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Overview

STI Taxand, Taxand Cyprus

STI Taxand is a tax law firm offering comprehensive legal services focused on taxation matters. This includes advising clients on tax planning, compliance, and disputes. Services cover income tax, corporate tax, international taxation, tax treaties, transfer pricing, Pillar Two and assistance with audits. Expertise in navigating complex tax codes and providing strategic counsel to minimise liabilities is a key aspect of our offerings. We also represent clients in negotiations with tax authorities and handle litigation if disputes arise.

With respect to transfer pricing, we provide guidance on strategic advisory, pricing policies, documentation, implementation, and compliance. We assist in developing and implementing strategies that align with regulatory requirements, mitigate risks, and optimise tax positions. This includes preparing transfer pricing documentation, conducting benchmarking analyses, planning and strategy, and supporting clients in transfer pricing audits and disputes. More specifically:

- Intra-group services or sale of goods pricing: advising on the pricing of services and products provided by one entity to another within the same group.
- Financial transactions transfer pricing: Analysing and advising on the transfer pricing implications of financial transactions, including intercompany loans, cash pooling and guarantees.
- Intellectual property valuations and pricing royalty rates: assessing the value of intellectual property for accurate pricing.
- Business restructurings: providing guidance on transfer pricing considerations during business restructurings, including the transfer of functions, risks, and assets (such as intangibles, or a portfolio of financial assets) among group entities.
- Assistance in tax controversy matters: supporting multinational enterprises in tax disputes, including obtaining Advance Pricing Agreements ("APAs") and Mutual Agreement Procedure ("MAP") agreements.

General: Transfer Pricing Framework

With effect from 1 January 2003, article 33 of the Income Tax Law of 2002, N118(I), as amended ("ITL"), incorporates the arm's length principle ("ALP") and is in line with Article 9 of the OECD Model. Further, with effect from 1 January 2022, ITL provides for specific documentation requirements that generally follow Chapter V of the OECD Transfer Pricing Guidelines ("OECD Guidelines") for all Cypriot taxpayers entering into controlled transactions unless such taxpayers fall under the documentation exemption threshold. It should be noted that the OECD Guidelines are expressly referred to by the ITL for interpretation purposes, ensuring that the domestic arm's length standard is interpreted consistently with Cyprus's double tax treaties, which follow the OECD Model.

The term "controlled transactions" refers to transactions falling within the scope of article 33 of the ITL. Under section 33(1), the transfer pricing rules apply where an enterprise participates, directly or indirectly, in the management, control or capital of another enterprise, or where the same persons participate in the management, control or capital of two or more enterprises, and where the conditions between them differ from those that would be agreed between independent enterprises. In addition, under section 33(2), the transfer pricing rules also apply to transactions between associated (connected) persons. Connected persons are defined in section 33(3) as persons connected through relationships including direct or indirect ownership or entitlement to at least 25% of the voting rights, share capital or income, as well as family, partnership, aggregation and acting-together rules.

Accepted Transfer Pricing Methodologies

Given that the OECD Guidelines have been legislatively incorporated into the ITL, all transfer pricing methods approved by the OECD should be equally applicable.

Considering that the ITL does not provide for a hierarchy between the five OECD-approved methods, the guidance provided in the OECD Guidelines with respect to the selection of the most appropriate transfer pricing method to the circumstances of the case should be followed. Notably, Cypriot taxpayers should provide justification for why the selected method is deemed suitable, taking into account the pertinent facts and circumstances. In our experience, while the Cyprus Tax Department ("CTD"), expresses a preference for the CUP method, the practical difficulty of identifying reliable comparables means the TNMM is the method most frequently applied.

Transfer Pricing Documentation Requirements

The CTD requires taxpayers to be able to substantiate all related party/intercompany transactions in transfer pricing documentation.

For tax years up to and including 2025, pursuant to an announcement issued on 1 February 2024 by the Ministry of Finance and the CTD, Cypriot taxpayers are required to prepare a Cyprus local file where the aggregate arm's length value of controlled transactions exceeds EUR 5,000,000 for intragroup financing transactions or EUR 1,000,000 for each of the other transaction categories set out in the Summary Information Table:

1) sale/purchase of goods;
2) provision/receipt of services;
3) financing transactions;
4) receipt/payment of IP licensing/royalties; and
5) others.

These thresholds apply retroactively from 1 January 2022.

Following the enactment of the tax reform, effective from 1 January 2026, revised thresholds apply for tax years 2026 onwards. The threshold for intragroup financing transactions has increased to EUR 10,000,000, the threshold for transactions involving the sale of goods has increased to EUR 5,000,000, and the threshold for all other categories of controlled transactions (i.e. services, IP licensing/royalties and other transactions) has increased to EUR 2,500,000.

Therefore, Cypriot taxpayers involved in controlled transactions are required to prepare a local file unless they fall below the relevant documentation exemption threshold. Taxpayers below this threshold remain subject to the arm's length principle; however, they are relieved from the obligation to prepare a full local file. The content of the local file is generally aligned with Chapter V of the OECD Transfer Pricing Guidelines.

A person holding a practising certificate from ICPAC or any other recognised institute of certified accountants in Cyprus should conduct a Quality Assurance Review for the local file. The local file must be prepared by the deadline for submitting the Income Tax Return for the relevant tax year. Following preparation, the taxpayer must submit the local file to the tax authorities within 60 days of request.

Under the Assessment and Collection of Taxes Law (1978, 4/78), as amended ("ACTL"), failure to submit the local file after receiving a request from the CTD will result in penalties ranging from EUR 5,000 to EUR 20,000. Finally, Cypriot taxpayers must also file the summary information table ("SIT") by the submission deadline of the tax return of the specific year of assessment. Failure to submit the SIT, incurs a penalty of EUR 500.

With respect to the master file, the obligation to prepare and maintain a master file applies exclusively to Cypriot taxpayers who serve as the ultimate parent or surrogate parent entity for a multinational group subject to Country-by-Country reporting.

All other entities are exempt from this requirement. Like with the local file, the content of the master file is generally aligned with Chapter V of the OECD Guidelines, and the taxpayer must provide and submit the master file to the tax authorities within 60 days upon request. Failure to submit the master file after receiving a request from the CTD will result in penalties ranging from EUR 5,000 to EUR 20,000.

Local Jurisdiction Benchmarks

The CTD considers local and pan-European benchmarks acceptable, given that they adhere to comparable search strategy standards of the OECD Guidelines. Generally, the CTD relies on contemporaneous and multiple-year data and uses the interquartile range to enhance the reliability of the results from benchmarking. Importantly, the ITL provides that the local file should be updated on a yearly basis, and any significant changes in the market conditions that may impact the information and data should be documented in the local file.

Focus on Financial Transactions

Under Article 33 of the ITL and Circular 7/2023, the CTD aligns its evaluation of intra-group financial transactions with Chapter X of the OECD Guidelines. The assessment requires an accurate delineation of the transaction to determine whether a financing arrangement should be characterized as debt or equity. This involves evaluating the commercial rationale of the transaction, the borrower's creditworthiness and financial capacity to service the debt, and the realistic alternatives available to both parties. To support the arm's length nature of the pricing, taxpayers must perform a detailed credit rating analysis of the borrower and benchmark the interest rates and terms against comparable uncontrolled transactions. In addition, following the abolition of the back-to-back financing circular with effect from 1 January 2022, the CTD requires a full functional and risk analysis for financing entities.

Advance Pricing Agreement "APA"/Bilateral Advance Pricing Agreement "BAPA" Overview

Cypriot taxpayers have the option to present APAs to the CTD to pre-determine pricing methodologies. These APAs can be applied unilaterally, bilaterally, or multilaterally and remain valid for a duration of up to four years. The APAs may concern both the methodology as well as the actual pricing.

Transfer Pricing Audits

Random transfer pricing audits can be conducted by the CTD, and all Cypriot taxpayers are subject to audit for any open tax year (the ordinary statute of limitation is six years but extends (to twelve years) in cases of fraud or willful default). In identifying areas of interest, the SIT serves as a risk assessment tool for the CTD in selecting the taxpayers for transfer pricing audit. This is because the SIT includes various useful information, such as an overview of the controlled transactions, specifying the counterparties' identity, their tax residency jurisdiction, and describing the nature of the controlled transactions (i.e. services, intangibles, financial transactions, sale of goods, and other).

Additionally, the corresponding values of these controlled transactions should be explicitly stated. Hence, tax inspectors are inclined to incorporate the SIT into their criteria for selecting taxpayers for audits, recognizing the significant role these factors play in the selection process. Currently, there seems to be more attention on financial transactions, in particular to intra-group loans.

The Burden of Proof in Transfer Pricing: Theory versus Practice in Cyprus

Under Article 33 of the ITL, taxpayers are required to comply with the arm's length principle, and also to maintain transfer pricing documentation for transactions that fall under specified categories and exceed certain thresholds or would have exceeded those thresholds if the transactions were conducted at arm's length. When taxpayers meet these documentation requirements, the burden of proof primarily rests with the tax authorities to demonstrate that the transactions are not conducted at arm's length.

However, if taxpayers fail to meet the minimum documentation requirements, the burden of proof shifts to them. In such cases, it becomes the taxpayer's responsibility to substantiate that the pricing of intragroup transactions adheres to the arm's length principle.

It is worth noting that the first deadline for preparing transfer pricing reports and submitting the SIT, under the ITL, is 31 May 2025. As a result, there have been relatively few transfer pricing disputes thus far. In time, we will see how the burden of proof evolves in practice and whether it aligns with the theoretical framework outlined by the law.

Additionally, Circular 6/2023, published on 6 July 2023, outlines the measures to be taken if transactions fall below the established thresholds, offering simplification options. The circular specifies that, even for transactions below the threshold, taxpayers should either maintain simplified documentation to demonstrate arm's length pricing or apply the safe harbour rules. This further underscores that, under Cyprus' legal framework, the burden of proof lies with the taxpayer in the absence of contemporaneous transfer pricing documentation.

Transfer Pricing Penalties

In addition to the penalties noted above, the ACTL outlines penalties for any additional taxes resulting from transfer pricing adjustments. Specifically, if the temporary income declared (including any revised estimated returns) is lower than 75% of the income as finally determined and shown in the tax return filed by the taxpayer or amended by the CTD by issuing additional assessment, in addition to the balance of the tax due an additional amount of tax equal to 10% is also payable. Further, interest is imposed where the tax due is not paid by the prescribed dates, either when the payment is due under a self-assessment or when the payment is due on the basis of an assessment raised by the CTD. Finally, in case a person fails to pay the tax due by the due date or within the period prescribed in a notice issued by the CTD, there is an additional penalty equal to 5% of the tax due.

Local Hot Topics and Recent Updates

In Cyprus, it seems that the CTD has focused strongly on financial transactions and the evaluation of arm's length interest rates over the last few years. Nevertheless, considering the implementation of the new documentation requirements and the annual submission of the SIT, it is anticipated that the scope of transfer pricing audits will extend to encompass additional controlled transaction types.

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Documentation threshold

Master file	Consolidated revenue exceeding EUR 750 million
Local file	Cumulatively, per category (as defined in the SIT) exceeds the arm's length amount of EUR 5,000,000 for intragroup financing transactions and EUR 1,000,000 for all other transaction categories per tax year up to and including 2025. From 2026 onwards cumulatively, per category (as defined in the SIT) exceeds the arm's length amount of EUR 10,000,000 for intragroup financing transactions, EUR 5,000,000 for sale of goods and EUR 2,500,000 for all other transactions per tax year.
CbCR	Consolidated revenue exceeding EUR 750 million

Submission deadline

Master file	To be submitted to the CTD upon request within 60 days.
Local file	Local file to be submitted to the CTD upon request within 60 days. Further, the local file should be readied by the deadline for submitting the Income Tax Return for the relevant tax year.
CbCR	Submission to the CTD must occur within 12 months following the conclusion of the MNE group's reporting fiscal year.

Penalty Provisions

Local file and master file	Ranging from EUR 5,000 to EUR 20,000
Tax return disclosure – late/incomplete/no filing	EUR 100 and penalties imposed under ACTL noted above
CbCR – late/incomplete/no filing	Ranging from EUR 500 to EUR 20,000
SIT	EUR 500 for late submission

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