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TAX UPDATE

CHANGES IN TAX LAWS
EU ANTI TAX AVOIDANCE DIRECTIVE

The Cyprus House of Representatives voted into law on 5 April 2019 amendments to the Income Tax Law implementing the EU Anti Tax Avoidance Directive (ATAD).

The anti-tax avoidance measures provided by the Directive are the following:

- Interest limitation: to discourage artificial debt arrangements designed to minimise taxes
- Controlled Foreign Company (CFC) rule: to deter profit shifting to lower or no tax jurisdictions
- General Anti-Abuse rule: to counteract aggressive tax planning when other rules don't apply
- Exit Taxation: to prevent companies from avoiding tax when re-locating assets
- Hybrid Mismatches: to prevent companies from exploiting national mismatches to avoid taxation

The provisions of the law introduce the Interest Limitation, CFC rule, and General Anti-Abuse Rule and will apply for years starting on or after 1 January 2019.

The remaining two changes for implementing the full requirements of the ATAD are expected to be introduced and become effective after 2020.

Interest Limitation Rule

Restriction of exceeding borrowing costs so not to exceed 30% of taxable income before interest, tax, depreciation and amortisation of assets (EBITDA).

Exceeding borrowing costs are the excess of borrowing costs over the interest income and other economically equivalent tax revenues. Borrowing costs include interest expenses on all forms of debt, other costs economically equivalent to interest, and expenses incurred in relation to raising finance.

The restriction does not apply to the following:

- Amounts below €3 million per taxpayer per year
- Standalone companies, i.e. companies not forming part of a group and which do not have a related business (participation of at least 25% in the share capital or the profits)
- Financial undertakings
- Loans used to fund long-term EU public infrastructure projects
- Loans concluded before 17 June 2016. The grandfathering provision will not apply to subsequent modifications of such loans.

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Controlled Foreign Company (CFC)

A CFC is an entity or permanent establishment (PE) whose income is not taxable or exempt in Cyprus if the following conditions are met:

- The Cyprus tax resident company holds a direct or indirect participation of more than 50% of the voting rights or is entitled to receive more than 50% of the profits, by itself or in combination with its associates, in the non-Cyprus tax resident entity, and
- The actual corporate tax paid on the profits of the Entity or the PE is lower than 50% of the tax that would be paid in Cyprus

The undistributed income of a CFC which results from non-genuine arrangements which 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 is regarded as non-genuine to the extent that the entity 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 a Company where the significant peoples functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled company's income.

Non distributed income is 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 and the next 7 months from the end of the tax period.

The CFC rule is not applied where the entity or the foreign PE have:

- Accounting profits of no more than €750,000 and non-trading income of no more than €75,000
- Accounting profits of no more than 10% of its operating costs for the tax year

General Anti-Abuse Rule

In the calculation of corporate income tax liability, the Cyprus Tax Department shall ignore an arrangement or series of arrangements which were put in place for the main purpose of obtaining a tax advantage.

Such arrangements are considered as non-genuine to the extent that they were not put in place for valid commercial reasons that reflect economic reality.