

Acceptable spreads on back-to-back loans

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Introduction

In July 2011, the Cyprus Tax Authorities issued the long-awaited Circular on the minimum acceptable spreads for back-to-back loans. This Circular has been welcomed by the financial industry as it can eliminate inherent tax risks on such transactions.

Related tax provisions in general

All transactions (including financing/loan arrangements) between related parties must, for tax purposes, be carried out at arm's length (e.g. at market rate), otherwise they are expected to have adverse tax implications.

Acceptable spreads for back-to-back loans

This Circular confirms the so-far unofficial position of the Cyprus Tax Authorities in accepting thin/small spreads for pure back-to-back loan transactions as at arm's length.

A pure back-to-back loan transaction is where a company borrows an amount and shortly afterwards on-lends the same amount. The minimum acceptable spreads as per the Circular, are as follows:

| Loan amount | Spread (profit margin) |
|--------------------|-------------------------------|
| € | % |
| < 50 million | 0,35 |
| 50 to 200 million | 0,25 |
| > 200 million | 0,125 |

E.g. borrowing €40m at 2% and on-lending it at 2,35%.

The above minimum acceptable spreads **per each** loan transaction are expected to be net of any related expenses or deductions. In cases where a lower net spread is applied, the Cyprus Tax Office is expected to make tax adjustments making up the difference, at least up to the spreads prescribed above.

For loans borrowed by the Cyprus company at 0% the minimum acceptable spread is 0,35% regardless of the amount involved.

For non back-to-back loans (e.g. loans out of own funds) the arm's length provisions are expected to be applied for tax purposes.

NOTES:

The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained. Totalserve Management Ltd will be glad to assist you in this respect. Please do not hesitate to contact us.