EU AntiTax Avoidance Directive (ATAD)

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The Cyprus Parliament voted on 5 April 2019 the first implementation law in Cyprus of the EU AntiTax Avoidance Directive (ATAD) and specifically on the following areas:

- Controlled Foreign Company (CFC) rule – effective date *01 January 2019*
- (Net) Interest limitation rule – effective date *01 January 2019*
- General Anti-Abuse rule (GAAR) – effective date *01 January 2019*
- Exit taxation provisions – effective date *01 January 2020*
- Hybrid mismatch rules – effective date *01 January 2020* (exception: certain reverse hybrid mismatch provisions - 01 January 2022)

The first ATAD implementation law will enter into force once it is published in the Cyprus Government Gazette with an effective date as from 1 January 2019.

The ATAD implementation law impacts only Cyprus corporate income tax taxpayers (Cyprus CIT taxpayers) and more precisely:

- Cyprus Tax Resident Companies, and
- Cyprus Permanent Establishments (PEs) of non-Cyprus tax resident companies

Controlled Foreign Company (CFC) Rule

The relevant CFC article in the ATAD allows Member States to choose between two options.

The first option is generally applicable to passive income of a CFC (*Option A*) while the second option is applicable to income arising from “non-genuine arrangements” (*Option B*), also referred to as the significant people functions approach. Cyprus adopted Option B.

The CFC rules apply to both Cypriot tax resident companies and non-Cypriot tax resident companies which have a permanent establishment (PE) in Cyprus.

Definition

The definition of a CFC follows the wording of the ATAD. As per the Law, a non-Cypriot tax resident company or a foreign PE of a Cypriot tax resident company whose profits are not subject to or exempt from (Corporate) Income Tax in Cyprus, shall be treated as a CFC if the following conditions are met:

a) A Cypriot tax resident company, alone or together with its associated enterprises, holds a direct or indirect participation of more than 50% in a non-Cypriot tax resident company. The threshold is determined in terms of participation in the share capital, voting rights or the entitlement to profits of the foreign company.

b) The actual tax suffered by the non-Cypriot tax resident company or the foreign PE is lower than 50%.of the tax that would have been imposed on that company or foreign PE had its profits been taxable in Cyprus.

It may be relevant to note the following:

- The definition of associated enterprises is generally based on a 25% direct or indirect participation (same definition as the one added for the purpose of applying the new interest limitation rules, see section below).
- The computation of the hypothetical Cypriot tax is made in accordance with the provisions of the Cypriot Income Tax Law.

➡ **Income to be included (CFC inclusion)**

*The **non-distributed income*** of a CFC which is derived from ***non-genuine arrangements*** that 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.

Non–genuine to the extent that the CFC would not own the assets which generate all or part of its income or would not have undertaken the risks, if it were not controlled by a taxpayer who carries out the significant people functions which are relevant to those assets and risks, and are instrumental in generating the CFC's income.

Non-distributed income is considered the 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, as well as the next 7 months from the end of the tax period.

➡ **It may be relevant to note the following**:

i) The amount of non-distributed income to be included in the tax base of the Cypriot controlling entity is computed by applying the general tax framework and provisions of the Income Tax Law.

ii) The CFC amount (whether or income or loss) which is to be included in the tax base of a Cypriot controlling entity is calculated based on the percentage of the profits that the Cypriot entity is entitled to receive from a CFC.

An exemption from the CFC rules apply where:

- The CFC's accounting profits do not exceed EURO 750,000, and non-trading income does not exceed EURO 75,000; or
- The CFC's accounting profits do not exceed 10% of operating costs for the tax period.

(Net) Interest limitation rule

The new provisions are expected to deny a deduction in respect of net interest expense (being gross interest expense less interest income) that exceeds 30% of the taxpayer's EBITDA (profit adjusted for tax purposes before interest, tax, depreciation and amortization) or €3 million, whichever is higher.

The limit is expected to be applied at the company level unless the company is a member of a group for Cyprus tax purposes, in which case the rule will be applied at the level of the Cyprus group.

➡ **Excluded from the scope of application of this rule:**

1. ***Standalone companies*** i.e. companies that on a worldwide basis are not members of a group/have no associates/no PEs, (i.e. a taxpayer that is not part of a group for financial reporting purposes and has no investments in associated companies (minimum 25% participation)) and

2. ***Financial institutions*** undertakings which broadly correspond to regulated financial undertakings such as banks, insurance entities, investment funds, pension funds and securitisation vehicles. (i.e credit institutions, insurance / reinsurance companies, occupational retirement pension funds, EU social security pension schemes, Investment Firms, AIFs and AIFMs, UCITs funds and UCITs management companies, OTC derivative counterparties – "CCPs", central securities depositories-"CSDs", and securitisation special purpose entities-"SSPEs").

3. **Financial arrangements** entered into before 17 June 2016 and not subsequently amended.

The draft law is expected to include a group equity carve-out provision that permits taxpayers to deduct net interest exceeding the 30% threshold if the taxpayer's equity to total assets ratio is higher than (or at least no more than 2% lower than) the equity to total assets ratio of the worldwide group.

The interest costs to be restricted may be carried forward for up to five years.

General Anti-Abuse Rule (GAAR)

The new provisions will allow the Commissioner of Taxation to disregard artificial arrangements whose main purposes include obtaining a tax advantage that defeats the object or purpose of the tax laws.

The Cyprus tax legislation and more specifically the Assessment and Collection of Taxes Law already contains a GAAR and therefore the

amending provisions are not expected to have significant implications on Cypriot taxpayers

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Exit Taxation

The draft provisions regarding exit taxation provide for taxpayers to be liable to tax being equal to the difference between the market value and the value for tax purposes of assets to be transferred outside the net of the Cyprus tax legislation while remaining under the same ownership

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