

# International Tax Alert

Cyprus

## Introduction of Advance Pricing Agreements in Cyprus: minimum acceptable net interest profit margins on back-to-back group financing activities

On 4 July 2011 the Income Tax Office in Cyprus ('*ITO*') has confirmed in a letter to the Institute of Certified Accountants of Cyprus ('*ICPAC*') that when a Cypriot tax resident company obtains and grants loans to related parties under certain circumstances the following interest profit margins will be accepted for the purpose of the application of the provisions of Section 33 of the Income Tax Law (i.e. at arm's length principle).

### 1. Interest-bearing loans

Amount of the loan receivable	Minimum acceptable net interest profit margin
EUR	%
<50 mio	0.35
50-200 mio	0.25
>200 mio	0.125

### 2. Interest free loans

The minimum net interest profit margin that the *ITO* is prepared to accept, irrespective of the amount of the interest free loan, is 0.35% of the principal amount of the loan receivable.

### 3. Conditions

The ITO is prepared to accept the above margins under the following conditions:

- ▶ the ultimate shareholder of the Cypriot tax resident company is not a Cypriot tax resident;
- ▶ the financing arrangements are back-to-back, i.e. a Cyprus tax resident company receives from a related company a specific amount through a loan and using the amount of the relevant loan, provides loans to another related company;
- ▶ the time period between the date on which the company receives a loan and the date on which it provides a loan does not exceed 6 months;
- ▶ the above margins are net of all directly related expenses;
- ▶ foreign exchange differences arising from such loans, whether realized or not, do not constitute tax allowable expenses in case of a loss and are not taxable in case of a profit.

### 4. Circumstances

In addition, the above margins will apply under the following circumstances:

- ▶ when a company receives a loan and uses the relevant amount received to provide more than one loan or in case a company receives more than one loan and provides only one loan;
- ▶ when a company borrows from a third person (e.g. bank) and lends to a related company, provided the bank has relevant guarantees from other related companies;
- ▶ in case where part of the loan provided has been financed out of equity, these provisions apply only for the amount of the loan being financed with the loan received;
- ▶ when instead of a loan other debt instruments are used (in this case, the advanced approval of the Cypriot tax authorities is required for the application of the above interest margins).

### 5. Advance Pricing Agreements

Since the above explained correspondence between the ICPAC and the ITO is of a general nature it is strongly recommended (and required in case of non-loan financing arrangements) in each specific case to confirm the application of the above mentioned margins with the ITO in advance and in writing via a so-called Advance Pricing Agreement ('APA').

Ernst & Young Cyprus can assist with preparation, filing and negotiation of such APA if required.

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