

Intra-Group Financing Transactions (“IGFTs”)

November 2017



Introduction

On 30/06/2017, following their initial announcement the Cyprus Tax Authorities published the new rules in relation to the tax treatment of IGFTs based on the arm's length principle to follow the guidelines of the Organization for Economic Co-operation and Development. These rules will be effective from 01/07/2017 and apply to existing and future IGFTs.

Old Legislation

Until 30/06/2017 the current pre-agreed minimum profit margins of 0.125% to 0.35% on qualifying intra-group back to back financing arrangements should be applied.

New Legislation

As per the new rules, IGFTs are defined as all activities of granting loans or advances to related entities remunerated by interest such as private loans, cash advances, bank loans and debentures. Two entities are deemed related if they fall under the scope of Section 33 of the Income Tax Law.

Application of the arm's length principle to IGFTs

The rules require that all IGFTs are in compliance with the arm's length principle and as such it is necessary to prepare a comparability analysis showing an accurate description of the arrangement and a comparison of its conditions and circumstances with comparable arrangements between independent entities.

Description of the arrangement

- Substance over form - What matters is the economic reality of the arrangement and the actual conduct of the parties prevails over any written contractual terms
- Functional analysis - Identify the economically substantial activities, responsibilities and functions, the assets used or provided in the context of the arrangement
- Risk analysis - Capacity to assume, manage and assume risks if they materialize (see below paragraph)

Risk analysis

A group financing company must determine if it has the sufficient equity level to assume the risk and it is considered to control the risk if it meets the following three criteria:

- It has the decision-making power to enter into a risk-bearing opportunity
- It has the capacity to address such risks
- It actually performs such decision-making functions.

To demonstrate that an entity controls and manages the risk and to validate that the management and control are exercised in Cyprus, the financing company must have an actual presence in Cyprus.

Actual presence is not officially defined, but the following actual presence criteria are provided in the new rule:

- The majority of board directors should be Cyprus tax residents
- The majority of board directors meetings must be held in Cyprus and the main management and commercial decisions must be made in Cyprus
- The majority of the shareholders meetings must be held in Cyprus
- The financing company must have qualified personnel controlling and managing the financial arrangements
- The financing company must prove substance of its active business in Cyprus with running offices and personnel

Comparable arrangements

Comparable arrangements that are observed in the open market must be identified to assess the arm's length remuneration. The identification process must be transparent, systematic and verifiable.

Minimum Requirements

The minimum requirements of such an analysis should include:

- A description of the computation of equity allocation required to assume risks
- A description of the group and the inter-linkages between the functions performed by the entities
- The precise scope of the transactions analysed
- A complete list of the potentially comparable transactions searched
- A rejection matrix for the aforementioned transactions (with rejection justification)
- The final list of comparable transactions selected
- A general description of the market conditions
- A list of all previous transfer pricing agreements concluded with other countries in relation to the transactions
- A list of all previous agreements concluded and being still valid with the entity or entities under analysis
- Projected income statements for the years covered by the request

Such analysis must be submitted by a licensed auditor who is required to carry out an assurance control confirming its quality.



Simplified plan

A simplified plan may be followed, at the option of the taxpayer, for which no analysis is required.

A financing company which meets the substance requirements mentioned above and pursues a purely intermediary financing activity to related parties will be deemed to comply with the arm's length principle if at least a 2% return after-tax on assets is received. This percentage will be regularly reviewed by the tax authorities.

Any entities that opt for the simplified plan are required to disclose this on their annual tax return.

Action needed

GTH Audit can assist clients to assess the impact of the new legislation on their existing or future financial arrangements and prepare and submit the relevant ruling or analysis to the tax authorities if it is required.

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