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Global
Tax Alert

New Transfer Pricing Rules as of 1 January 2022

About this newsletter

On Thursday, 30 June 2022 the Cyprus Parliament passed a law introducing detailed transfer pricing legislation, marking a new era in company taxation, with effect from 1 January 2022. The OECD Transfer Pricing Guidelines have been legislatively incorporated in Cyprus. This short article serves as an overview of the relevant highlights of the law.

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1. Introduction

On 30 June 2022 the Cyprus parliament enacted for the first-time detailed transfer pricing legislation and incorporated the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD TP Guidelines) into the Cypriot Income Tax Law of 2002.

Transfer pricing is the way tax law allocates income to related companies and permanent establishments. Cyprus is one of the last countries in the EU to implement transfer pricing rules. Before the enactment of this law, the legal basis to address transfer pricing issues rested on the arm's length principle (ALP), as found in section 33 of the ITL. Section 33 is identical to Article 9 of the OECD Model Tax Convention and was incorporated into the Cypriot ITL in 2002. For almost 20 years, Cypriot ITL provided no guidance as to how to apply the ALP in practice, creating some uncertainty in the market and limited options for obtaining a binding ruling.

2. Applicability of new law

According to the Cypriot legislation, the new transfer pricing rules apply to transactions between related parties (legal persons and individuals). For legal entities, the new law provides detailed rules as to the meaning of the term "related parties" in an effort to capture different relations that there is a "control" situation. The main rule of the law is that when one legal entity participates in the share capital of another legal entity through the direct or indirect holding of share of at least 25 per cent, the two parties are considered related parties.

3. What you are required to do?

The law provides for two types of requirements for tax residents in Cyprus. The first one is to submit a summary information table which includes intercompany transactions, general information about the group, the profile of the business and the transfer pricing method used. The second requirement is to prepare a transfer pricing study to justify compliance with the arm's length principle subject to a small size exemption. The small size exemption applies when the controlled transactions cumulatively, per category, do not exceed € 750,000 per tax year.

4. Transfer Pricing study

A key requirement of the law is to prepare a transfer pricing study. As the law explicitly incorporates the OECD Guidelines, any transfer pricing study has to cross-reference the OECD Guidelines, which currently are more than 700 pages long and updated regularly.

The OECD Guidelines in 2017 have been heavily amended as a result of the Base Erosion and Profit Shifting (BEPS) project. The OECD Guidelines articulate a nine-step process for undertaking a transfer pricing analysis. Key elements of an OECD transfer pricing study include:

- Accurate delineation of the transaction (industry analysis and value chain analysis);
- Recognition of the transaction;
- Comparability analysis and functional analysis;
- Finding comparables;

- Selection of the most appropriate transfer pricing method. Transfer pricing methods of the OECD TP Guidelines are: the comparable uncontrolled price method; the resale price method; the cost-plus method; the profit split method; and the transactional net margin method.
- Comparability adjustments;
- Arms-length range;
- Special rules in intangibles, risks allocation, profit splits and financial transactions.

5. Deadlines

The Transfer Pricing Study and the summary information table for a particular year should be prepared no later than the due date for submitting the taxpayer's Income Tax Return for that year.

6. Advance Pricing Agreements

The new law provides specific provisions regarding Advance Pricing Agreements based on the arms-length principle.

7. What happens if a transfer pricing study is not performed at all or correctly?

- damage to reputation;
- potential unfunded corporate tax liabilities;
- potential VAT liabilities;
- increased scrutiny audits from tax authorities;
- interest and penalties.

8. Penalties

The new law provides specific penalty provisions. In the event of late submission of the summary information table, a five hundred euros (€500) fine is imposed. Further, in case the documentation is not made available to the Tax Commissioner within 60 days from the notification of a request, a fine of five thousand euros (€5,000) is imposed, and if it is not made available from the sixty-first (61st) day until the ninetieth (90th) day a fine of ten thousand euros (€10,000) is imposed, while if it is not made available at all or made available after the ninetieth (90th) day a fine equal to twenty thousand euros (€20,000) is imposed.

9. Conclusion

Overall, a few conclusions can be reached:

(a) The Cyprus Parliament passed a law introducing detailed transfer pricing legislation in Cyprus effective from 1 January 2022.
(b) The law explicitly incorporates the OECD Guidelines as a whole.
(c) Specific transfer pricing documentation is required, subject to a small size exemption.
(d) Significant penalties provisions exist for non-compliance.
(e) As the law explicitly incorporates the OECD Guidelines, any transfer pricing study has to cross-reference the OECD Guidelines. This requires highly specialized transfer pricing people.

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