Council of the European Union

Brussels, 2 June 2023
(OR. en)

9875/23
ADD 4

LIMITE

FISC 103
ECOFIN 501

REPORT

From:	General Secretariat of the Council
To:	Delegations
Subject:	Code of Conduct Group (Business Taxation) - Report to the Council

Cyprus - 2013 Guidance intermediate companies - use of safe-harbour rule [2019 CoCG decision]

I. Background

1. We recall that in 2017 Cyprus published a Circular[1] which, amongst other TP issues, also provided for a simplification measure, the so called safe-harbour rule. It applied in the case of a purely intermediary entity providing financing (i.e. where an entity provides loans to a related entity and these loans are funded by loans received from other related entities). The Circular allowed that the intermediary financing entity may receive a minimum return of 2% net profit on assets[2]. The use of the simplification measure was to be notified by the entity to the tax authority in its tax return[3].

2. In 2019 during the Monitoring of the Guidance on intermediate companies, the Cypriot authorities had confirmed that spontaneous exchange of information takes place when the taxpayer makes use of the safe harbour rule.

3. Further clarification has been asked whether exchange of information is provided also in instances where a taxpayer uses the safe harbour in his commercial accounts and then applies, based on a transfer pricing analysis, a downward adjustment in the tax return in order to achieve an arm's length remuneration. The Cypriot authorities explained that the decision of a company to make use of the simplification measures in a tax year is declared in the tax

[1] Circular dated 30 June 2017 with title "Tax treatment of intra group back-to-back financing transactions"
[2] This percentage is regularly reviewed by the Tax Department based on relevant market analyses.
[3] The taxpayer is not allowed to derogate from the minimum percentage, unless this is properly justified in transfer pricing analysis.

return[4] of the respective tax year and it is not communicated to the Tax Department at any point in time before[5]. Therefore, if a company, at the time of the submission of its tax return has made use of the simplification measures, it will tick the relevant box, and such information will be exchanged spontaneously; otherwise, in case it has applied a different return based on a transfer pricing study, the relevant box will not be ticked and no exchange of information will take place." As the relevant spontaneous exchange of information takes place when the taxpayers makes use of the safe-harbour, the measure was considered to be compliant with the Guidance. However, as for the Luxembourg measure, the Group decided to further monitor the use of the safe-harbour rule and its actual effects.

II. Preliminary remarks regarding the data provided

4. In the context of the 2022 *Annual monitoring exercise of the actual effects of certain measures*, Cyprus was invited to submit the relevant data for tax years 2019 and 2020. Following the initial request and subsequent clarifications, Cyprus provided incomplete data (see Annex 7).

5. The **data provided for 2019** shows that **1.205 companies** performing intra-group financing have used the safe harbour. Such data was compiled from the tax returns field by the relevant taxpayers. This represents **6% of the total number** of companies having performed intra-group financing activities in 2019 in Cyprus. On the other hand, there is no information on the actual loan amounts involved and covered by the safe harbour.

<u>Regarding the exchange of information on the use of safe-harbour (*Question 5 - first indent*)</u>

6. Based on the data communicated by Cyprus, automatic exchange of information in application of the DAC 6, hallmark E1 took place. Based on the Directive, 31 reports were sent. That would mean that out of the 1.205 companies having used the safe-harbour, only 31 transactions took place with related parties in the EU. The overwhelming majority of such transactions has taken place with non-EU related parties.

<u>Regarding the exchange of information on the use of safe-harbour combined with a downward adjustment (*Question 5 - second indent*)</u>

7. Cyprus did not provide any information whether companies after having applied the safe harbour provisions made a subsequent downward adjustment, as this could not be extracted from the records. As a result, no spontaneous exchange of information took place.

8. For **tax year 2020,** the data covering first three questions was not provided. Only the number of reports done under DAC 6, hallmark E1 was provided: these reports have increased from 31 in 2019 to 53 in 2020.

[4] It is noted that following the issuance of the circular "Tax treatment of intra-group back-to-back financing arrangements" the company's tax return was amended so as to incorporate a tick box, in which the taxpayer specifies whether it has made use of the simplification measures.
[5] Except in the case that the Company has applied for a tax ruling.

9. Finally, Cyprus informed that **the safe harbour**[6] is **no longer applicable as of 1 January 2022**[7]. Accordingly, as of 1 January 2022, the intra-group «back-to-back» financing transactions must be performed at arm's length pricing and conditions. Furthermore, subject to conditions, there may be an obligation to prepare a transfer pricing documentation file to document the said transactions, like all other related party transactions which fall under the provisions of the relevant legislation.

III. Conclusions

10. The Commissions services take note of the abolition of the simplification measure as of 1 January 2022.

11. Based on the information received, the Commission services cannot draw any meaningful conclusions regarding the actual use of the safe harbour rule in tax years 2019 and 2020, given the partial lack of data, especially as regards the actual loan amounts involved and covered by the safe harbour.

12. It is the Commission services' view that the monitoring should continue so that Cyprus is given the opportunity to provide the complete data for 2019, 2020 and 2021. As the measure has been abolished as of 1 January 2022, the monitoring can be discontinued, once Cyprus has provided such data.

IV. Follow-up

i. The COCG agreed that the monitoring should continue for the years 2019, 2020 and 2021.

ii. The Group agreed that the monitoring should be discontinued once such data is provided.

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[6] The recognition of the net profit margin of 2% based on the provisions of interpretative circular 3 mentioned above.
[7] https://www.mof.gov.cy/mof/tax/taxdep.nsf/All/C23F42DD0F0316E3C2258952003343ED?OpenDocument
On 5 January 2023, the Tax Department issued circular 1/2023, which states that interpretive circular 3 (dated 30 June 2017) and circular 5 (dated 2 January 2019) will not be applicable as of 1 January 2022. Hence, the last date of their application was 31 December 2021.

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	Cyprus	**2019**	**2020**
1	Overall number of companies performing Intra-Group financing	19.940 (as per the tax returns submitted)	The info is not available
2	Number of companies having used the safe harbour provisions (2% net return)	1.205 (as per the tax returns submitted)	The info is not available
3	The total values of the financial assets of the companies having used the safe harbour	The total values according to the tax returns is available, but the value of assets for which the safe harbour rule was applied cannot be retrieved.	The info is not available
4	Number of companies having applied the safe harbour provisions (2% net return) and afterwards made a downward adjustment	The info is not available, as it cannot be extracted from the records.	The info is not available
5	Overall number of information exchanges sent *-regarding the use of safe harbour :* *-regarding use of safe harbour and downward adjustment:*	There is only automatic exchange of information done through DAC 6 directive, hallmark E1: 31 reports. There is no "spontaneous exchange of information".	There is only automatic exchange of information done through DAC 6 directive, hallmark E1: 53 reports. There is no "spontaneous exchange of information".
6	The name of the MSs to which the relevant information was sent	DAC 6 directive, hallmark E1: The name of the MSs to which the relevant information was sent: CZ, DE, DK, EE, FR, GB, LV, MT, NL, PL, PT, RO, SK.	DAC 6 directive, hallmark E1: The name of the MSs to which the relevant information was sent: AT, BG, CZ, DE, DK, EE, ES, GB, IT, LU, LV, MT, NL, PL, PT, RO