



Anti-Abuse - New MLI Provisions



As of 7th June 2017, Cyprus, together with other countries has signed the MLI Treaty which provides for the abuse of provisions in any agreements/structures which may lead to the non-application of the Double Tax Treaties Cyprus has concluded with other contracting States.

All tax treaties covered by the MLI must include an anti-abuse rule to prevent treaty benefits from being granted in unintended circumstances. This follows the BEPS Action 6 final report on 'Preventing the Granting of Treaty Benefits in Inappropriate Circumstances', under which jurisdictions must implement one of the following approaches:

1. A PPT;
2. A PPT and either a simplified or a detailed limitation-on-benefits (LOB) provision; or
3. A detailed LOB provision supplemented by an anti-conduit rule.

Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that **obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit**, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.

The above shall apply in place of or in the absence of provisions of a Covered Tax Agreement that deny all or part of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits.

If the treaty itself provides stricter anti-avoidance rules, then these rules will prevail.

So far, the majority of signatories to the MLI have opted for a PPT only. The PPT will apply to deny treaty benefits if, having regard to all relevant facts and circumstances, it is reasonable to conclude that obtaining the treaty benefit was one of the principal purposes behind such transaction.

As an exception to this rule, if granting the benefit would be in accordance with the object and purpose of the relevant provisions (objective test), the treaty benefit will not be denied.

Actions that should have been taken or taken now to face MLI challenges

- Identify and review existing structures that rely on obtaining treaty benefits to determine if there are commercial reasons for such establishment and the level of substance available.
- Consolidate structures which involve SPVs into one company.
- In planning new structures take into consideration the MLI requirements discussed earlier on, including commercial reasons, activities and substance.

Setting up a strictly pure SPV financing company in Cyprus

We must consider at the outset the purpose of setting up such an SPV in Cyprus, and if the only reason for the establishment of such company is to take advantage of the Treaty benefits between Cyprus and another country (for example Russia) which may be explained below as follows.

A BVI Tax Resident company wishes to grant a loan to a Russian company at 8% interest per annum.

The BVI has no treaty with Russia.

Therefore, the BVI may establish a Cyprus company, lend money to the Cyprus company, which then will lend the money to the Russian company, leaving a percentage profit margin in the Cyprus company, and the Withholding Tax is 15% under the new Cyprus – Russia Double Tax Treaty.

In applying to this structure, the PPT (Principal Purpose Test), it will be noticed that the reason of such arrangement is to take advantage of the Treaty between Cyprus and Russia, and there will be no Treaty benefit granted. In this case, normal Withholding Tax rates will apply.

A Cyprus Holding company by itself organized to provide financing with no other activities will not have any Tax benefits from the Treaty Network that Cyprus has established.

A Holding company must be able to meet the PPT criteria under the MLI (Multilateral Instrument).

The stand-alone holding company SPV is no longer a suitable solution.

Taking into account any business risks or considerations (if any), a group based in Cyprus, in addition to its holding activities, it could provide financing to group companies and centralize cash management, license intangibles, provide HR, accounting marketing and other services and carry out trading activities.

An international group sets up a company in Cyprus to act as a regional investment company and regional headquarters for the group.

EXAMPLE:

Factors taken into account in choosing the location:

- Availability of skilled properly trained labor who can effectively manage the Investments of the company
- Reliability of legal system
- Business friendly environment
- Political stability
- Extended DTT network

In this case, the PPT test will not apply as there were other important reasons other than taking advantage of the treaty network provided:

- The Cypriot company is making all the decisions necessary for its business through its own properly qualified and empowered management team
- It has assets and assumes real risks for performing its functions
- The business is carried out by its own personnel out of its own fully fledged offices and facilities
- Maintains proper books of accounts in Cyprus and fully complies with its local filing requirements

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