
Cyprus' public consultation on the EU's Anti-tax avoidance Directives (ATAD1 & ATAD2)

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Public consultation

The Cyprus tax authority (CTA) opened on 14 November 2017 a public consultation on Cyprus' transposition into national law of the two EU Directives on anti-tax avoidance (ATAD1 & ATAD2). The public consultation invites comments from interested parties until 8 December 2017.

The CTA has published, in the Greek language, the wording of an initial draft bill (the Consultation Document) and seeks comments and suggestions in order to assist in the finalisation of the bill.

Based on ATAD1&2 all EU Member States must implement minimum standard measures for corporate taxpayers in respect of: (i) interest expenses, (ii) exit taxation, (iii) controlled foreign companies (CFCs), (iv) hybrid mismatches, and (v) a general anti-abuse rule (GAAR).

Within the minimum standards there are choices that EU Member States need to make based on the available options contained in the ATADs. The Consultation Document reflects Cyprus' initial draft choices, but as this is Cyprus' first step in implementing the ATADs we note that any formal legislative proposal may deviate substantially from the draft in the Consultation Document. We anticipate that final legislative proposals and voting by the Cyprus Parliament will take place mid-2018.

Expected effective dates

The Consultation Document reflects effective dates for the proposals that are not earlier than what is required by the ATADs; these effective dates are:

- Interest limitation rule, CFC rule, GAAR rule – 1 January 2019
- Exit taxation provisions – 1 January 2020
- Hybrid mismatch rules – 1 January 2020 (exception: certain reverse hybrid mismatch provisions - 1 January 2022)

Consultation Document in a nutshell

As we note above, the Consultation Document reflects certain initial draft choices of Cyprus as regards ATAD1&2, but any formal legislative proposal may deviate substantially from the draft proposals which are explained below:

Interest limitation rule

According to this rule, interest costs that would otherwise be deductible under the Cyprus income tax law are only deductible up until 30 percent of adjusted Cyprus taxable profit (i.e. taxable earnings before interest, tax, depreciation and amortisation - taxable EBITDA). This rule applies to the amount of exceeding deductible interest costs i.e. the amount by which deductible interest costs exceed the amount of taxable interest income. Where a company is a member of a Cyprus group the

above applies at the level of the Cyprus group, otherwise it applies per company. The Cyprus group for this rule has a 75 percent relationship condition and is referred to below as “the Cyprus taxpayer”.

Standalone companies (i.e. that on a worldwide basis are not members of a group/have no associates/no permanent establishments) and financial institutions are excluded from the interest limitation rule. Also excluded from this rule are loans entered into before 17 June 2016, but not any subsequent amendments thereto. Additionally the financing of certain public infrastructure projects and their associated income are excluded.

The interest limitation rule contains a 3 million euro safe-harbour threshold. Furthermore, there is group ratio exception, which is based on the available equity at the level of the Cyprus taxpayer as compared to the available equity within the Cyprus taxpayer’s consolidated group for financial reporting purposes (on a world-wide basis). If the ratio of “equity/total assets” is higher at the level of the Cyprus taxpayer (or even up to 2% lower) as compared to its consolidated group (on a world-wide basis), the interest limitation rule, in effect, does not apply.

The Consultation Document also contains a carry forward rule so that non-deductible excessive interest costs may be carried forward to other years for up to 5 years, which is in line with Cyprus’ 5 year income tax loss carry forward rule.

Proposed measures regarding CFCs

The ATAD provides EU Member States with two different approaches with respect to measures to combat structures with CFCs. CFCs are low taxed (<50% of the domestic tax) foreign companies, directly or indirectly controlled by an EU MS resident company. In the first approach (Model A), passive income (such as interest, royalties and dividend income) of a CFC is to be included as current income in the taxable base of a domestic company and taxed in accordance with domestic rules, unless the CFC is an EU/EEA resident involved in substantial economic activities. The second approach (Model B) is based on the so-called arm’s-length principle. This approach combats structures where income of a domestic company is allocated artificially to a CFC.

The Consultation Document follows a Model A approach. We expect that Model B will also be explored during the consultation process.

Rules regarding exit taxation

The Consultation Document provides for exit taxation in cases where an asset leaves the taxing jurisdiction of Cyprus but remains under the same ownership (e.g. when a company transfers a taxable asset from its Cyprus head-office to an exempt foreign permanent establishment). We expect that this rule will be limited in its scope and apply only to those assets that are otherwise taxable to Cyprus income tax, although this is not clearly provided for in the Consultation Document.

GAAR

The Consultation Document includes the ATAD GAAR which will allow the CTA to ignore non-genuine arrangements where (one of) the main purpose(s) is to obtain a tax advantage that defeats the object or purpose of the tax provision. Arrangements are regarded as non-genuine to the extent they are not put into place for valid commercial reasons which reflect economic reality. We expect this rule to apply only to ‘wholly artificial arrangements’ as set out in the EU tax framework.

Hybrid mismatch rules

The hybrid mismatch rules will capture many cases of cross-border double non-taxation where hybrid mismatches (i.e. differences in the characterization of an instrument, payment, permanent establishment or entity by different taxing jurisdictions) are involved.

Let's talk

For a deeper discussion of how this development might affect you or your business, please contact:

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