

Cyprus ratifies the Base Erosion and Profit Shifting Multilateral Instrument

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In brief

The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the 'MLI') is a global instrument for updating bilateral double tax treaties (DTTs) for the DTT related outcomes of the OECD/G20 Base Erosion and Profit Shifting (BEPS) project.

Cyprus deposited with the OECD its instrument of ratification of the MLI on 23 January 2020. The date of "entry into effect" as regards Cyprus' application of the MLI for any particular bilateral DTT covered by the MLI depends upon various possible legal processes/options by the other contracting party jurisdiction but such date cannot be earlier than 1 January 2021 for the purposes of Cyprus' corporate income tax (CIT), personal income tax (PIT) and Special Contribution for Defence (SDC); exceptionally an application for a Mutual Agreement Procedure (MAP) as revised under the MLI may be possible for tax periods earlier than 1 January 2021, and possibly as from 1 November 2020 for Cyprus Capital Gains Tax (CGT).

The main impact of the MLI for Cyprus' DTTs covered by the MLI is the "Principal Purpose Test" (PPT). The PPT provides that a bilateral DTT benefit shall not be granted, if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the bilateral DTT. This measure is designed to tackle "treaty shopping" and puts a strong emphasis on ensuring that operations are supported by appropriate substance and reflect a principal commercial rationale.

In detail

Background to the MLI

The October 2015 OECD/G20 Action 15 Report “Developing a Multilateral Instrument to Modify Bilateral Tax Treaties” concluded that a multilateral instrument to enable countries to swiftly modify their bilateral DTTs in line with the BEPS project outcomes was desirable and feasible. An Ad hoc Group of over 100 interested jurisdictions was established to develop the MLI, the text of which was agreed in November 2016. Jurisdictions have been able to sign up to the MLI since 1 January 2017, with a first high-level signing ceremony taking place on 7 June 2017 in Paris (where Cyprus signed the MLI). To date over 90 jurisdictions have signed the MLI with additional jurisdictions having expressed their intention to sign.

The MLI modifies the bilateral DTTs that it covers with a series of BEPS-related provisions. A bilateral DTT is modified by the MLI if both parties to the bilateral DTT are signatories to the MLI and if both choose to list the bilateral DTT as a “covered DTT” under the MLI.

Cyprus ratification of the MLI

Following signature jurisdictions should each complete their own domestic process to ratify/accept/approve the MLI. Cyprus’ MLI instrument of ratification was deposited with the OECD on 23 January 2020, following which the date of “entry into force” of the MLI for Cyprus is 1 May 2020.

The date of “entry into effect” as regards Cyprus’ application of the MLI for any particular “covered DTT” cannot be earlier than 1 January 2021 for the purposes of Cyprus’ corporate income tax (CIT), personal income tax (PIT) and Special Contribution for Defence (SDC); exceptionally an application for a Mutual Agreement Procedure (MAP) as revised under the MLI may be possible for tax periods earlier than 1 January 2021, and possibly as from 1 November 2020 for Cyprus Capital Gains Tax (CGT). The date of “entry into effect” as regards the other contracting party jurisdiction’s application of the MLI depends upon various possible legal processes/options for that other contracting party jurisdiction, for example as regards India’s taxes we understand that the date of “entry into effect” of the MLI for India’s application of the Cyprus – India DTT is as from 1 April 2021.

Cyprus MLI position

A jurisdiction has various choices to make under the MLI, in addition to choosing which of its bilateral DTTs it wishes to be a “covered DTT” there are choices regarding which of the MLI’s various provisions to opt in to or opt out from, in whole or in part. Nevertheless, certain minimum standards of the BEPS project reflected in the MLI are generally obligatory and not optional. The actual impact of the MLI on any particular “covered DTT” typically depends upon both contracting party jurisdictions to the bilateral DTT making ‘matching’ decisions under the MLI, although there are limited instances where the MLI allows jurisdictions to make asymmetrical choices.

Upon ratification Cyprus deposited with the OECD a 25-page list of notifications and reservations which constitutes Cyprus’ “MLI Position”. The main points to highlight from Cyprus’ “MLI Position” are:

- Cyprus has listed the vast majority of its bilateral DTTs as being a “covered DTT” under the MLI, excluding recent bilateral DTTs in cases where such bilateral DTT already reflects the BEPS project. As noted above, a bilateral DTT is only modified by the MLI if both contracting party jurisdictions to the bilateral DTT choose to list it as a “covered DTT” under the MLI. For example, while Cyprus has listed its bilateral DTT with the United States (US) in its MLI Position, that DTT will not be a “covered DTT” unless the US subsequently signs the MLI and lists the Cyprus-US DTT as a “covered DTT”.
- As regards the minimum standards under the BEPS Action 6 Report “Preventing the Granting of Treaty Benefits in Inappropriate Circumstances”, Cyprus adopted the PPT. The PPT provides that a bilateral DTT benefit shall not be granted, if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the bilateral DTT. This measure is designed to tackle “treaty

shopping” and puts a strong emphasis on ensuring that operations are supported by appropriate substance and reflect a principal commercial rationale. Cyprus has not opted for the restrictive provisions of the Simplified Limitation on Benefits (SLOB) and, thus, a SLOB will not apply to Cyprus “covered DTT” (even in cases where the other jurisdiction to the bilateral DTT has opted for the SLOB).

- Concerning the minimum standards under the BEPS Action 14 Report “Making Dispute Resolution Mechanisms More Effective” Cyprus follows the improved procedures as set out in the MLI.
- Cyprus has made full reservations (opt-outs) as regards the following articles of the MLI such that the following articles of the MLI will not apply to “covered DTTs” due to Cyprus’ full reservation, even in cases where the other contracting party jurisdiction to the bilateral DTT has opted for them:

Article 3 – Transparent entities

Article 4 – Dual resident entities

Article 5 – Application of methods for elimination of double taxation

Article 8 – Dividend transfer transactions

Article 9 – Capital gains from the alienation of shares/interests of entities deriving their value principally from immovable property

Article 10 – Anti-abuse rule for permanent establishments (PE) situated in third jurisdictions

Article 11 – Application of tax agreements to restrict a party’s right to tax its own residents

Articles 12-15 – PE related provisions

Articles 18-26 – Arbitration

The takeaway

The ratification of the MLI by Cyprus is a step towards Cyprus’ network of bilateral DTTs being modified by the provisions of the MLI in cases where the bilateral DTT is a “covered DTT”. This step illustrates Cyprus’ commitment towards implementing the recommendations of the OECD/G20 BEPS Project on tackling “treaty shopping”.

For Cyprus’ “covered DTTs” the main impact of the MLI is the introduction of the PPT which may operate to deny bilateral DTT benefits (such as a reduced withholding tax (WHT) rate on payments to Cyprus), under conditions. The PPT puts a strong emphasis on ensuring that operations are supported by appropriate substance and reflect a principal commercial rationale in order to support a bilateral DTT benefit claim. Taxpayers should assess the MLI’s impact and consider whether changes to group structures, locations of people or transactional flows would be advisable.

Let's talk

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