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Cyprus's Response to the EU Commission's Action Plan for Fair and Efficient Corporate Taxation in the EU

In June 2015 the EU Commission published its Action Plan for Fair and Efficient Corporate Taxation in the EU, aimed at combating what the Commission regards as abusive tax avoidance and over-aggressive tax planning, and promoting “growth, competitiveness and fairness”. In the view of the Commission, actions by individual Member States have been ineffective in combating tax avoidance and a concerted EU initiative is necessary.

Principal Features of the Action Plan

The Action Plan comprises five main strands. The first of these is the re-launch of the Common Consolidated Corporate Tax Base (“CCCTB”) initiative. When first put forward by the Commission in 2011, the initiative envisaged the development of a uniform basis for calculating taxable profits which would apply throughout the EU. Companies trading internationally in the EU could adopt this so-called common tax base to calculate a consolidated profit for the EU. The consolidated profit would then be apportioned between the member states in which it was earned, by reference to a prescribed formula and taxed at national tax rates. The proposal failed to secure the political support of the EU Council of heads of government, and was temporarily shelved.

There are two principal differences between the original CCCTB initiative and the revamped version. The first is that it will no longer be voluntary, but mandatory for companies operating across national borders. Secondly, implementation will be phased, with the first phase comprising the development of a uniform set of rules for calculating taxable profits, to be used throughout the EU. Consolidation of profits will be deferred until a later, as yet unspecified, stage.

The second objective of the Action Plan is described by the Commission as “effective taxation where profits are generated”, by preventing profit-shifting, limiting preferential tax regimes and putting in place effective CFC rules. One measure that has already been taken in this regard is the amendment of the Parent-Subsidiary Directive to introduce a general anti-avoidance rule and withhold its benefits from arrangements that exploit differences in national rules to pay dividends that are tax-deductible for the paying company and exempt from tax in the hands of the recipient. Further measures envisaged include amendment of the Interest and Royalties Directive, by introducing a subject-to-tax requirement and effectively preventing the benefits associated with interest and royalty payments unless they create taxable income elsewhere in the EU.

The third objective of the Action Plan is enhanced transparency and in pursuit of this the EU Commission compiled and published a consolidated blacklist of non-EU countries regarded by Member States as non-cooperative, which was criticized by many orga-

nizations, including the OECD. In addition the Commission launched a public consultation to gather views on proposed public disclosure of certain tax information.

In order to help achieve the fourth objective of the Action Plan, which is improvement of the tax environment for businesses, the Commission proposes measures to allow losses incurred by one member of a group of companies to be offset against profits of another for tax purposes throughout the Single Market, rather than solely within national borders, as is currently the case.

Finally, in order to achieve the fifth objective, of improved co-ordination between Member States, the Commission proposes to update the Code of Conduct on Business Taxation, a non-binding list of criteria used to identify tax provisions that give rise to damaging competition.

July 2015 Tax Proposals

In July 2015 the Cyprus government presented to the parliament draft legislation amending the Income Tax Law and other laws relating to taxation. In addition to encouraging economic activity and attracting inward direct investment, certain of the proposed amendments have the specific objective of reforming the tax regime in order to make it more attractive, fair, and effective.

Transposition of Amendments to the Parent-Subsidiary Directive

One of the proposed amendments transposes into national law the recent amendments to the Parent-Subsidiary Directive referred to above. It amends section 8(20) of the Income Tax Law to provide that the usual dividend exemption, in respect of dividends received by a Cyprus tax resident, will not be available if the dividend is allowed as a tax deduction in the jurisdiction of the company paying it. In addition, it introduces a general anti-avoidance rule allowing the tax authorities to disallow relief if, taking into consideration all relevant facts and circumstances, they consider that the main purpose or one of the main purposes of the arrangement or the series of arrangements between the company receiving the dividends and the company paying them was to take advantage of the relevant exemption.

Limitation of Loss Relief on Intellectual Property Rights

In 2012 Cyprus introduced a highly-attractive intellectual property box regime, offering by far the lowest effective rate of tax (less than 2.5%) on income from IP assets, effective exemption of gains on disposal and the fewest restrictions on the scope of the concessions.

In order to match the 80% exemption of IP income from tax, carry-forward of losses associated with the use or disposal of IP rights will be limited to 20% of the actual loss. This restriction should only affect losses resulting from unrecovered administrative costs, thus leaving unaffected any losses incurred by investment in research and development.

IP box schemes recognize the inherent mobility of IP rights and encourage migration to jurisdictions that offer optimal exploitation of such rights, promoting healthy competition and investment in research and development. The recent agreement by OECD and G-20 member countries on a modified nexus approach will close the existing Cyprus scheme to new entrants after June 2016 and require significant dilution of benefits. However, companies that enter the current scheme before June 2016 will enjoy substantial benefits for at least the ensuing five years.

Refinement of Transfer Pricing Provisions

Cyprus does not have specific transfer pricing rules in its domestic legislation, but the arm's length principle is incorporated into the Income Tax Law in article 33, which allows the tax authorities to impose additional taxes on profits or benefits arising from related party transactions. Currently the only adjustments that can be made are to increase profits, and there is no provision for the corresponding expenses and losses to be compensated.

The proposed amendment to Article 33 will further enhance the arm's length principle by creating the idea of notional expense in addition to the existing

concept of notional profit. Where a deemed profit may be assessed on one of the parties to a related-party transaction, a corresponding deduction will be allowed for the counterparty to the transaction. In addition to providing more equitable treatment, this change should have the practical benefit of attracting more multinational businesses.

Conclusion

The proposed amendments are expected to be enacted when the parliament reconvenes after the summer recess. The early adoption of the EU policies is in line with the government's long-term strategy for developing the business services sector, which is based on providing a competitive, business-friendly environment with the highest standards of reliability and transparency. It is therefore fully in step with current international thinking and, indeed, the latest OECD BEPS announcements. Cyprus offers significant advantages for businesses of substance engaging in real economic activities, as well as a reassurance of stability and safety, as it complies with rising international standards.

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