



FAQs on back-to-back financing arrangements


2 February 2022 – The Cyprus Tax Department (CTD) has issued a new **Frequently Asked Questions (FAQs)** section on its website associated with **Interpretative Circular 3** dated 30 June 2017 titled “Tax treatment of intra group back to back financing transactions”.

The Circular provides for the application of transfer pricing methodology to such activities based on the arm’s length principle as advocated by the Organisation for Economic Co-operation and Development (OECD).

Further details on the contents of the Circular can be found in our [Tax Alert 55](#) of 11 July 2017.

The key points that are included in the FAQs posted on the CTD website on 24 January 2022, are summarized below:

- a) The answers to the FAQs are applicable to all transactions that fall within the scope of the Circular and relate to loan agreements concluded as at the date of the issue of the FAQs (i.e. 24 January 2022), as well as to those loan agreements which were concluded prior to that date and have not been examined by the CTD by that date.
- b) Transfer Pricing documentation prepared is not filed with the Cyprus Tax Authorities as part of the annual tax filing process but should only be submitted if requested.
- c) The expert who prepares the transfer pricing study is someone who possesses sufficient practical experience, competence and technical knowledge to prepare a transfer pricing study in accordance with the OECD TP Guidelines and the provisions of the Cyprus Income Tax Legislation. A transfer pricing expert is qualified by sufficient evidence of his/her technical expertise, training and knowledge in transfer pricing matters.
- d) If a company opts for the simplification measure (2% margin after tax) because it is functionally reduced as it is purely an intermediary financing entity should only prepare a functional analysis.
- e) In case the company does not have a transfer pricing study in place (and does not come under the simplification measure), the Cyprus Tax Authorities may assess the company's taxable profits on the basis of the available information and at their own discretion.
- f) A transfer pricing should be prepared when an intra group loan is initiated and updated when:
 - new loans are provided or received by the company, or
 - significant terms of the existing loans change or amended, or

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- the functional profile of the company changes, or
 - the market and economic conditions change significantly (if applicable).

The above list is indicative and it is not exhaustive.

- g) “Specialized personnel” as mentioned in the Circular should have sufficient knowledge, possess competence and experience to perform decision making functions and to control the risks of a controlled transaction under consideration. Reference is made to relevant parts of the OECD TP Guidelines with respect to what is meant by “control over risk”.

It is clarified that there is no requirement for a company to hire specialised personnel provided that its board of directors has sufficient knowledge, possesses competence and experience to perform the decision-making functions and to control the risks of the transactions under consideration.

- h) Contributions from shareholders who are physical persons fall within the scope of the Circular regardless of whether these are interest bearing or not.
- i) The Circular states that in cases where the simplification measure is used, the minimum margin of 2% after tax is applied on the value of the company’s assets.

The term "company's assets" is interpreted as the assets relating to the intra group back-to-back financing transactions (i.e. loan receivables) only. Moreover, the value of the loan receivables means their principal amount.

Accrued interest could also be included in the value of the company's assets under specific facts and circumstances (e.g. if a loan agreement includes provisions for capitalization of the interest or if as per the actual conduct of the parties accrued interest could be considered as additional financing).

- j) A company that carries out back-to-back intra-group financing activities and also carries out other activities still falls within the scope of the provisions of the Circular in respect of its back-to-back financing transactions.
- k) The Circular applies to both cross-border transactions and domestic transactions between related companies.

As always, the Taxation Department of Costas Tsielepis & Co Ltd is at your disposal should you require any further information or clarifications on this or any other tax issue.