Response to EU Anti-tax Avoidance Directive

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Introduction

On 5 April 2019 the House of Representatives approved legislation implementing the EU Anti-tax Avoidance Directive (2016/1164/EC) in Cyprus with the aim of improving the resilience of the internal market against cross-border tax avoidance practices.

The provisions relating to interest deductibility, controlled foreign company (CFC) rules and the general anti-abuse rules (GAARs) came into effect on 1 January 2019, while the provisions relating to exit taxation and countering hybrid mismatches are expected to be introduced after 2020.

Interest deductibility

Rules on interest deductibility aim at limiting the possibility of deducting interest which is now set at 30% of taxable income before interest, taxes, depreciation and amortisation (EBITDA). Taxable EBITDA is defined as the total of net taxable income calculated in accordance with Cypriot income tax laws increased by the exceeding borrowing costs. However, the 30% restriction does not apply for amounts below €3 million per taxpayer and does not apply to companies that do not form part of the group and which have no related business (ie, a participation of at least 25% in the share capital or at least 25% of profits). The law also excludes financial undertakings from the scope of the interest limitation rules (ie, credit institutions, investment firms, alternative investment fund managers and management companies of undertakings for collective investment in transferable securities).

CFC rules

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

- In the case of a non-Cypriot tax resident entity, the Cypriot tax resident company alone or together with its associated enterprises holds a direct or indirect participation of more than 50% in such an entity.
- The company or PE is low taxed (ie, the income tax that it pays is lower than 50% of the Cypriot corporate income tax that it would have paid under income tax law).

Cyprus has opted for Model B, since it gives the possibility to 'carve out' CFCs via the thresholds provided by the EU Anti-tax Avoidance Directive. Carving out would apply to entities that have accounting profits of:

- less than €750,000 and non-trading income of less than €75,000; or
- more than 10% of operating costs.

GAARs

Transactions which are not carried out for valid commercial reasons will give rise to tax liability, which will be calculated in accordance with income tax law. Cyprus already incorporates within its tax legislation numerous anti-abuse rules. It is expected that relevant articles within the legislation will be amended and enhanced to provide greater and specific powers to the Inland Revenue director to disregard non-genuine arrangements which have no valid commercial reason that reflect economic reality. The GAAR will apply only to corporate transactions. The updated Organisation for Economic Cooperation and Development (OECD) Model Tax Treaty also contains specific references to anti-abuse measures and implications (the new Article 29 provides for 'principal purpose' and 'limitation of benefits').

Exit taxation

The draft legislation issued by the Inland Revenue has no exit tax provisions. However, the deadline imposed for implementation (1 January 2020) will need to be met. Cyprus is expected to adhere to the EU Anti-tax Avoidance Directive. As exit taxes affect taxable assets and bearing in mind that certain assets are specifically exempt from the imposition of any Cypriot tax (ie, titles), the imposition of exit taxes should not create material consequences.

Hybrid mismatches

Draft legislation issued by the Tax Department is in line with the EU Anti-tax Avoidance Directive and is expected to be implemented by 1 January 2020. At present, the only part of Cyprus tax law aimed at hybrid mismatches addresses dividend and income funds – whereby a dividend received by a Cyprus tax resident entity is subject to corporate tax where the dividend has been claimed as a tax-deductible expense at the level of the payer.

Comment

With the new legislation to fully implement the EU Anti-tax Avoidance Directive into national law, the government has again demonstrated its commitment to supporting international efforts to tackle tax avoidance practices. Cyprus's legislation is not only fully aligned with EU measures tackling aggressive tax planning, but also with the OECD's initiatives to combat tax avoidance following the Base Erosion and Profit Shifting (BEPS) initiative implemented in 2015 and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS effective from July 2018. These changes are significant and necessitate careful review of all corporate structures to ensure that they remain compliant with the latest developments.

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