

D.A.C.6 IMPLEMENTATION IN CYPRUS

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Tags

Arrangements

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Hallmarks

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INTRODUCTION

As a member of the E.U., Cyprus is subject to the same obligation as all other E.U. states to implement the Directives on Administrative Cooperation (“D.A.C.”) including D.A.C.6, for which the Cyprus Ministry of Finance (“M.O.F.”) submitted draft legislation in 2019. The D.A.C.6 draft legislation under consideration in the Cypriot Parliament, with discussions ongoing before the appropriate Parliamentary Committee. Several amended drafts of the implementing legislation were submitted, but with the COVID-19 emergency measures, the legislative process ground to a halt in March 2020. The process started up recently and the law was passed on March 18, 2021.

Reporting deadlines have been extended twice, currently to June 30, 2021. An additional extension of the deadline for filing information on reportable cross-border arrangements (“R.C.B.A.’s”) set out in the D.A.C.6 Directive has been granted. The submission deadline for D.A.C.6 has been extended up to June 30, 2021, for the following cases:

- R.C.B.A.’s carried out between June 25, 2018 and June 30, 2020, that should have been reported by February 28, 2021.
- R.C.B.A.’s carried out between July 1, 2020 and December 31, 2020, that should have been reported by January 31, 2021.
- R.C.B.A.’s carried out between January 1, 2021 and May 31, 2021 and which should have been (or should be) be reported within 30 days from the earliest of
 - the day made available for implementation,
 - the day they were ready for implementation, or
 - the day on which the first step towards implementation has been (or will be) made.
- R.C.B.A.’s for which secondary intermediaries have provided (or will provide) assistance, aid or advice between January 1, 2021 and May 31, 2021, that should have been or should be reported within 30 days following the next day where such assistance, aid or advice was provided.

However, application of D.A.C.6 is immediate due to its retroactive effect. Deadlines for the commencement of exchanges between countries have also been extended as a result of the various extensions.

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GENERAL CONSIDERATIONS AND CONCERNS

The Cypriot Government recognizes that the application of D.A.C.6 is challenging for smaller countries in the E.U. The government department that will monitor the D.A.C.6 law implementation is yet to be fully staffed in view of the COVID-19 situation. The various lockdowns have challenged the Government's capacity to provide appropriate training and briefing. The Cypriot Government is aware that many medium to small professional firms likely will experience difficulties in installing and maintaining the necessary internet systems required for reporting. This will lead to outsourcing of reports to larger firms. In addition, this will lead to sharp increases in operating and compliance costs and fees that may adversely affect Cypriot competitiveness in the international business sector.

The M.O.F. is aware that the scope of D.A.C.6 reporting obligations is broad and that it may capture arrangements that arise for commercial reasons more than for tax planning reasons. Consequently, the M.O.F.'s view on the Main Benefit Test ("M.B.T.") is to compare the value of (i) tax advantages against (ii) other benefits and considerations on a case by case basis.

The Cypriot Tax Department defines tax benefit as any of the following advantages:

- The grant of relief or an increase in previously granted relief on tax
- Avoiding tax or reduction of tax
- Deferral of tax payments
- Avoidance of an obligation to withhold tax

The cardinal element of the proposed law is that the tax advantage reported under D.A.C.6 must be seated in the E.U. This means that an arrangement resulting in a tax benefit which affects only the tax base of a non-E.U. jurisdiction does not fall within the M.B.T. Hence, Hallmarks for which the M.B.T. must be met are removed from reporting when the C.B.A. reduces tax in a country other than a Member State of the E.U.

Ultimate beneficial owners of Cypriot companies are monitored in existing compliance rules. If any individual who is a tax resident of a Member State of the E.U. secures tax treatment in Cyprus that adversely affects the tax base of that E.U. Member State, information on that cross border arrangement ("C.B.A.") will be captured by the law and will be reportable once the D.A.C.6 legislation is enacted.

The objectives of the M.O.F. are identical to those of the E.U. Consequently, the reporting obligation in Cyprus will include targeting and capturing potentially aggressive tax planning arrangements resulting in tax base erosion of one or more E.U. Member States. It will not matter whether C.B.A.'s of a Cypriot company are with an E.U. Member State or a country that is not an E.U. Member State. If the Member State's tax base is of a kind that could be adversely affected by a transaction, reporting will be required by intermediaries.

In addition to D.A.C.6, the Cypriot Government will continue to adhere to all previous directives on administrative cooperation in the field of taxation. These include the following:

- Targeting attempts at circumventing mandatory automatic exchanges of financial information (such as C.R.S.)
- Exchanges of information on cross border tax rulings
- Country-by-country reporting
- Facilitating access to anti-money laundering information by tax authorities

Regarding reportable arrangements to be included in D.A.C.6, the M.O.F. has adopted the minimum standards under which D.A.C.6 reporting will not be required for local arrangements and for arrangements with non-E.U. states where the tax base of an E.U. Member State is not affected adversely.

The internal taxes that will be addressed by the Cypriot legislation include only the Income Tax, the Special Defense Tax, and the Capital Gains Tax. No other direct or indirect taxes are covered by the proposed law. Penalties for noncompliance with various reporting obligations may not exceed €20.000 per R.C.B.A.

BASICS TO BE ADOPTED BY CYPRUS

The D.A.C.6 basic provisions addressed by the legislation and enacted are as follows:

- **The M.B.T. and the Hallmarks falling within the M.B.T.** This includes standardized documentation that is actively promoted and sold off-the-shelf, thus potentially leading to aggressive tax planning potentially eroding the tax base in any E.U. Member State, is well defined. The net is cast widely to catch even usual commercial arrangements therefore analysis of a cross border arrangement is quite a difficult and complex task.
- **The Hallmarks not requiring a finding as to the M.B.T.** These R.C.B.A.'s are defined widely. Among other elements, R.C.B.A.'s will include the following:
 - Transactions between Cypriot companies and companies and other entities based in E.U. and O.E.C.D. blacklisted countries
 - Transactions between Cypriot companies and recipients of income who are not tax resident in any country
 - Transactions otherwise resulting in deduction of depreciation on the same asset in multiple jurisdictions
 - Transfers of assets significantly projected to reduce valuation of the transferor's income stream
- **Automatic Exchanges of Information ("A.E.O.I.")**. Arrangements which circumvent A.E.O.I. by utilizing jurisdictions that are not regulated or compliant must be reported.
- **Transfer Pricing**. Transfer pricing elements such as exploiting the existence of safe harbor rules, and transfer of hard-to value intangibles in an arrangement.

DEFINITION OF INTERMEDIARIES

In general, the Cypriot Government has adopted the definition of an intermediary that is provided by D.A.C.6. Consequently, intermediaries include all persons devising, drafting, advising on, and marketing tax planning arrangements. Also included are persons that assist in implementing those arrangements.

On the other hand, exemption has been granted to those providing tax compliance and auditing services. Lawyers have also been exempted due to professional confidentiality regulations in Cyprus, as with other E.U. Member States. However, these exemptions are conditional. The exempted professional is required to review and analyze the objectives of the client's arrangements and must provide notice to clients that, because of the exemption for the accountant, tax return preparer, or lawyer, the client is required to ensure that its tax advisers and primary intermediaries have reported the R.C.B.A. and must provide the relevant report reference number. If the other intermediaries fail to report, clients must be advised that the reporting obligation shifts to them. Failure by exempted persons to carry out notification responsibilities may give rise to penalties for noncompliance.

The complication in Cyprus, is that clients typically are Cyprus registered companies with ultimate beneficial owners that are resident outside Cyprus. This poses a problem for resident directors in Cyprus, who bear the responsibility of noncompliance. To protect company directors, the M.O.F. strategy will require lawyers, auditors, and tax compliance firms to maintain detailed documentation in order to avoid the statutory penalties.

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FURTHER CYPRUS CONSIDERATIONS

- Cyprus adopted the position in the draft law, that E.U. approved tax schemes implemented in Cyprus such as the I.P. Box regime, Tonnage Tax regime in the shipping industry, and the N.I.D. (Notional Interest Deduction) do not fall within the proposed D.A.C.6 law.
- Regarding Hallmarks that are applicable without reference to the M.B.T., the Cypriot position is that most of these will only be applicable provided the arrangements in question are with legal entities based in countries on the E.U. and/or O.E.C.D. Noncooperative Jurisdiction lists. Cyprus implements strictly rules attacking transactions with companies based in listed jurisdictions.
- Cyprus has adopted the common goal of E.U. tax authorities to react proactively and decisively when tax rules may facilitate aggressive and harmful tax practices.
- The M.O.F. has adopted a policy that ensures access to a level playing field for large and small taxpayers.

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