer.

(d) Low-value adding services

This subcategory refers to the provision and receipt of low-value adding services. As per the OECD TP Guidelines, low-value adding services are intra-group services which:

- Are of a supportive nature,
- Are not part of the core business of the group (i.e., not creating the profit-earning activities or contributing to economically significant activities of the group),
- Do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles, and
- Do not involve the assumption or control of substantial or significant risk by the service provider and do not give rise to the creation of significant risk for the service provider.

Such transactions will be deemed to comply with the arm's length principle if there is a **minimum profit mark-up of 5% on the relevant costs.** In the case of receipt

of low-value adding services, the **profit mark-up on the relevant costs should not exceed 5%.**

Minimum documentation to be maintained per subcategory

The following table details the minimum documentation that should be maintained for each subcategory of simplification measures:

Subcategory	Minimum documentation
Financing subcategories (a) – (c)	<ol style="list-style-type: none"> 1. Brief description of the functional analysis (functions performed, assets used, risks assumed). 2. Description of the characterization of the entity, based on the results of the functional analysis. 3. Detailed description of the loans (agreement dates, amounts, balance at the end of the year, maturities, guarantees, interest rates, amendments to the loan terms etc). 4. The reasons justifying that the loans fall within the selected subcategory of simplification measures. 5. Financial analyses, reconciliations and explanations on the use of the simplification measure for the calculation of the taxable income of the taxpayer.
Low-value adding services (d)	<ol style="list-style-type: none"> 1. Description of the categories of the low-value adding services provided.

	<ol style="list-style-type: none"> 2. Identity of the beneficiaries. 3. The reasons justifying that each category of services qualifies as a low-value adding service. 4. Description of the selected allocation keys. 5. Calculations supporting the determination of the cost pool and of the applicable mark-up. 6. Calculations showing the application of the selected allocation keys. 7. Financial analyses, reconciliations and explanations on the use of the simplification measure for the calculation of the taxable income of the taxpayer.
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C. Reporting obligations and DAC6 reporting

Taxpayers who elect to use the simplification measures should declare their election in the relevant part of their income tax return / summary information table for controlled transactions, by the deadline for the submission of the income tax return for the relevant tax year.

The minimum TP documentation should be submitted to the Cyprus Tax Department upon request, within 60 days from the receipt of such request.

It is noted that if the accounting profit from the controlled transactions is higher than the profit resulting from a TP Study or a simplification measure, the Cyprus Tax Department will not make a downward adjustment to reduce the taxable profit of the taxpayer.

The use of the simplification measures by taxpayers who perform cross border transactions, should be subject to DAC6 reporting under hallmark E1, with the exception of taxpayers who choose to apply the simplification measures for low-value adding services in full compliance with the methodology and documentation requirements of the OECD TP Guidelines.

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



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