



Circular 6/2023: Transfer Pricing documentation and simplification measures

31 August 2023 - The Commissioner of Taxation issued [Circular 6/2023](#) (the Circular), providing guidance for documenting related-party transactions and introducing simplification measures for various types of intercompany transactions that may be applied, provided that the relevant taxpayer is not obliged to maintain a Cyprus Local File based on the provisions of Article 33 (9)(a) of the Income Tax Law.

It is emphasized that the simplification measures (if applied) are subject to DAC6 reporting obligations under Hallmark E.1.

The Circular provides guidance to tax residents of Cyprus, or permanent establishments in Cyprus of non-tax resident persons who are engaged in transactions with related parties but do not have an obligation to prepare a Local File. Such transactions are arrangements that do not exceed (or should have not exceeded based on the Arm's Length principle) €750.000 in aggregate per category of transaction per tax year.

Arm's Length principle and minimum documentation requirements

The minimum documentation requirements for persons who carry out related party transactions but are exempt from the obligation to maintain a Cyprus Local File include the following, irrespective of the type/category of the transaction:

- Brief description of the functional analysis (functions performed, assets used, risks undertaken)
- Company characterization based on the functional analysis performed
- An indication of the most appropriate transfer pricing method regarding the transaction category and the reasons for selecting that method
- Determination of the Arm's Length price based on the internal or external comparability search results, or any other relevant analysis performed in accordance with the recommendations of the Organisation for Economic Co-operation and Development Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD TP Guidelines), such as the use of valuation models recommended for documenting financial guarantees.

A taxpayer that is exempt from the obligation to maintain a Cyprus Local File and opts to use a simplification measure for one or more types/categories of controlled transactions should, at a minimum, comply with points (a) and (b) described above, in addition to the following specific provisions relating to the Simplification Measures.

General provisions for the application of the simplification measures

The types/categories of transactions subject to simplification measures are:

- Back to back financing arrangements
- Financing arrangements funded by equity
- Receipt of financing from connected persons used for business purposes
- Low value-adding services

The general provisions for applying the simplification measures for all of the above types/categories of transactions are:

- The use of the simplification measure should be accompanied by the minimum documentation requirements as detailed for each category.
- Such documentation must be provided to the tax authorities within 60 days upon request.
- The Tax Commissioner has the right to amend, from time to time, the minimum or maximum returns/profit mark-up considering, among other things, any relevant changes in the local and global market conditions.
- In the absence of transfer pricing documentation supporting the Arm's Length price of a transaction, no deviation from the minimum or maximum margin/profit mark-up stipulated in the simplification measures is allowed. If the accounting profit from controlled transactions is higher than the Arm's Length profit determined based on a transfer pricing study or via the use of the simplification measures, the Tax Department will not proceed to any downward adjustment of taxable income (subject to the provision of Article 33 (5) of the ITL).
- The taxpayer must disclose 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.

For a taxpayer to use any simplification measure, the sum of all controlled transactions falling within the ambit of the relevant category as detailed in the Summary Information Table (e.g., Goods, Services, IP related, Financing, Others) may not exceed (or should not have exceeded based on the Arm's Length principle) €750,000 in the specific tax year.

Under no circumstances may a taxpayer use the simplification measures for a controlled transaction that falls within a category for which the taxpayer is obligated to maintain a Cyprus Local File (i.e., the total of controlled transactions in the specific category exceeds or should have exceeded based on the Arm's Length principle, €750,000 in the specific tax year). Moreover, simplification measures may not be used if internal comparables are available.

DAC6 reportability relating to the use of the simplification measures

The simplification measures described above, should constitute "unilateral safe harbor" rules for the purposes of the relevant DAC6 legislation. A cross-border arrangement involving the use of "unilateral safe harbor rules" should be considered as a reportable cross-border arrangement for the purposes of Hallmark E.1. Intermediaries and taxpayers should be aware of the reporting obligations that may arise following the introduction of the Circular.

The simplification measures:

Eligible Transactions	
1.	Loans or cash advances to related parties which are funded out of financial means.
2.	Loans or cash advances receivable from related parties which are funded out of own capital.
3.	Loans payable to related parties to the extent that the funds obtained are used in the business.
4.	Low value-adding services

Remarks concerning the use of simplification measures:

- The safe harbour amounts returns are before the deduction of taxes.
- For the first three cases above, in addition to the principal amount, the relevant safe harbour should also be applied to any interest charged but not paid.
- The safe harbours are subject to review and may be amended from time to time depending on the prevailing market conditions or other factors.
- In case a taxpayer has reliable internal comparables at its disposal, then the use of the safe harbour is not permitted.

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