



# Cyprus implements EU ATAD Exit Taxation & Hybrid Mismatches

The Cyprus Parliament on June 19th 2020, voted for the Cyprus transposition of the European Union (EU) Anti-Tax Avoidance Directive (ATAD) for Exit taxation and Hybrid mismatch rules. The Directive essentially completes Cyprus' transposition of the EU ATADs i.e. ATAD I and II that were adopted by the EU in 2016 and 2017 respectively.

On August 20th 2020, the relevant law was published in the Gazette, amending the Assessment and Collection of Taxes Law with immediate effect (for the current tax year 2020), with the exception of certain reverse hybrid mismatch provisions that have an effective date from the tax year 2022.

## Exit Taxation Rules

### Scope

A Cypriot Tax Resident Company or a Non Cypriot Tax Resident Company, having a permanent establishment in Cyprus, is subject to tax at an amount equal to the market value of any assets that are transferred at the time of their exit, minus their tax value in the following instances:

1. The Cypriot Tax Resident Company transfers assets from the Company's head office in Cyprus, to its permanent establishment in a third country or other Member State, insofar as Cyprus has no longer the right to tax the transferred assets due to the transfer.
2. The Non -Cypriot Tax Resident Company, having a permanent establishment in Cyprus, transfers assets from its permanent establishment to its head office or another permanent establishment outside Cyprus insofar as Cyprus no longer has the right to tax the transferred assets due to the transfer
3. The Cypriot Tax Resident Company transfers its tax residency outside Cyprus (i.e. to a third country or other Member State) except the assets that remain and are effectively connected to Cyprus, through its permanent establishment.
4. The Non -Cypriot Tax Resident Company, having a permanent establishment in Cyprus, transfers its activity and business to another jurisdiction (outside Cyprus i.e. to a third country or other Member State) insofar as Cyprus no longer has the right to tax the transferred assets, due to the transfer.

### Asset Value subject to Tax

Based on the above instances, the starting value of the transferred assets for tax purposes shall be equal to their market value at the same time. This effectively means that any profit being made at the point of exit, shall be subject to Cyprus Income Tax. Similarly, when a company transfers its assets to Cyprus from another EU Member State, the assets' starting value in Cyprus shall have the same value at the time of exit/transfer as established by the transferor EU Member State. The latter does not apply in cases where the value does not reflect the market value of the assets.

In addition, the Exit Taxation Rules are not applicable in cases where the assets are expected to return to Cyprus within one year, provided that they either relate to the financing of securities, are provided as collateral to meet capital requirements or for liquidation purposes.



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## Payment Deferral of Exit Tax

The Corporate Income Tax is due for payment at the time of the transfer. In cases where the transfer is being made to another EU Member state or a European Economic Area based State with which Cyprus has agreements concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures (EU Directive 2010/24) subject to ATAD I, a Cypriot Tax Resident Company or a Non -Cypriot Tax Resident Company, having permanent establishment in Cyprus, has the option to pay in instalments in a period of over five years.

## Hybrid Mismatch Rules - Scope

In general, the scope of anti-hybrid mismatch rules is to ensure and to cover cases of double deductions and/or payments in countries without taxation, effectively avoiding the payment of tax. The provisions of these rules are limited in hybrid entities; reverse transfers also include rules on hybrid transfers and on reverse hybrid entities. Hybrid mismatches are cases when, as a result of differences in the legal qualification of payments or entities for tax purposes in two jurisdictions, a double deduction arises or there is deduction of income in one state without inclusion in the tax base of the other. The new law offers a way to neutralise this effect of hybrid tax position. The law shall apply to companies subject to Cyprus Corporate Income Tax where adjustments are required, to the extent a mismatch occurs, such as double deduction and/or double tax credit.

## Double Deduction

Subject to the Law, a hybrid mismatch resulting in a deduction of a payment, shall be denied in Cyprus, if Cyprus is the investor jurisdiction. If Cyprus is the payer jurisdiction, the deduction shall be denied if the deduction is not denied by the investor jurisdiction. Deductions shall be eligible to set off against dual inclusion income in the current or the following tax year, effective in both Cyprus and other jurisdictions.

## Deduction Without Inclusion

Subject to the Law, a hybrid mismatch resulting in a deduction of a payment without inclusion for tax purposes or in a deemed payment between the head office and the permanent establishment or between two or more permanent establishments in any country, shall be denied in Cyprus, if Cyprus is the payer jurisdiction. If Cyprus is the payee jurisdiction and the deduction has not been denied by the payer jurisdiction, the mismatch amount shall be taxable. Exceptions to this rule apply as Cyprus has opted under the possibility provided by the EU Directive, not to include the income as taxable and apply the hybrid rule where the mismatch is made: (i) to a hybrid entity, or (ii) to a payment or a deemed payment involving permanent establishment and hybridity.

Note that a temporary exclusion with regards to hybrid mismatches resulting from payments of interests under associated (grouped) financial instruments applies until December 31st 2022.



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## Imported mismatch

Any deductions of any payments by a Cypriot Tax Resident Company or a Non Cypriot Tax Resident Company, having a permanent establishment in Cyprus, shall be denied in the case of an imported mismatch, should they directly or indirectly fund deductible expenditure essentially creating hybrid mismatches between companies/parties outside of Cyprus. Subsequently this rule shall not apply in cases where one of the jurisdictions involved has made the equivalent adjustment to neutralise the hybrid mismatch.

## Disregarded PE income

When a hybrid mismatch involves a permanent establishment not subject to income tax, unless a double tax treaty (DTT) with a third country exists, Cyprus shall exempt the said income.

## Hybrid Transfer for Double Tax Credit

When a hybrid transfer is placed to produce withholding tax or double tax credit, Cyprus shall limit the relief it grants in proportion to the net taxable income in Cyprus vis a vis the payment derived from the transferred instrument.

## Reverse hybrid entities

As per the Law, this rule shall be effective as of January 1st, 2022. A reverse hybrid entity is considered an entity incorporated in Cyprus that does not pay its taxes in Cyprus, but in another jurisdiction (i.e. a partnership where its partners are considered its tax -payers instead of the partnership itself) such as the jurisdiction of the investor. Under certain conditions, a reverse hybrid entity may be regarded a resident of Cyprus in cases where income is not taxed in Cyprus or in any other jurisdiction. In these cases, its income is subject to Corporate Income tax and Special Contribution to the Defence Fund in Cyprus. The above rule shall not apply to collective investment vehicles, such as alternative investment funds.

## Tax residency mismatches

Cyprus shall deny the deduction for payments, expense or loss, in cases where tax residency mismatch exists. These cases apply when the payer is a tax resident in two or more jurisdictions for tax purposes, excluding cases of dual-inclusion income. Moreover, should the other jurisdiction be an EU Member State, the deduction will be denied only if the taxpayer is not deemed to be resident in Cyprus according to the double taxation treaty between Cyprus and the other Member State concerned. In such cases, the "loser" State under the tax residency tie-breaker rule of the relevant double tax treaty between Cyprus and that other EU Member State shall deny the deduction.

## Moving forward

With the above in mind, we advise all corporates and multinationals holding structures in the EU, doing business with the EU or moving their tax residency, to get in touch with our Tax Advisory Team for an advice as per these changes in consideration of future transactions or restructuring.