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# Transfer pricing developments in Cyprus - new documentation obligations

## In brief

On 30<sup>th</sup> June 2022, the Cyprus Parliament approved the long awaited amendments to the Cyprus Income Tax Law and new Regulations to introduce Transfer Pricing (“TP”) documentation compliance obligations (Master File, Cyprus Local File, Summary Table) for Cyprus tax resident persons and permanent establishments of non Cyprus tax resident persons situated in Cyprus, that engage in transactions with related parties (“Controlled Transactions”). A formal Advance Pricing Agreement (“APA”) procedure has also been introduced. Specific penalties for non compliance with the new obligations are now in place by an amendment to the Assessment and Collection of Taxes Law. The law amendments and Regulations are effective from the tax year 2022 onwards.

## In detail

### Amendments to the Income Tax Law

The Income Tax Law amendment clarifies that the arm’s length principle (as per Article 33 of the Law) may be applied and interpreted in accordance with the TP Guidelines issued by the OECD (as amended from time to time).

In addition, the Income Tax Law amendment introduces new TP documentation compliance obligations and a formal procedure for obtaining an APA (details of which are provided in the relevant Regulations). These new requirements are described below in more detail.

The Income Tax Law has also been amended to update the definition of related parties and introduce a minimum 25% relationship threshold relevant for companies.

In summary, two companies are considered as related if the same person (and its related persons) or group(s) of persons (under certain conditions) directly or indirectly:

- hold 25% of the voting rights or share capital of both companies, or
- have the right to at least 25% of both companies' income.

A company is also considered related to a person (and its related persons) that directly or indirectly:

- hold 25% of its voting rights or share capital, or
- have the right to at least 25% of its income.

Two or more persons are considered related if they act together (or take directions) to directly or indirectly:

- hold 25% of the voting rights or share capital, or
- have the right to at least 25% of the profit of a company.

## **TP Documentation compliance obligations and APA procedure**

### **The new TP Documentation File obligation**

As from the tax year 2022 onwards, Cyprus tax resident persons and permanent establishments of non Cyprus tax resident persons situated in Cyprus that engage in domestic and/or cross-border Controlled Transactions, subject to exemptions mentioned below, are required to prepare on an annual basis a TP Documentation File, which consists of the "Master File" and the "Cyprus Local File".

The Cyprus Tax Department ("CTD") is issuing a relevant Notification to announce (amongst others) the required detailed contents of the Master File and Cyprus Local File.

**Contents:** The required contents of the Master File and Cyprus Local File closely follow the definition and suggested contents of Master File and Local File as per the OECD TP Guidelines and BEPS Action 13 Report.

**Exemptions:** The following exemptions shall apply:

- **Master File:** Only Cyprus tax resident entities that are the ultimate parent or surrogate parent entity of an MNE group falling under the scope of Country by Country reporting have an obligation to prepare and maintain a Master File. All other persons are exempt from this obligation.
- **Local File:** Persons that engage in Controlled Transactions with arm's length value less than EUR 750,000 p.a. in aggregate per transaction category (e.g. sale/purchase of goods, provision/receipt of services, financing transactions, receipt/payment of IP licencing/royalties, others) are exempt from the obligation to prepare a Cyprus Local File.

**Quality Review:** A person who holds a Practicing Certificate from the Institute of Certified Public Accountants of Cyprus (ICPAC) or another approved by the Council of Ministers body of certified auditors in Cyprus is expected to perform a Quality Review of the Cyprus Local File.

**Format and Language:** The TP Documentation File should be maintained by the taxpayer in electronic or paper format and may be prepared in a generally acceptable language, preferably in English, however, the CTD may request its translation in Greek if necessary.

**Relevant Deadlines:** The TP Documentation File must be prepared and be subject to Quality Review (to the extent applicable as mentioned above) on an annual basis, by the deadline of filing the Income Tax Return for the relevant tax year.

The TP Documentation File needs to be retained in compliance with the general document retention obligations for tax purposes, however it should be submitted to the CTD upon request by the CTD (e.g. for the purpose of tax audit) and specifically within 60 days from the notification of such request. Penalties shall be imposed for late or non filing of the TP Documentation File (as described below).

**TP Documentation File updates:** The TP Documentation File must be updated on an annual basis and include details regarding the impact of market fluctuations or other events on the information and analyses included therein.

### The Summary Table disclosure requirement

A Summary Table must be prepared by all taxpayers that engage in Controlled Transactions on an annual basis, disclosing details regarding such transactions, including the names and tax identification codes of the related counterparties, and the respective values per transaction category (sale/purchase of goods, provision/receipt of services, financing transactions, receipt/payment of IP licences/royalties, others).

The Summary Table must be submitted electronically together with the Income Tax return for the relevant tax year.

### Administrative Penalties

As per the amendment to the Assessment and Collection of Taxes Law, the following new administrative penalties are introduced:

- In the case of late submission of the TP Documentation File following the notification by the CTD to the tax payer of a request for submission, the following penalties will apply:

EUR 5,000	If the TP Documentation File is filed after the 60th day but before the 91st day from the notification of the submission request
EUR 10,000	If the TP Documentation File is filed after the 90th day but before the 121st day from the notification of the submission request
EUR 20,000	If the TP Documentation File is filed after the 120th day from the notification of the submission request

- In the case of non submission of the TP Documentation File following the notification by the CTD of a request for submission, a penalty of EUR 20,000 will apply.
- In the case of non submission of the Summary Table a penalty of EUR 500 will apply.

## Advance Pricing Agreement (“APA”) procedure

Cyprus tax resident persons and non Cyprus tax resident persons that have a permanent establishment situated in Cyprus may submit to the CTD an APA Request with respect to current or future domestic or cross border Controlled Transactions. The detailed framework of the APA procedure and other relevant matters are described in the new Regulations that have been issued and are summarised below.

The APA request may cover the various conditions and assumptions relevant for determining the arm’s length pricing of the Controlled Transactions for a specified period, including:

- the critical assumptions on the functional and risk profile of the parties involved,
- the relevant market conditions,
- the applicable TP method to be followed,
- the identified uncontrolled comparable transactions and any necessary adjustments made to determine the arm’s length price range,
- any other specialised matter relating to the pricing of the Controlled Transactions.

The CTD examines the APA request and approves or rejects it.

**Relevant timelines:** The CTD should issue the APA decision within 10 months (the CTD may notify extension of this deadline up to 24 months) from the date of submission of the APA request by the taxpayer.

The APA decision may be applicable for a maximum term of four years, however, it can not apply for any tax year prior to the tax year in which the request is submitted.

**Bilateral and Multilateral APAs:** The APA request for cross border Controlled Transactions may be bilateral or multilateral, involving the tax authorities in other jurisdiction(s) with which Cyprus has concluded a Double Tax Treaty. In such cases, a corresponding request needs to be filed by the taxpayer with the authorities in the other jurisdiction(s) and the CTD may consult in writing with such authorities under the relevant mutual agreement and exchange of information procedures and applicable EU legal framework, for the purpose of issuing the APA decision.

**Validity of APA decision:** The prices of the Controlled Transactions covered by an APA decision will be considered as arm’s length, provided that any conditions included in the APA decision are met, and that the critical assumptions on which the APA was based continue to be valid and applicable.

An approved APA decision is considered **binding**, however, it can be **revised** during its agreed term upon request of the taxpayer or at the discretion of the CTA, only if:

- the critical assumptions on which the APA decision was based are proven incorrect; or
- the conditions or critical assumptions on which the APA decision was based have substantially changed so that it is impossible to apply the APA decision; or
- if an arbitration process is followed for transactions covered by the APA decision, under an effective Double Tax Treaty or the EU Arbitration Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises.

Revised APA decisions issued by the CTD shall apply for the remaining of the term of the original APA decision.

The CTD may **revoke** an APA during its term (in which case the APA is considered as not issued) if it is established that:

- the critical assumptions on which the APA was based were incorrect due to misinterpretation of fault attributed to the taxpayer; or
- the taxpayer has failed to comply with one or more of the key terms and conditions included in the APA.

An APA may be cancelled by the CTD at any time during its term if it is established that:

- there is a significant change to the critical assumptions and conditions on which the APA was based; or
- the taxpayer has failed to comply with key terms of or obligations described in the APA; or
- there is a substantial change in the applicable tax provisions which significantly affect the APA.

An APA cannot be **cancelled** if it may be revised. However when cancelled, the APA ceases to be in effect from the relevant date specified in the cancellation decision issued by the CTD.

## The takeaway

The updating of the Income Tax Law on TP matters and the introduction, from tax year 2022 onwards, of wider TP documentation obligations and a formal APA process, will have an impact on most of the (local or multinational) groups and companies having presence in Cyprus that engage in transactions with related parties.

Businesses therefore, need to act proactively so as to understand the impact of the new rules on their operations and invoicing flows and clearly identify the TP related implications and risks to which they may be exposed, so as to take any necessary steps for mitigating risks and ensuring compliance with the new requirements in the most efficient and effective way.

We will be happy to assist in navigating through the changes, determining how they apply to you and what steps you need to take to ensure compliance.

## Let's Talk

For a deeper discussion of how this issue might affect your business, please contact:

Nicos P Chimarides  
Partner  
Tax & Legal Services Leader  
[nicos.chimarides@pwc.com](mailto:nicos.chimarides@pwc.com)

Christos Charalambides  
Partner  
Head of Direct Tax  
[christos.charalambides@pwc.com](mailto:christos.charalambides@pwc.com)

Eftychios G Eftychiou  
Partner  
Head of Tax Technical Committee  
[eftychios.eftychiou@pwc.com](mailto:eftychios.eftychiou@pwc.com)

Ioanna Stylianidou  
Director  
Head of Transfer Pricing  
[ioanna.stylianidou@pwc.com](mailto:ioanna.stylianidou@pwc.com)

Or your usual PwC contact

**PwC Cyprus**  
PwC Central  
43 Demostheni Severi Avenue  
CY-1080 Nicosia, Cyprus  
P O Box 21612  
CY-1591 Nicosia, Cyprus

[www.pwc.com.cy](http://www.pwc.com.cy)

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