



Cyprus implements the European Union (EU) Anti-Tax Avoidance Directive (ATAD)

On the 5th of April 2019, the Cyprus Parliament adopted the law for the implementation of the provisions of the EU ATAD. The provisions of this law are effective from 1 January 2019 and refer to the following areas:

- Controlled Foreign Company (CFC)
- Limitation of interest deductibility (LoID)
- General anti-abuse rule (GAAR)

The above provisions of the law impact Cyprus tax resident companies and permanent establishments (PE) of non-Cyprus tax resident companies.

The remaining measures of the ATAD are expected to be implemented during 2019 and should be effective as from 1 January 2020. These measures relate to:

- Exit taxation provisions and
- Anti - hybrid rules – However, certain reverse hybrid mismatch rules should be applicable from 1 January 2022).

In addition to the above, the Cyprus Tax Department (CTD) is due to issue interpretative tax circulars for the practical application of the CFC rules and LoID provisions of the law.

The above mentioned provisions of the law that are effective as from 1 January 2019 are summarized below:

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1. Limitation of interest deductibility (LoID)

1.1. Scope

Subject to the options provided by the ATAD, Cyprus has excluded from the scope of application of this provision *standalone entities* and *financial undertakings*. The term '*standalone companies*' mostly corresponds to companies that on a worldwide basis are not members of a group, have no associates and no PEs. As for the '*financial undertakings*', these broadly cover regulated financial undertakings such as banks, insurance entities, investment funds, pension funds etc.

Where the company is a member of a *Cyprus group*, the LoID is applicable at the level of such a group, with the latter following the 75% relationship condition as per the relevant provisions of the Cyprus income tax legislation.

1.2. How LoID works

The LoID rule provides that the *excess borrowing cost* (EBC) which exceeds 30% of taxable income before interest, taxes, deductions and amortization (EBITDA), is not deductible for the purposes of calculating the taxable income of a company.

However, this rule contains a threshold of €3m whereby the EBC is basically deductible up to the amount of €3m per tax year, per Cyprus tax resident company or Cypriot group, depending on the specific case at hand. So, EBC up to €3m is not subject to the LoID. In the case of a Cyprus group, the €3m applies for the aggregate EBCs of the Cyprus Group, and not per taxpayer.

The *taxable EBITDA* is determined by adding back to the taxable profit of the year, the EBCs, depreciation, amortisation and deductions in relation to tangible and/or intangible fixed assets. The 80% deemed deduction on qualifying intellectual property (IP) profits as per the Cyprus IP tax regime is added back to the taxable profit for the purposes of determining the taxable EBITDA.

As for *EBCs*, these are defined as the amount of tax deductible borrowing costs in excess of the amount of taxable interest income / other taxable income economically equivalent to interest.

The term '*borrowing costs*' covers interest expenses on all forms of debt, other costs economically equivalent to interest expenses as well as expenses incurred in connection with the raising of finance i.e. payments under profit participating loans, financing related hedging costs and guarantee fees. As for the Cyprus Notional Interest Deduction (NID) granted on new equity (applicable as from 1 January 2015), this is not considered as '*borrowing costs*' for the purposes of this rule.

Finally, LoID applies to EBCs irrespective of whether the financing is with related or third parties.

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1.3. Exclusions from the LoID

As mentioned above, the LoID does not apply to *standalone entities* and *financial undertakings*. Other specific exclusions from LoID are the following:

- Loans used to fund long-term public infrastructure projects where the project operator, borrowing costs, assets and income are all located in the EU,
- Loans concluded before 17 June 2016, with the exclusion not applying to any subsequent modification of such loans,
- A group equity escape, which is based on the level of equity of the Cyprus tax resident company / Cyprus group, as compared to the level of equity within the Cyprus tax resident company's / Cyprus group's consolidated group for financial reporting purposes (on a world-wide basis). In cases where the ratio of *equity / total assets* is higher at the level of the Cyprus tax resident company / Cyprus group, or at the most lower by 2% of the group ratio i.e. consolidated group for financial reporting purposes, the LoID does not apply for that tax year.

1.4. Carry forward of EBC

EBCs which are not deductible in a tax year due to the application of LoID, can be carried forward and be deducted from the taxable income of the company for the next 5 years. This is in line with Cyprus' five year income tax loss carry forward rule.

Also, any unused interest capacity i.e. the excess of 30% of taxable EBITDA over EBC within a tax year, which cannot be deducted in the current tax year can be c/f for use for the next 5 years. It is further clarified that for the calculation of the unused interest capacity, the €3m threshold is not taken into consideration.

1.5. Reorganizations

In the case of a reorganization, any accumulated EBC and unused interest capacity will be transferred to the 'surviving' / transferee company in accordance with the relevant provisions of the Cyprus tax legislation regarding the reorganization of companies.

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2. Controlled Foreign Companies (CFC) Rule

2.1. Scope

As per the CFC rule, a non-Cyprus tax resident company, or a foreign PE of a Cyprus tax resident company whose profits are not subject to or are exempt from corporation tax in Cyprus, shall be treated as a CFC, subject to the below criteria being met:

- a Cyprus tax resident company, alone or together with its associated enterprises, holds a direct or indirect participation of more than 50% (of the voting rights or of capital, or is entitled to receive more than 50% of the profits) in a non-Cyprus tax resident company, and
- the actual corporate tax paid by the non-Cyprus tax resident company or the foreign PE is lower than 50% of the tax that would have been imposed on that company/PE, had it been taxable in Cyprus.

2.2. The CFC income calculation

As per the options provided in the ATAD for CFC purposes, Cyprus has adopted option B which is applicable to *income arising from non-genuine arrangements* / *significant people functions* approach.

When a non-Cyprus tax resident company / foreign PE meets the above CFC criteria, the non-distributed income of such a CFC (which is derived from *non-genuine arrangements* that have been put in place for the purpose of obtaining a tax advantage and which are controlled by the controlling Cyprus tax resident company) is added to the taxable income of the Cyprus tax resident company.

An arrangement will be regarded as '*non-genuine*' to the extent that the CFC would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it were not controlled by the Cyprus tax resident company where the significant people functions, which are relevant to those assets and risks, are carried out and substantially contribute in the generation of the CFC's income.

The '*non-distributed income*' of the CFC is considered to be its accounting profit after tax, which has not been distributed to the controlling Cyprus tax resident company during the tax year in which the profit is derived, or within the next 7 months from the end of the tax period.

The attribution of profits of a CFC and the inclusion into the taxable profit of the Cyprus tax resident company is made in accordance with the arm's-length principle as this is defined in the Cyprus Income Tax Law and is limited to the amount of the non-distributed income of the CFC. Here, it should be noted that:

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- The amount of non-distributed income to be included in the taxable profit of the Cyprus tax resident company is calculated by applying the relevant provisions of the Cyprus tax legislations / framework and
- The CFC income or loss to be included in the taxable profit of the Cyprus tax resident company is calculated based on the percentage of the profits that the Cyprus tax resident company is entitled to receive from the CFC.

2.3. Exceptions from the CFC rule

The CFC rule is not applicable to non-Cyprus tax resident companies or exempt foreign PEs which have either:

- ✓ accounting profit of no more than €750.000 & non-trading income of no more than €75.000, or
- ✓ accounting profits of no more than 10% of their operating costs for the tax period (operating costs do not include the cost of goods sold outside the country where the non-Cyprus tax resident company / exempt foreign PE, is tax resident and payments to associated enterprises).

2.4. Avoidance of double taxation

Provisions for the avoidance of double taxation have been included in the CFC rules and especially on income previously included in the taxable profit of the Cyprus tax resident company under the CFC rule, which is subsequently distributed or realised through a disposal of investment.

Any foreign tax paid on the income of the CFC / PE, can be credited against the corporation tax payable in Cyprus, if such income is included in the taxable profit of the Cyprus controlling company.

3. General anti-abuse rule (GAAR)

The GAAR aims to ignore arrangements which have 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, and which are not genuine having regard to all relevant facts and circumstances.

Non-genuine arrangements are arrangements which are not put into place for valid commercial reasons that reflect economic reality.

Key message

The adoption of ATAD shows clearly the country's commitment to comply with EU's tax directions and the international tax environment in general.

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