

# Cyprus: Ratification of multilateral instrument

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 On January 22 2020 the instrument of ratification of the Multilateral Convention to Implement Tax Treaty Related Matters (MLI), and the Cyprus position on the minimum standards of the MLI and explanatory statement, were published in the Official Gazette of the Republic.

The BEPS MLI is designed to allow countries to swiftly incorporate new tax treaty provisions in their existing bilateral tax treaties (in line with measures arising from the G20/OECD BEPS Project). The MLI does not operate in the same manner as an existing treaty protocol amendment – rather it 'complements' existing treaties and is to be read in conjunction with the treaty at hand. While the MLI provides flexibility on each state's sovereign right over the adoption of the MLI positions, some elements contained therein (*inter alia* the provisions on the prevention of treaty abuse and dispute resolution) are considered as OECD/G20 minimum standards for those jurisdictions participating in the BEPS initiative.

Cyprus approved the minimum actions as prescribed by the MLI – Action 6 (purpose of covered tax agreement [CTA]), Action 7 (treaty abuse) and Action 14 (making dispute resolution mechanisms more effective). Cyprus has covered all of its existing double tax treaties (with the exception of existing treaties which have already bilaterally agreed to the minimum actions).

The publication of the above completes the domestic procedures by Cyprus for entry into force of the MLI, with deposition of the Instrument having taken place on January 23 2020. The entry into force will take place on May 1 2020, this being the first day of the month after the three-month period following the deposition, as required in Article 34 of the Convention. For provisions relating to withholding taxes, the earliest entry into effect date will be January 1 2021 (provided that the other contracting jurisdiction has also submitted its instrument of ratification with the OECD before, or during, 2020). For provisions relating to other taxes, the earliest entry into effect date will be November 1 2021 (provided that the other contracting jurisdiction has also submitted its instrument of ratification with the OECD before, or during, January 2020).

## Summary of minimum standards adopted

### Action 6 – purpose of a CTA

Article 6 provides for the amendment of the preamble of tax treaties to include the purpose of a CTA.

Cyprus has provided notification of the amendments on the preamble of all its 61 CTAs through Article 6(3),

clarifying that their purpose is to eliminate double taxation without creating opportunities for non-taxation, or reduced taxation, through tax evasion or avoidance (including through treaty-shopping arrangements). The provisions of Article 6(3) will only apply where all contracting jurisdictions have provided similar notifications, thus creating a 'matching position'.

### **Action 7 – treaty abuse**

Article 7 contains a general anti-abuse rule based on the principal purpose of transactions or arrangements (PPT). It also contains an option to supplement the PPT with a simplified limitation on benefits (LOB) provision. The majority of signatories to the MLI, including Cyprus, have opted for a PPT alone. Cyprus has not provided any notification as regards adoption of the LOB provision.

The PPT effectively acts to deny treaty benefits if it is determined that the principal purpose of an arrangement, or transaction, was to obtain the treaty benefit. Persons to whom a treaty benefit is denied under the PPT may still be able to claim a treaty benefit, if they can establish that obtaining the benefit would be in line with the object and purpose of a specific treaty provision (objective test).

Cyprus has chosen to apply Article 7(4) of the MLI, in cases where the competent authority determines that such benefits would have been granted in the absence of the transaction or arrangement.

### **Action 14 – improving dispute resolution mechanisms**

Action 14 relates to a commitment by countries to implement a minimum standard to ensure that they resolve treaty-related disputes in a timely, effective and efficient manner. Approving the integration of Action 14 ensures that Cyprus complies with minimum standards for making dispute resolution mechanisms more effective.

In addition, the MLI introduces a mandatory binding arbitration (Articles 18 to 26) procedure. A party to the MLI that chooses to apply this procedure with respect to its CTAs must notify the 'depository' accordingly. This procedure will apply in relation to two contracting jurisdictions with respect to a CTA only where both contracting jurisdictions have provided such a notification. Cyprus has not yet opted in for mandatory binding arbitration but may do so at a later stage.

Where Articles 18 to 26 are not adopted, treaty parties are reliant on the mutual agreement procedure (MAP) article in tax conventions.

### **Impact of the MLI on Cyprus tax resident entities**

The PPT in effect is an anti-treaty abuse provision within the treaty itself. It seeks to disallow particular treaty benefits where, broadly, the principal purpose of establishing a particular transaction was to obtain the benefits of a tax treaty.

The PPT aims at tackling artificial arrangements and so the OECD makes it clear that where there is a core business activity and other reasonable explanations for setting up a transaction in a certain way (or in a certain jurisdiction) then the mere existence of a tax treaty benefit should not be sufficient to consider that such a benefit was one of the principal purposes.

As a result, treaty benefits linked to the use of a Cyprus tax resident entity will follow a pragmatic approach. Existing and new structures will need to ensure and display the by now known, globally accepted 'substance' requirements. Cyprus tax resident companies must ensure that their interests are protected via the application of the relevant objects and purpose of the international treaties and requirements imposed therein. Failure to adhere to these requirements may result, *inter alia*, in recharacterisation of incomes, loss of treaty benefits, double taxation, enhanced rates of withholding taxes, monetary penalties/prosecutions and application of controlled foreign corporation rules. In light of these developments, clients are advised to review their structures and seek to understand how these developments may affect them.



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