Executive summary

The Cypriot Ministry of Finance (MoF) circulated, on 19 March 2019, a draft bill (the Bill) to transpose the European Union (EU) Directive 2018/822/EU of 25 May 2018 on the mandatory disclosure and exchange of cross-border tax arrangements (referred to as DAC6 or the Directive) into the Cypriot national legislation. The Bill will amend the existing Cypriot law on Administrative Cooperation in the field of Taxation.

Following an announcement of the Cypriot tax authorities on 22 October 2019, the Bill is now officially subject to the public consultation procedure and public comments on the proposed draft text are requested by 12 November 2019. The draft legislation will then be subject to the formal legislative process and is expected to be enacted into law by the end of 2019.

Official guidance is expected to be issued by the tax authorities to provide clarification on the interpretation of specific terms and provisions of the Cypriot Mandatory Disclosure Rules (MDR) legislation. The guidance notes will be issued after the enactment of the law.

If implemented as currently proposed, the Cypriot MDR legislation will be broadly aligned with the requirements of the Directive.
Detailed discussion

Background

The Directive requires intermediaries (including EU-based tax consultants, banks and lawyers) and in some situations, taxpayers, to report certain cross-border arrangements (reportable arrangements) to the relevant EU member state tax authority. This disclosure regime applies to all taxes except value added tax (VAT), customs duties, excise duties and compulsory social security contributions.\(^2\) Cross-border arrangements will be reportable if they contain certain features (known as hallmarks). The hallmarks cover a broad range of structures and transactions. For more background, see EY Global Tax Alert, Council of the EU reaches an agreement on new mandatory transparency rules for intermediaries and taxpayers, dated 14 March 2018.

EU Member States are to adopt and publish national laws required to comply with the Directive by 31 December 2019. The Cypriot legislation will take effect from 1 July 2020.

The key differences between the draft Cypriot legislation and the Directive are as summarized below.

Scope of taxes covered
The scope of taxes covered by the Bill is fully aligned with the Directive and applies to all taxes except VAT, customs duties, excise duties and compulsory social security contributions.

Reportable arrangements
Under the Directive, an arrangement is reportable if:
   - The arrangement meets the definition of a cross-border arrangement; and
   - The arrangement meets at least one of the hallmarks A-E specified in Annex IV of the Directive.

Under DAC6, cross-border arrangements are defined as arrangements concerning more than one Member State or a Member State and a third country. The hallmarks can be distinguished as hallmarks which are subject to the main benefit test (MBT), and those which by themselves trigger a reporting obligation without being subject to the MBT.

The overall definition of “reportable arrangements” in the Bill follows the definition provided for in the Directive. Domestic arrangements are not covered by the Bill.

Hallmarks A-E of the Directive
The hallmarks included in the Bill mirror the hallmarks A-E specified in Annex IV of the Directive, including those that are subject to the MBT and those that are not.

Main benefit test
In accordance with DAC6, under the Bill, the MBT will be satisfied if it can be established that “the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement, the obtaining of a tax advantage.”

In addition, the MBT included in the Bill includes additional text (which does not appear in the Directive). The additional text appears to indicate an intention to link the definition of “tax advantage” to the scope of taxes covered under Article 2(1) of the Directive. Therefore, the text of the Bill appears to imply an “EU-nexus” MBT, i.e., that the tax advantage is limited to tax advantages obtained in Cyprus or another EU Member State.

Moreover, the definition of “tax advantage” included in the Bill is further defined by reference to the following:
   - (i) Relief or increased relief from tax
   - (ii) Repayment or increased repayment of tax
   - (iii) Avoidance or reduction of a charge to tax or an assessment to tax
   - (iv) Deferral of a payment of tax or advancement of a repayment of tax
   - (v) Avoidance of an obligation to withhold tax

where the obtaining of a tax advantage cannot reasonably be regarded as being consistent with the principles on which the relevant provisions, that are relevant to the reportable cross-border arrangement, are based.

It is expected that the public consultation process will provide further clarity on how this test should be applied in practice.
Intermediaries
Under the Directive, intermediaries with EU nexus have the primary obligation to report arrangements to the tax authorities. The Directive gives Member States the option to exempt intermediaries from the obligation to report where the reporting obligation would breach legal professional privilege (LPP). If there are no intermediaries which can report, the obligation will shift to the taxpayers.

The Bill defines intermediaries in the same manner as the Directive. The Bill also takes up the option included in the Directive to exempt intermediaries from the obligation to report where the reporting obligation would breach LPP. The draft Cypriot legislation only exempts “lawyers” as defined by the law.

Reporting deadlines
Under DAC6, for intermediaries (and relevant taxpayers), the trigger events for reporting under the Directive (from 1 July 2020) are when the reportable arrangement is “made available for implementation”; or when the reportable arrangement is “ready for implementation” or when “the first step of implementation has been made.”

Under the Directive, reporting starts from 1 July 2020 and exchanges between jurisdictions from 31 October 2020. However, reports will retroactively cover arrangements where the first step is implemented between 25 June 2018 and 30 June 2020.

The reporting deadlines included in the Bill are fully aligned with those of the Directive. In addition, the Bill includes the option under the Directive for periodic reporting by intermediaries on marketable arrangements, which may also apply on a three-month basis.

Penalties
Where an intermediary or relevant taxpayer fails to report an arrangement to the Cypriot tax authorities, an administrative fine between €10,000 and €20,000 is expected to apply.

In the case of a delay in reporting of up to 90-calendar days from the date prescribed in the Bill by an intermediary or relevant taxpayer to the Cypriot tax authorities, an administrative fine between €1,000 and €5,000 is expected to apply. If the delay in reporting exceeds 90-calendar days from the date prescribed in the Bill, then the Cypriot tax authorities can impose an administrative fine between €5,000 and €20,000.

Where an intermediary is exempted from reporting due to LPP obligations and such intermediary fails to notify other intermediaries or the relevant taxpayer about the exemption from filing to assume their reporting obligations, an administrative fine between €10,000 and €20,000 is expected to apply. In the case of a delay in the above notification, an administrative fine between €1,000 and €5,000 can be imposed by the Cypriot tax authorities, which, if such delay exceeds 90-calendar days, will range between €5,000 and €20,000.

In the case of incomplete or misleading reporting of an arrangement by an intermediary or relevant taxpayer to the Cypriot tax authorities, an administrative fine between €1,000 and €10,000 is expected to apply.

Where an intermediary or relevant taxpayer fails to provide the Cypriot tax authorities with information or documents for an arrangement within 14 days from the date of the notice of the tax authorities, an administrative fine between €1,000 and €10,000 is expected to apply.

In the case of a failure to pay the administrative fines imposed or of the continuance of the relevant breach, the Cypriot tax authorities can further increase the administrative fine imposed, which cannot exceed €20,000.

As implied by the provisions of the Bill, penalties will also apply for failures to report for the transitional period.

Protection of reporting in good faith (marginal reporting)
The Bill includes a provision on the protection of reporting in good faith. This covers circumstances in which intermediaries reasonably believe that they need to report an arrangement to the Cypriot tax authorities, based on the information in their knowledge, possession or control at the time of reporting, even if the circumstances or information available prior to, or at the time of submission, did not enable the intermediary to know precisely whether it was a reportable arrangement or whether one or more hallmarks exist (i.e., marginal reporting) or even if later circumstances or information prove that the intermediary's judgment was incorrect. Under the Bill, the “good faith” reporting by an intermediary is not considered to be a breach of any contract, law or regulation (including the Cypriot MDR law) and does not entail any liability on the part of the intermediary.
Next steps

The Cypriot tax authorities appear to limit the MBT to tax advantages obtained in respect of taxes levied in Member States (in accordance with the scope of taxes included in Article 2(1) of the Directive), thus appearing to introduce an “EU-nexus” MBT. This position will require further clarification during the public consultation phase.

Determining if there is a reportable cross-border arrangement raises complex technical and procedural issues for taxpayers and intermediaries. Taxpayers and intermediaries who have operations in Cyprus should review their policies and strategies for logging and reporting tax arrangements, so that they are fully prepared for meeting these obligations.

Endnotes


2. DAC6 sets out a minimum standard. Member States can take further measures; for example, (i) introduce reporting obligations for purely domestic arrangements; (ii) extend the scope of taxes covered; (iii) bring forward the start date for reporting.
For additional information with respect to this Alert, please contact the following:

**Ernst & Young Cyprus Limited, Nicosia**

- Petros Krasaris  petros.p.krasaris@cy.ey.com
- Panayiotis Tziongouros  panayiotis.tziongouros@cy.ey.com
- Stavros Karamitros  stavros.karamitros@cy.ey.com
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