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Global Tax Alert

Cyprus Tax Authorities announce withdrawal of Minimum Margin scheme effective 1 July 2017

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Executive summary

The Cypriot Tax Authorities (CTA) have announced their intention of withdrawing the Minimum Margin scheme (the MMS) with effect 1 July 2017.

The MMS refers to intra-group financing arrangements falling within the ambit of the policy for obtaining and granting of loans from and to related parties as per the correspondence dated 4 July 2011 between the Tax Committee of the Institute of Certified Public Accountants (ICPAC) of Cyprus and The Commissioner of Tax of Cyprus.

Detailed discussion

Current legislative framework and practice

The arm's length principle (ALP) was codified in the Cyprus tax law in 2003 following Article 9 of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention. As such, all transactions entered into with related and/or connected parties should be concluded on an arm's length basis. However, Cyprus tax laws do not include any specific transfer pricing rules or transfer pricing documentation requirements.

Building a better working world

The MMS was introduced in 2011 in an attempt to provide guidance as to the minimum margins (spreads) that the CTA are willing to accept for intra-group financing arrangements (back-to-back loans). In accordance with the provisions of the MMS, the CTA accept that when a Cypriot tax resident company is engaged in group financing transactions, certain net financing margins (ranging from 0.125% to 0.35% per annum) should be considered as an appropriate minimum contribution to the taxable profit of the Cypriot financing company for the purpose of applying the ALP codified in the law.

Drivers for the abolition of the MMS

In the letter sent by the CTA informing the Tax Committee of the ICPAC of their intention to withdraw the MMS, it is made clear that the withdrawal of the MMS was the result of the international tax developments (OECD/G20 Base Erosion and Profit Shifting (BEPS) initiative) as well as the meticulous review of the MMS in the context both of the Code of Conduct for business taxation as well as from an European Union State aid perspective. Further, the CTA take the view that the spread on intra-group (back-to-back) financing arrangements should be supported by a transfer pricing study which needs to be based on the OECD transfer pricing guidelines.

Practical implications

As indicated above, the intention of the CTA is to withdraw the MMS with effect as from 1 July 2017. At the same time, the CTA plan to introduce detailed transfer pricing legislation (at least for intra-group financing activities) based on the OECD transfer pricing guidelines.

If the MMS is withdrawn during the 2017 tax year, it means that taxpayers will have to calculate the taxable margin based on two different set of rules.

It is certain that a very large number of taxpayers will be affected by these changes. It is therefore recommended that taxpayers undertake a review of their existing financing arrangements and structures in order to assess the impact of the changes and timely take corrective actions in an attempt to ensure their conformity with the new framework.

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