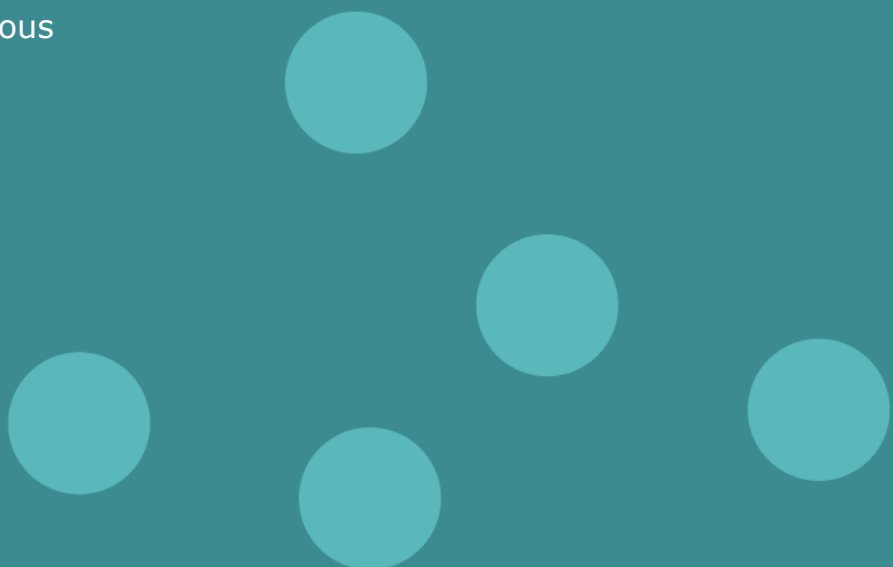




Valuations in Transfer Pricing and Cyprus Tax Practice

Marios Palesis
Theodora Charalambous
Katerina Anastasiou



A. INTRODUCTION

Valuations have become increasingly important in tax, corporate and regulatory practice, as taxpayers and businesses are often required to support the market value of assets, businesses, rights or transactions. In practice, a valuation helps translate commercial facts, projected cash flows, economic conditions and risk assumptions into a defensible and supportable value conclusion.

A valuation is not relevant only when a business is bought or sold. It may also be required in intra-group reorganisations, mergers and acquisitions, post-merger integration, transfers of shares or intellectual property, intercompany financing, guarantees, debt conversions, distributions in kind, capital reductions, liquidations, and cases where value may leave a country together with assets, functions or risks.

B. PURPOSE OF VALUATIONS

A valuation may be required in a variety of commercial, financial, tax, regulatory, or transaction contexts to determine the economic worth of an asset, business, or arrangement. A robust valuation should be grounded in a clear understanding of value drivers, business operations, relevant flows, functional responsibilities, and the intended purpose of the analysis.

Typical situations in which taxpayers may require a valuation include:

- Transfers of shares, business interests or business lines within a group or as part of M&A activity;
- Licensing, transfer or sale of intellectual property and other intangibles;
- Business restructurings involving the transfer of functions, assets, risks or profit potential;
- Post-merger integration, legal entity rationalisation and the redesign of transfer pricing policies;
- Intra-group financing arrangements, guarantees and instruments with embedded options or conversion features;
- Exit situations where Cyprus may cease to tax the value of assets or activities;

- Distributions in kind on capital reduction, dissolution or liquidation, and capitalisation of distributable reserves; and
- Termination, impairment or material modification of existing arrangements.

C. LEGAL FRAMEWORK UNDERPINNING THE NEED FOR VALUATION

The need for valuations in Cyprus arises partly from the legislation itself, in particular the Cyprus Income Tax Law 118(I)/2002, as amended (“**ITL**”). The ITL contains several provisions where market value, fair market value, arm’s length pricing or documented value is relevant to determining the applicable tax treatment. Valuations therefore serve a dual purpose: they are both a commercial tool and a tax compliance instrument, often carrying direct legal and financial consequences if absent or inadequately supported.

A number of regulatory provisions across Cyprus legislation which give rise to a requirement or a strong practical need for a valuation, are outlined below:

Arm’s Length Principle - Article 33 of ITL

Article 33 adopts the arm’s length principle for transactions between related parties and provides for adjustments where the conditions of a controlled transaction differ from those that would have been agreed between independent parties. Where the subject matter of the transaction between related parties is not readily observable in the market or difficult to price by reference to comparable transactions, a valuation may be the most reliable way to support the taxpayer’s position. This is most relevant where the transaction involves hard-to-value items — such as shares, intangibles, functions, risks or profit potential. Where the subject matter is unique, complex or not readily benchmarkable, a valuation can help substantiate the arm’s length nature of the transaction and support the relevant tax treatment.

Exit taxation – Article 33B of ITL

Article 33B is also relevant as it introduces an exit taxation framework based on market value of the assets, transposing the EU Anti-Tax Avoidance Directive (ATAD)

requirements into Cyprus law. The provision applies to Cyprus tax resident companies or Companies with PE in Cyprus and is triggered where Cyprus loses taxing rights over assets or activities, most commonly upon the migration of a company's tax residence, the transfer of assets to a foreign permanent establishment, or the transfer of a permanent establishment out of Cyprus. In such cases, the taxable gain is measured by reference to the market value of the assets at the time of exit less their tax base. Given that the market value at the date of exit feeds directly into the tax computation, a robust and contemporaneous valuation is not merely supporting documentation, it is central to the calculation itself.

Eductions for intangible assets and capital contributions – Article 9(1)(I) and Article 9B(3)(f) of ITL

Article 9(1)(I) governs the deduction available for capital expenditure incurred on the acquisition or development of an intangible asset, which is ordinarily spread over the asset's useful life (or over 20 years, for intangibles with an indefinite useful life). The paragraph addresses the case relevant to this article where an intangible asset is introduced into a company in exchange for the issue of share capital, the capital expenditure attributable to that asset for the purposes of this deduction cannot exceed the market value of the asset at the date of its introduction into the business, and no deduction at all is granted unless that market value is documented to the satisfaction of the Tax Commissioner. This is particularly relevant in group reorganisations and IP holding structures, where intangibles are commonly contributed to a Cyprus company in exchange for shares.

Article 9B(3)(f) imposes a parallel restriction in a different context. Article 9B grants Cyprus companies a Notional Interest Deduction (NID) calculated by reference to "new capital" introduced into the business. Where new capital is introduced in the form of assets in kind, which may include intangible assets, but is not limited to them, the amount treated as new capital for NID purposes cannot exceed the market value of those assets at the date of their introduction, and no NID is available on that capital at all unless the value is properly documented to the Commissioner's satisfaction.

Taken together, these two provisions mean that a Cyprus company receiving assets, including intangibles, in exchange for shares faces a documented valuation requirement on two separate fronts: the amortisation deduction available under Article 9, and the Notional Interest Deduction available under Article 9B. Failure on either front does not merely restrict the deduction to a lower amount; it can eliminate the deduction on that capital entirely.

Capital allowances on fixed assets – Article 10(2) of ITL

Under Article 10(2), where fixed assets are introduced into a company in exchange for shares, the capital allowances claimable on those assets cannot exceed their fair market value at the date of introduction. No allowance will be granted in excess of a documented fair market value, and where the value attributed to the assets is not adequately supported, the Tax Commissioner may challenge and restrict the allowances accordingly. An independent valuation at the date of introduction therefore provides the most reliable basis for substantiating the claimed allowances.

Deemed dividend distribution of assets – Article 3(2) of Special Defence Contribution Law 117(I)/2002

Article 3(2) of the SDC Law makes market value directly relevant in several corporate events. Where assets are distributed to shareholders in the context of a capital reduction, dissolution or liquidation, the excess of the market value of the distributed assets over the paid-up capital constitutes a deemed dividend subject to SDC. Any transfer of assets in the context of a profit distribution or capital reduction is deemed to occur at market value regardless of the consideration actually paid. Furthermore, the capitalisation of distributable reserves constitutes a dividend in the hands of the shareholders. From 1 January 2031, the redemption of shares in a collective investment scheme established in corporate form will also be treated as a capital reduction for these purposes. These provisions illustrate that the need for a valuation can arise across a broad range of corporate transactions and events.

OECD TP Guidelines

Cyprus transfer pricing rules are interpreted in light of the OECD Transfer Pricing Guidelines, to which express reference is made for interpretive purposes. The Guidelines are particularly relevant where valuation issues arise in connection with intangibles, hard-to-value intangibles, financial transactions and business restructurings, providing the framework for determining arm's length prices and dedicating specific guidance to the pricing and valuation of intangible assets.

Restructurings

For restructurings, robust documentation, prepared in accordance with Article 33 of the ITL, the Cyprus TP Regulations and Chapter IX of the OECD Transfer Pricing Guidelines, should explain the commercial and financial relationships before and after the restructuring, the business reasons and expected benefits, the viable options realistically available, the tax consequences of the transfers, the transfer of profit potential, and whether compensation for the restructuring is due and, if so, what is the purpose. Therefore, a well-documented valuation report can play a key role in supporting the arm's length nature of the restructuring, evidencing the value transferred, and substantiating whether any compensation is warranted.

D. VALUATION METHODOLOGIES

The selection of an appropriate valuation methodology is a critical step in any valuation exercise. No single approach is universally applicable. The choice depends on the nature of the asset being valued, the purpose of the valuation and the availability of reliable data.

The three principal methodologies recognised in valuation practice are the income approach, market approach and cost approach, summarised below.

Approach	Key features	Typical use cases
Income approach	Values an asset or business by reference to the present value of expected future economic benefits/ cash flows.	Intellectual property, business lines, customer-based assets, complex financial instruments.
Market approach	Derives value from observable market evidence such as comparable transactions, quoted prices or valuation multiples.	Assets or transactions for which reliable comparable market data is available.
Cost approach	Considers the amount required to recreate or replace an asset, often adjusted for obsolescence.	Certain routine or early-stage assets, replacement analyses and some internal-use assets.

E. RISKS OF NOT HAVING A PROPER VALUATION

Where a valuation is missing, generic, prepared for the wrong purpose, or disconnected from the actual facts of the transaction, the taxpayer's position may be significantly weakened. Tax authorities may challenge the valuation date, the assumptions used, the discount rate, useful life, comparable data, projected benefits, or even the appropriateness of the method selected.

The practical risks include difficulty supporting market value in exit taxation, restructurings, capital reductions, asset transfers, distributions in kind, liquidations, or asset introductions in exchange for shares; tax adjustments, restricted or eliminated deductions, additional assessments, interest or penalties where the value adopted is not properly supported; increased controversy risk, prolonged audits, and uncertainty over the tax treatment adopted; a weaker documentation position where the commercial rationale, assumptions, available alternatives and expected benefits are not adequately evidenced; the risk of relying on a valuation prepared for a different purpose

without testing its suitability for the transaction at hand; and, in a related-party or cross-border context, potential transfer pricing adjustments and double taxation exposure.

F. HOW CAN TP ALFA SERVICES LIMITED ASSIST

TP ALFA SERVICES LIMITED can assist you to:

- Assess whether a valuation is required for a particular transaction, reorganisation or distribution event;
- Identify the correct valuation question and align it with the broader tax and legal analysis;
- Select the most appropriate valuation methodology and critically test the key assumptions used;
- Prepare supporting documentation for transfers of shares, businesses, intangibles, financial instruments and distributions in kind;
- Support acquisitions, disposals, due diligence workstreams and post-merger integration projects;
- Prepare or challenge the business justification and before-and-after analysis for restructurings;
- Assess whether restructuring compensation may be due and how it should be supported;
- Support capital reductions, liquidations, exit scenarios and business restructurings where market value needs to be evidenced; and
- Represent and support clients during tax authority reviews, audits and transfer pricing disputes.

If your group is considering a capital reduction, a distribution in kind, a liquidation, a post-acquisition integration, an intra-group transfer or a migration of assets or functions, obtaining valuation advice at the planning stage can materially reduce tax uncertainty and help avoid avoidable controversy later.

DISCLAIMER

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Authors

Marios Palesis

Director - Partner

tp@tpalfa.com

Theodora Charalambous

Manager

tp@tpalfa.com

Katerina Anastasiou

Senior Associate

tp@tpalfa.com

T.P. Alfa Services Limited

12 Egypt Street

1097 – Nicosia

tp@tpalfa.com

www.tpalfa.com