

Transfer pricing –Circular 6/2023

On 6 July 2023, the Cyprus Tax Department released a new Circular (6/2023) titled “*Simplification measures for persons that are exempt from the obligation to maintain a Cyprus Local File*” (i.e. have controlled transactions of less than EUR 750,000 in aggregate per category on an annual basis).

The Circular provides guidance with regards to the minimum transfer pricing documentation which is required to be maintained to support the arm’s length nature of their transactions with related parties (*controlled transactions*).

In addition, the Circular introduces optional *simplification measures* that can be used by such persons for *certain controlled transactions*.

Minimum transfer pricing documentation requirements

The Circular clarifies that persons who are exempt from the obligation to prepare a Cyprus Local File should maintain **minimum documentation** for their controlled transactions:

- **Brief functional analysis** (functions performed, assets used, risks undertaken);
- **Characterisation of the entity** based on the results of the functional analysis;
- Selection of the most appropriate **transfer pricing method** with regard to the transaction category and the reasons for selecting that method;
- **Benchmarking study** based on the internal or external comparability search results.

Simplification measures

Persons exempt from the obligation to prepare a Cyprus Local File may choose to apply the simplification measures for the following types of controlled transactions:

- **Back-to-back financing**, i.e., financing provided to related parties that is financed out of debt;
- **Financing** received or provided (not falling in the above category);
- **Low value-adding services**.

Important remarks

1. Simplification Measures **can only be applied** for the respective categories of transactions that **do not exceed** the threshold of EUR 750,000 in aggregate per category on an annual basis.
2. Simplification Measures **cannot be applied** if reliable **internal comparable transactions** can be used to determine the arm’s length level of prices for such controlled transactions.
3. The required documentation (“Simplified Local file”) must be provided to the tax authorities **within 60 days upon request**.
4. The taxpayer must disclose the use of one or more simplification measures by including this information in the **taxpayer's Income Tax Return/Summary Information Table** form by the return's submission deadline.

Simplification rates

The applicable simplification rates as stated in the Circular, are the following:

- A minimum **pre-tax net return of 2.5%** on the average outstanding receivable balances for **back-to-back financing** arrangements.
- A pre-tax interest rate equal to at least the **ten-year government bond yield rate** of the jurisdiction in which each borrower operates **increased by 3.5%** for **financing provided** by a Cypriot tax resident person to a related party.
- A pre-tax interest rate equal to or less than the **ten-year government bond yield rate** of the Republic of Cyprus **increased by 1.5%** for **financing received** by a Cypriot tax resident person from a related party.
- For low value-adding services, a **markup on costs of at least 5%** for services being **provided**, and a **maximum of 5%** for services being **received** by a Cypriot company.

Persons who elected to apply the simplification measures should also maintain supporting documentation as stated in the Circular.

DAC6 consideration

As stated in the Circular, the application of simplification measures by a person who carries out cross-border controlled transactions constitutes such transactions **as reportable cross-border arrangements** in accordance with Article 2 (1) and Annex IV, Part II, Label E.1 of the Administrative Cooperation in the Field of Taxation Law of 2012 (205(I)/2012), as amended, and according to the provisions of Regulation 42(2) of Κ.Δ.Π. 438/2021 (referred to as DAC6 provisions).