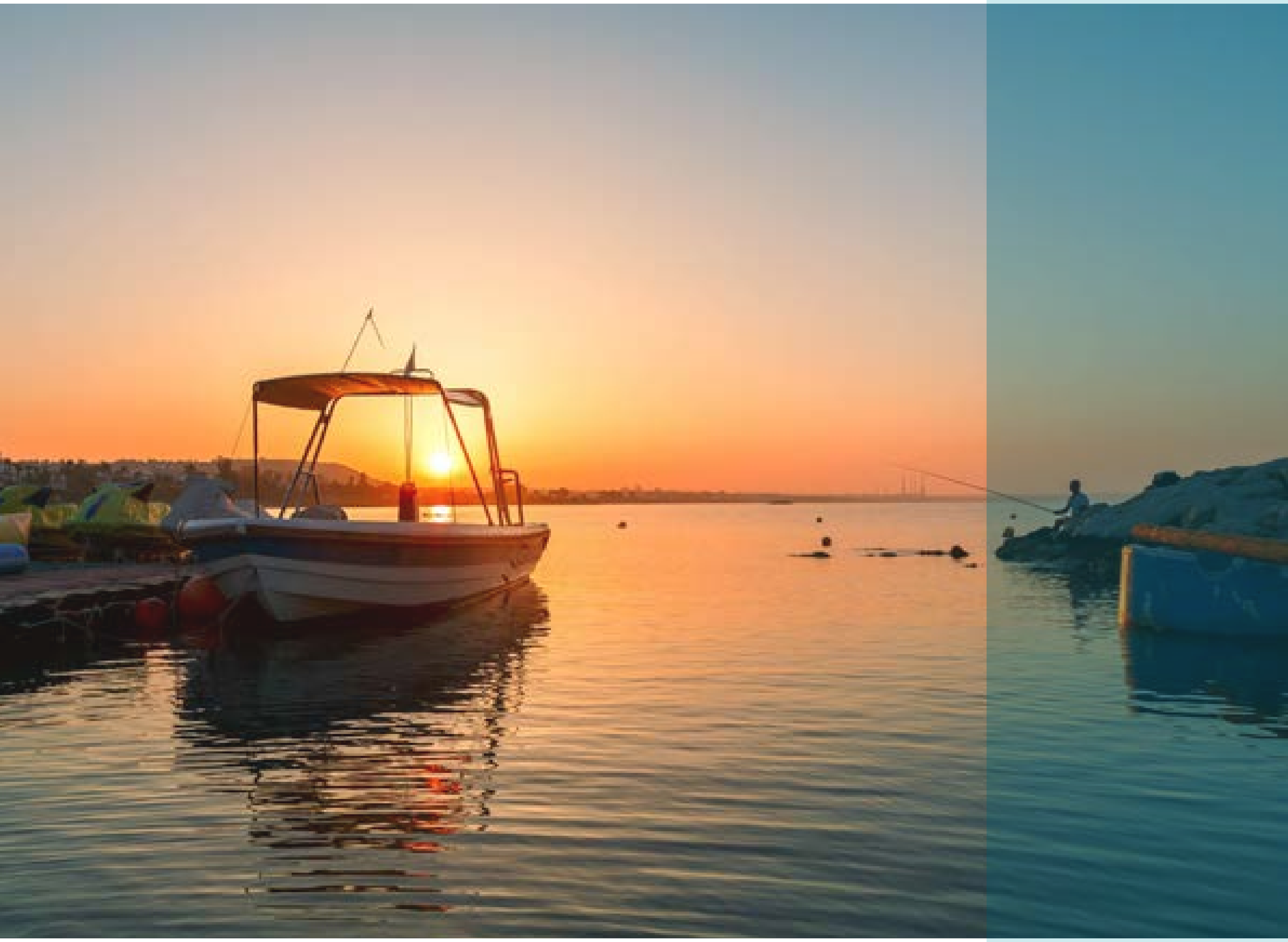
CYPRUS OPTION

ADIT



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Cyprus option
What you'll cover and what you'll gain

The Cyprus module is one of fourteen elective modules available to ADIT students. Introduced to the ADIT syllabus in 2014, and aimed at tax professionals around the world working with Cypriot international tax issues, this module addresses the tax regime of Cyprus as it relates to cross-border situations and transactions affecting individuals and companies.

What you'll cover

The Cyprus module gives candidates in depth knowledge of the Cypriot tax system in an international context. Key topics include:

- Income Tax
- The Special Defence Contribution
- Capital Gains Tax
- Immovable Property Tax, Stamp Duty and Land Transfer Fees
- VAT and indirect taxation
- The Cyprus Double Taxation Treaty Network
- Trusts
- Reorganisations and BEPS

What you'll gain

- A thorough grounding in current international tax issues in the context of Cyprus
- A robust understanding of theory coupled with practical application, giving you the confidence to apply these principles to your daily work
- Up to date knowledge of fast-changing developments in tax law, as exams are regularly updated to cover current tax laws and emerging trends

Cyprus option
Syllabus

I		Income Tax	
	A	Basic concepts	5%
	B	Sources of Income	10%
	C	Deductions, exemptions and personal allowances	10%
	D	Special modes of taxation	5%
	E	Reorganisations	5%
	F	Base Erosion and Profit Shifting (BEPS)	5%
	G	Double taxation relief and Cyprus Double Taxation Treaty Network	25%
II		Special Defence Contribution	5%
III		Capital Gains Tax	8%
IV		Immovable Property Tax	
V		Collection and Assessment Tax	
VI		Trusts	10%
VII		Land Transfer Fees	
VIII		Stamp Duty	
IX		Value Added Tax	10%
X		Organisation of the Tax Department	2%

I Income tax

A	Basic concepts	
	1. Meaning of residence for individuals and relevance of the term	3
	2. Meaning of residence for legal entities and relevance of the term	3
	3. Explanation of transparency of partnerships	1
	4. Meaning of tax year	2
	5. Explanation of the implications of statute law, case law and tax circulars	1
	6. Meaning of arm’s length transactions and implications of Article 33	2
B	Sources of Income	
	1. Explanation of income of residents vs. non-residents	2
	2. Income from business including from isolated transactions (badges of trade)	3
	3. Income from employment including benefits in kind and 90-day rule	2
	4. Income from dividends	2
	5. Income from interest, including explanation of interest income treated as business income	2
	6. Income from pensions and annuities	2
	7. Income from immovable property, including value of owner’s benefit	2
	8. Income from intellectual property	3
	9. Income from trading goodwill	2
	10. Income from benefit on debit balances	3
C	Deductions, exemptions and personal allowances	
	1. The concept of chargeable income	3
	2. Deductible and non-deductible expenditure	3
	3. Exemptions available including overseas permanent establishments	2
	4. Deemed interest expense on ‘fresh capital’ injection from 1 January 2015	3
	5. Tax treatment of losses	3

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	6.	Capital allowances	3
	7.	Personal allowances	3
	8.	Social insurance and social cohesion fund contributions	2
D		Special modes of taxation	
	1.	Shipping and aircraft businesses	1
	2.	Insurance companies	1
	3.	Royalties	2
	4.	Film rentals	2
	5.	Income of professionals, artists and other public entertainers	2
	6.	Income of companies providing services to the upstream energy sector	2
E		Debt restructuring	
	1.	Definition of restructuring, lender, restructuring price	2
	2.	Exemption from taxation of amounts written off restructured loans	2
	3.	Provisions to which exemptions do not apply	2
F		Reorganisations	
	1.	Types of reorganisations	1
	2.	Tax implications of reorganisation schemes	1
	3.	Exemptions do not apply in cases of artificial arrangements for the purposes of avoidance or deferral of taxes	2
G		Base Erosion and Profit Shifting (BEPS)	
	1.	Understanding of the concept of BEPS, and BEPS as a tax avoidance issue	1
	2.	BEPS by trading, royalty and financing companies	2
	3.	Provisions in Cyprus legislation to combat BEPS	3
	4.	Double taxation avoidance where related companies are caught in BEPS, the European code of conduct EC2006/C176/02 and the relevant provisions of Article 9 OECD MC	1
H		Double taxation relief and Cyprus Double Taxation Treaty Network	
	1.	Double tax treaty relief	3
	2.	Unilateral relief and relief for underlying tax	3
	3.	Outline of OECD model convention	3
	4.	Cyprus's double taxation treaty network, including knowledge of the most popular treaties for inward and outward investment	3
	5.	Restriction of Foreign Dividend income exemption if it erodes the taxable base of the remitter company	2
	6.	Restriction of unilateral double taxation relief on foreign dividends received in cases of artificial arrangements for the purposes of avoidance or deferral of taxes	2
	7.	Multilateral automatic exchange of information (Application of the OECD Common Reporting Standard (CRS))	1

II Special Defence Contribution

A		Application of Special Defence Contribution (SDC)	
	1.	Residents and domiciled vs. non-domiciled residents and non-residents, including when beneficial owner of structure is non-domiciled or non-resident	1
B		Taxation of dividends	
	1.	SDC on dividends and deemed dividend distribution rules	1
	2.	Exemption of SDC on dividend between resident companies and four year exception rule	1
	3.	Clawback of deemed distribution exemption on reorganization, on future disposal of previously exempt asset transfer	2
	4.	Definition of restructuring, lender, restructuring price	1
	5.	Exemption from deemed distribution of amounts written off restructured loans	2
	6.	Provisions whereby exemption from deemed distribution of amounts written off from restructured loans does not apply, and general anti-avoidance provisions	2

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C	Taxation of interests	
	1. SDC on interest including explanation of application when interest is considered business income	1
	2. Application of the reduced rate	1
D	Taxation of Rental Income	
	1. SDC on rental income	1

III Capital Gains Tax

A	Chargeable gain	1
B	Rollover relief	1
C	Application to sale of shares	1
D	Exemptions and losses	1
E	Exemption from scope of tax of disposals of taxable property acquired up to 31 December 2016	1
F	Definitions of restructuring, lender, restructuring price	2
G	Capital Gains Tax exemption for amounts written off from restructured loans	2
H	Provisions under which exemptions do not apply	2
I	Tax is the obligation of the borrower, but the lender has the obligation to withhold in cases where exemptions do not apply	2
J	Definitions of sale and leaseback, finance lease, simple finance lease, lessor, leasehold premium, lessee, connected person and company	2
K	Transfer of leasehold premiums between connected parties; tax obligation on the lessee, the lessor has the obligation to withhold the tax	2

IV Immovable Property Tax

A	1 January 1980 values and rates of tax	1
B	Payment and assessment	1
C	Purchaser payment of tax where legal transfer of property is still pending	1

V Collection and Assessment Tax

A	Method and dates of payment of tax, including temporary taxation provisions	2
B	Penalties for late or non-payment	2
C	Powers of the Commissioner	1
D	Definitions for debt restructuring, lender, restructuring price	1
E	Memo on immovable property transferred to the lender when the property is transferred under a debt restructuring scheme	1
F	Commissioner discretion to transfer the memo to another property, to negotiate a settlement to free it from the memo or to grant relief for insolvent individuals of illiquid companies	1
G	Objections, assessments and appeals	1

VI Trusts

A	The Cyprus International Trust vs. the Cyprus Trust	3
B	Administration of a trust for tax purposes	3

VII Land Transfer Fees

A	Rates of fees	1
B	Definitions for restructuring, lender, restructuring price	1
C	Anti-avoidance; false declaration of the restructuring price	1

VIII Stamp Duty

A	Basic rules regarding instruments liable to duty	1
B	Definitions for restructuring, lender, restructuring price	1
C	Stamp duty exemption for documents within a debt restructuring scheme	1
D	General anti-avoidance provision regarding artificial arrangements for tax avoidance	1

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Syllabus

IX Value Added Tax

A	Meaning of taxable person and taxable supply	2
B	Place of supply rules for goods and services, including triangulation and reverse charge principle	2
C	The application of VAT to cross-border acquisitions and supplies	2
D	The application of VAT to imports and exports	2
E	VAT mixed transactions	2
F	Optional cash accounting scheme	2
G	Application of harmonised time limits for issuing invoices for intra-Community trade	2
H	Electronic invoices: content, storage, transmission, integrity and authenticity	2
I	Tax point changes for lawyers’ services and services in the building industry	2
J	Definitions for debt restructuring, lender, restructuring price	1
K	Memo on immovable property transferred to the lender when the property is transferred under a debt restructuring scheme	1
L	Commissioner discretion to transfer the memo to another property, to negotiate a settlement to free it from the memo or to grant relief for insolvent individuals of illiquid companies	1

X Organisation of the Tax Department

A	Organisation of the Tax Department	3

Cyprus option
Recommended ways to prepare for the exam

Course Provision

There are study options to suit everyone, from classroom learning to self-study. Whatever your preference, you'll find a method and providers that work for you. Find out more at www.adit.org.uk/courses

Publications

CTR. *A Practical Application of Income Tax in Businesses* (CTR Publications)
This manual covers all tax legislation in Cyprus in detail, giving an article-by-article explanation of the law, and including important court decisions and tax circulars. Loose leaf binder with subscription required for updates.
Available only in Greek.
Available from CTR Publications:
www.ctrpublications.com

CTR. *A Practical Application of VAT in Businesses* (CTR Publications)
This manual covers all VAT legislation in Cyprus in detail, giving an article-by-article explanation of the law, and including important court decisions and tax circulars. Loose leaf binder with subscription required for updates.
Available only in Greek.
Available from CTR Publications:
www.ctrpublications.com

Neofytou, N. *Cyprus in International Tax Planning* (Redimus Services Ltd, 2014) [ISBN: 9789963203109]

OECD, Committee on Fiscal Affairs. *Model Tax Convention on Income and on Capital* (Paris: OECD, 2017) [ISBN: 9789264287945]
Available from the OECD online bookshop:
www.oecdbookshop.org
Candidates may take a copy of this text into the examination.
Available from the OECD:
www.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017_mtc_cond-2017-en
Or available from Turpin Distribution:
http://ebiz.turpin-distribution.com/products/348283-model-tax-convention-on-income-and-on-capital-condensed-version-2017.aspx

OECD, Committee on Fiscal Affairs. *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (Paris: OECD, 2017) [ISBN: 9789264262737]
Chapter 1 is of relevance to the syllabus for this module.
Available from the OECD:
www.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017_tpg-2017-en
Or available from Turpin Distribution:
http://ebiz.turpin-distribution.com/products/338729-oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017.aspx

Savvides, S. *Cyprus Tax Laws loose-leaf books in Greek* (CTR Publications) [ISBN: 99635950104]
Available from CTR Publications:
www.ctrpublications.com

Terra, B. and Kajus, J. *A Guide to the European VAT Directives 2016. Volume 1* (IBFD, 2016) [ISBN: 9789087223571]
Available from IBFD: www.ibfd.org

Tolley Exam Training. *ADIT International Materials for 2018* (LexisNexis, 2018)
Candidates may take a copy of this text into the examination.
Available from LexisNexis:
examtraining@lexisnexis.co.uk

Van Raad, K. *Materials on International, TP and EU Tax Law 2018-2019.* Volume A (Leiden: International Tax Centre, 2018) [ISBN: 9789082585414]
Candidates may take a copy of this text into the examination.
Candidates with a pre-2016 edition may instead take Volume 1 of the earlier edition into the examination.
Available from the International Tax Centre at Leiden University:
www.itc-leiden.nl or b.bosman@itc-leiden.nl
Or available from Wildy & Sons: www.wildy.com

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Recommended ways to prepare for the exam

Court cases

Particular attention should be given to the following court decisions:

- Canada: Prévost Car Inc vs. The Queen, 2008 D.T.C. 3080, on the definition of the term 'beneficial ownership' in the context of a double tax treaty
- CY: Hagop Matossian, Case 1102 [14.9.1992], on tax of notional profit, enforcing the principle laid down in the UK case of Sharkey vs. Wernher [1956]
- CY: Faunus Investment Company Ltd, Case 423/85 [30.12.1986], on rule that double tax treaty provisions override local tax law provision
- CY: Serafino Shoe Industry and Trading Limited, Case 757 [16.05.1991], on rules on interpreting provisions of tax law
- CY: Canon Assurance Limited, Case 1203, [26.01.1996], on existence of permanent establishment
- ECJ: Marks and Spencer plc vs. David Halsey (Her Majety's Inspector of Taxes), Case C-446/03 [13.12.2005], on use of losses from foreign subsidiary as group relief
- UK: Wood vs. Holden [26.01.2006], on place of management and control

The following court decisions are also of interest:

- CY: Limassol Land Investments Ltd [1957], on badges of trade
- CY: Rallis Makrides [Ράλλης Μακρίδης] [18.2.1967], on badges of trade
- CY: Amani Enterprises (Houses) Ltd, Case 438 [27.3.1990], on badges of trade
- CY: Lavar Shipping Co. Ltd, Case 1109 [15.7.1994], on general principle regarding deduction of losses
- CY: Ktimatiki Etaireia A X"Savva Ltd [Κτηματική Εταιρεία Α. Χ"Σάββα Λτδ], Case 2090, [18.12.1997], on badges of trade
- CY: Theodosis Karaolis Holdings Ltd and A Kapetanios Holdings Ltd, Case 138/05 [11.02.2009], on computation of taxable gain for capital gains tax purposes when selling shares in a company that owns immovable property in Cyprus

International court cases can be found through a simple internet search.

Cyprus court cases are available free of charge from the Cyprus Bar Association's website:
www.cylaw.com

Tax Laws and Treaties

Particular attention should be given to the following:

- *1998 Cyprus/Russia Double Taxation Convention, together with 2010 Protocol*
- *The Income Tax Law, Law 118(I)/2002*

Both items are available from the Ministry of Finance website: www.mof.gov.cy

Other Tax and VAT Laws and Circulars

Particular attention should be given to the following circulars issued by the Department of Inland Revenue of Cyprus:

On exchange differences:

- Circular 1990/23 – Tax treatment of exchange differences
- Circular 2008/4 – Tax treatment of exchange differences arising directly or indirectly from the sale and purchase of shares

On the income/profit tax exemption on sale of titles:

- Circular 2008/13 – List of investment products that constitute 'titles'
- Circular 2009/6 – Amendment to circular 2008/13

On the deductibility of interest expense:

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- Circular 2010/8 – Interest that is not deductible for the purposes of calculating taxable income (Article 11 of the Income Tax Law)

On deduction of losses and distribution of expenses at arriving at taxable income:

- Circular 2008/14 – Deduction of losses and distribution of expenses and deductions for the purposes of determining taxable income

On when interest income constitutes business income:

- Circular 2003/8 – Article 8(19) of the Income Tax Law and Article 3(2)(b)(i) of the special contribution for the defence of the Republic Law

On debt restructuring:

- Circular 2016/2 – Debt restructuring

On BEPS:

- Double taxation relief for related companies, Law 11(III)/2006 (90/436/EEC)
- Circular 2007/5 – Acknowledgement of Law 11(III)/2006 and application of EU code 2006/ C176/02
- Letter of Director of Taxes dated 4 July 2011 to ICPAC on acceptable profit margins (within the frame of s.33 of Law 118(I)/2002 on triangular loan relationships between connected companies)
- ACTL Ministerial Order 161/2016 dated 20 May 2016 on Multilateral Automatic Exchange of Information (Adoption of the OECD Common Reporting Standard)

On double tax relief:

- Circular 2011/14 – Providing tax relief with regards to overseas tax that was paid on income arising outside of the Republic and which is taxable in the Republic (Articles 35 and 36 of the Income Tax Law)

On double tax treaties:

- Circular 2012/11 – Protocol that amends the Double Tax Treaty between Cyprus and Russia

Tax circulars are available only in Greek, and are available from the Ministry of Finance website: www.mof.gov.cy/mof/ird/ird.nsf/dmlcirculars_gr/dmlcirculars_gr?OpenDocument

Particular attention should be given to the following VAT circulars, issued by the authorities:

- Interpretative Circular 86 – Place of supply of services – changes after 1 May 2004
- Interpretative Circular 139 – Change in the place of supply rules for services as of 1 January 2010
- Interpretative Circular 145 – Change in the place of supply rules for certain services as of 1 January 2011

The following VAT circulars are also of interest:

- Interpretative Circular 101 – Sale of buildings with the land
- Interpretative Circular 105 – Barter transactions in the construction industry
- Interpretative Circular 127 – Deduction of input VAT when applying the reverse charge
- Interpretative Circular 166 – Obligation to register under Article 11B

VAT circulars exist only in Greek and are available from the Ministry of Finance website: www.mof.gov.cy/mof/vat/vat.nsf/All/EB4F13A5B6603053C225723C002A8DDF?OpenDocument

European Union Directives

The following EU Directives are of interest:

- Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated

Recommended ways to prepare for the exam

companies of different Member States [Interest and Royalties Payments Directive]

- Council Directive 2003/123/EC of 22 December 2003 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [Parents – Subsidiary Directive]
- Council Directive 2005/19/EC of 17 February 2005 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States [Mergers Directive]

Cyprus option
June 2017 examination questions

Transparent and accessible past papers

Real questions and answers from previous exams are available to ADIT students to help with their study. Practice with previous exams helps students become familiar with the format of the exam, identify areas for further study and focus on exam technique.

Other papers available

PRINCIPLES OF INTERNATIONAL TAXATION

AUSTRALIA	IRELAND
BRAZIL	MALTA
CHINA	SINGAPORE
CYPRUS	TRANSFER PRICING
EU DIRECT TAX	UNITED KINGDOM
EU VAT	UNITED STATES
HONG KONG	UPSTREAM OIL & GAS
INDIA	

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2017

PAPER 2.03 – CYPRUS OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

TIME ALLOWED – 3¼ HOURS

This paper has **three** parts: **Part A**, **Part B** and **Part C**.

You need to answer **five** questions in total.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **The** question in **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

Further instructions

- All workings should be made to the nearest month and in Euros, unless otherwise stated.
- Start each answer on a new page and clearly indicate which question you are answering. If you are using the on-screen method to complete your exam, you must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.
- Marks may be allocated for presentation.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering Parts B and C.
- The first 15 minutes of the exam consists of reading time. You will be allowed to annotate the question paper during this time; however, you will **not** be permitted to start writing or typing your answer, or use a calculator. The Presiding Officer will inform you when you can start answering the questions.

PART A

You are required to answer BOTH questions from this Part.

1. Mr Xing, aged 45, was born and raised in Tigral, a country in East Asia. In July 2015 he visited Cyprus for a holiday with his family and fell in love with the island. In October 2015 Mr Xing returned to Cyprus and applied for citizenship through the Citizenship by Investment program. In the same month, he bought a house in central Limassol for €700,000 and invested €5 million in a Cyprus real estate company (X Ltd), acquiring 55% of its shares.

In February 2016 Mr Xing's application was approved, and Mr Xing became a citizen of Cyprus in March 2016. Between March and July 2016, Mr Xing made a series of visits to Cyprus. During this period, he bought a deserted hotel in Larnaca for €6 million and spent another €1.6 million on its renovation. This was rented soon after to a tour operator, at an annual rent of €400,000. The hotel was built in 2000, at a cost of €900,000 on land which had been purchased two years previously for €400,000. It was rented out to a hotel operator in June 2016.

In July 2016 Mr Xing and his family moved permanently to Cyprus and they soon realised that the house in Limassol was too small for the family's needs. Accordingly, Mr Xing sold the house for €900,000 and bought a larger house in a rural area for €750,000 in September 2016. Mr Xing did not sell any of his property in Tigral, as his wife is not yet sure as to whether she will stay in Cyprus or move back to Tigral.

In October 2016, a friend of Mr Xing also decided to apply for Cyprus citizenship by investment, and accordingly made an investment of €2.5 million in X Ltd, acquiring 15% of X Ltd shares. As a result of this transaction, Mr Xing's holding in X Ltd was reduced to 45%. X Ltd did not have any transactions between October 2015 and October 2016.

Mr Xing is the founder of Xing Aviation Co plc, a company registered in Tigral and listed on the country's stock exchange. He is also the managing director of the company and holds a controlling interest in its share capital. He also holds a substantial amount of corporate bonds in the company. His salary from Xing Aviation plc in 2016 remained at the same level as for 2015, despite the fact that most of Mr Xing's time in 2016 was spent in Cyprus, either alone or with his family. Tax was withheld at source on Mr Xing's salary. Withholding tax in Tigral is at a rate of 10% on both outbound dividends and interest.

During 2016, Mr Xing was physically present in Cyprus for a total of seven months. He spent four months in Tigral, and spent the remaining month on business in other countries.

Cyprus has a double tax agreement (DTA) with Tigral, based on the OECD Model Tax Convention.

You are required to:

1) Discuss the tax residency position of Mr Xing for 2016, in light of his dual citizenship and the changes to his personal and economic ties. (12)

2) Explain the Cyprus Income Tax and Capital Gains Tax treatment of, and application of Special Defence Contribution to, Mr Xing's income for 2016. Your response must refer to all sources of income and transactions mentioned above. Calculations are required, but there is no requirement to compute the taxes payable. (13)

Total (25)

2. ADC Technical Projects SA (ADC) is a company which specialises in building ports. It is registered in Grevandia, an EU member state. ADC has recently been offered three projects, to build part of a port on the east coast of Cyprus. Project 1 will last for five months, Project 2 for eleven months, and Project 3 for 24 months. The company has the option to accept either one or more of the three projects.

ADC plans to use a number of its Grevandian staff members, but will also employ local staff in Cyprus and will be required to import building materials from Grevandia to Cyprus for use at the site.

The corporate income tax rate in Grevandia is 26%, whereas the tax rate on dividends is 10%. Grevandia applies the ordinary credit method of applying double tax relief on foreign income.

Cyprus and Grevandia have a double tax agreement (DTA), based on the OECD Model Tax Convention.

You are required to:

1) Explain the direct and indirect tax implications for ADC in Cyprus if only Project 1 is undertaken. (2)

2) Explain the direct and indirect tax implications for ADC in Cyprus if only Project 2 is undertaken. (4)

3) Explain the direct and indirect tax implications for ADC in Cyprus if Project 3 is also undertaken, in addition to Project 1 and/or Project 2. (4)

4) Notify ADC of the most tax efficient way of structuring its operation in Cyprus if only project 3 is undertaken. (6)

5) Explain ADC's social security obligations in relation to both its Grevandian and Cypriot employees. (5)

6) Explain the personal income tax position of the Grevandian employees in each of the three different projects, assuming that Grevandian employees will not be substituted during the project's execution stage. (4)

Total (25)

PART B

You are required to answer THIS question.

3. Pear Corp was registered in 2006 as an International Business Company (IBC) in a zero tax, non-EU jurisdiction. Pear Corp is 60% beneficially owned by Mr Andreou, a Cyprus tax resident, and 40% beneficially owned by Ms Murat, a Turkish Cypriot citizen who is tax resident in another EU State but also holds a Cyprus passport. The company's directors are local professional directors. Business strategy is formulated by Andros and Aishe who never participate in board meetings, all of which take place in the country of incorporation of the company.

Pear Corp's business is software development and support. Its main clientele consists of businesses from EU member states, the Middle East and central Asia. It maintains branches in Cyprus, Teshland (a non-EU State) and Urland (a non-EU State).

The Cyprus branch employs mostly administrative staff who undertake invoicing and receipt of money from EU states. The Teshland branch has the same function as the Cyprus branch for the Middle East and the Caucasian republics. Production and software support functions are mainly carried through the Urland branch, which employs some 100 programmers. The Urland branch does not perform any invoicing and therefore records no sales. The company's profit and loss account can be analysed as follows:

Branch	Cyprus €	Teshland €	Urland €	Company Total €
Income	1,000,000	800,000	0	1,800,000
Expenditure	(60,000)	(40,000)	(400,000)	(500,000)
Company's professional fees				(10,000)
Net profit/(loss) before taxation	940,000	760,000	(400,000)	1,290,000

Andros and Aishe do not receive any salary from Pear Corp. Instead they take out 60% of the company's after tax profits as dividends each year.

You are required to:

1) **Discuss the tax residency position of Pear Corp and the direct tax implications of the company's setup and operations.** (9)

2) **Discuss any business restructuring options available to Pear Corp which could result in a reduction of its direct tax liability.** (7)

3) **State the VAT compliance obligations of the Cyprus branch of Pear Corp.** (4)

Total (20)

PART C

You are required to answer TWO questions from this Part.

4. The OECD, the EU and other countries have in recent years engaged on what is known as the BEPS project".

   You are required to briefly explain what is meant by 'BEPS'. Explain the statutory measures that Cyprus has taken in response to the BEPS project, and identify the areas of the BEPS Action Plan in which Cyprus is significantly behind other countries. (15)

5. In 2015, Cyprus introduced the concept of domicile in its tax legislation.

   You are required to explain how 'domicile' is determined in the context of Cypriot tax legislation, and the tax implications on a non-domiciled individual who is a tax resident of Cyprus. (15)

6. You have been presented with the following transactions:

   a) Advocacy services undertaken by a Cypriot taxable person to a person residing outside the EU.

   b) Consultancy services performed by a Cypriot taxable person to a consultancy firm established outside of Cyprus.

   c) Entrance to an exhibition, for which a fee was charged by a Cyprus taxable person to a non-taxable person. The exhibition took place in another EU member state.

   d) Carriage of passengers from Cyprus to a non-EU destination by a Cyprus taxable airline, on a contract signed by a non-EU person.

   e) Services provided by a Cypriot civil engineer to a taxable EU person, relating to a building site located in another EU country.

   f) Services provided by a Cypriot civil engineer to a taxable EU person, relating to a building site located outside of the EU.

   g) Valuation services performed by a Cyprus taxable person on an artwork situated in an auction house in Italy, which belongs to a non-taxable Greek resident person.

   h) IT services undertaken by a Cyprus taxable person, to the non-EU branch of another Cyprus taxable person.

   You are required to determine the place of supply of the service in each of the above transactions for VAT purposes, and to state the corresponding VAT compliance obligations of the Cyprus taxable party. (15)

7. DGH Holdings Ltd (DGH) is a company registered and tax resident in Cyprus. During 2016, DGH had the following income:

	Note	€
Dividends from A Ltd	1	12,000
Dividends from B Ltd (net)	2	30,000
Interest from C Ltd (net)	3	15,000
Branch 1 dividends (net)	4	20,000
Branch 2 dividends (net)	5	8,000
Branch 3	6	0
Tourist apartments in Italy (EU)	7	16,000

Notes

1) A Ltd is a tax resident of another EU member state. DGH holds 20% of equity shares in A Ltd. No tax was withheld at source.

2) B Ltd is a tax resident of a non-EU state. DGH holds 25% of convertible shares in B Ltd. B Ltd has elected for the dividends payable to holders of convertible shares to be treated as a finance cost in its country of tax residence. Tax withheld at source was at a rate of 5%.

3) C Ltd is a 100% subsidiary of DGH and a tax resident of a non-EU state. Tax withheld at source was at a rate of 25%.

4) Branch 1 is a registered branch of DGH in another EU member state. The company withdraws all post-tax profits generated by Branch 1. Branch 1 paid income tax on its profits of €3,000.

5) Branch 2 is a registered branch of DGH in a non-EU state. During 2016, Branch 2 made a net profit of €50,000 but only remitted €10,000 to DGH after a deduction of branch remittance tax at source, at a rate of 20%.

6) Branch 3 is a registered branch of DGH in a non-EU state. Branch 3 incurred losses of €80,000.

7) The tourist apartments in Italy are duly licensed tourist apartments in Italy. During 2016 DGH made a pre-tax profit of €20,000 and paid taxes of €4,000 in Italy.

You are required to calculate DGH's Corporate Income Tax and Special Defence Contribution liabilities for 2016, stating any assumptions you made. (15)

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2017

PAPER 2.03 – CYPRUS OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

Tax residency of physical persons is determined by reference to physical presence according to Cyprus Tax Law.

As Mr Xing was physically present in Cyprus for more than 183, he is deemed as Cyprus tax resident for the 2016 tax year.

The question does not tell us as to how Tigral law determines tax residence of physical persons And therefore Mr Xing could find himself in a dual tax residency position, which means that The tie-breaker rules of Article 4 OECD MC will have to be applied between the Cyprus and Tigral competent authorities in such a case.

According to the tie-breaker rule, if both States consider an individual as their tax resident on the basis of physical presence or any other criterion. The next stage is to examine where the individual's center of vital interests are found.

From the facts of the case, Mr Xing's center of economic interests remains in Tigral, as he is still the managing director and controlling shareholder of a Tigral company. However, his family (personal) ties during 2016 were with Cyprus.

As personal (family) ties were in Cyprus during 2016, on balance Mr Xing will most probably be treated as a Cyprus tax resident.

Assuming that the center of vital interests cannot be easily be agreed between the competent authorities, the final test is that of citizenship.

However Mr Xing is a citizen of both countries and the citizenship test cannot be applied, although Mr Xing is still Tigral domiciled.

Part 2

Capital gain on sale of first private residence (900k-700k=€200K) – specifically exempt as acquisition and disposal took place before the end of year 2016 (s exemption).

Hotel rental income – Rent accruing in 2016 less 20% less annual capital allowances on initial cost of €900,000 @ 4% annually, taxed at standard personal income tax rates.

Hotel's renovation will be treated as a capital expense and not deductible for income tax purposes.

Hotel rental income – specifically exempt from special defense contribution (SDC), as Mr Xing is a non-dom.

Deemed divestment in real estate company (investment of Mr Xing's friend in October 2016). (Value of company in October 2015 was 5m/55% = €9m / Value of company in October 2016 was 2.5/15% = €16.67m / Mr Xing's gain (55%-45%) x (16.67-9)=€766,000 less lifetime exemption of €17.100 will be subject to capital gains tax at 20%.

Dividends and interest received from Xing Aviation Co Plc are specifically exempt from income tax.

Dividends and interest received from Xing Aviation Co Plc will be exempt from SDC, as Mr Xing is a non-dom.

Despite the analysis in part 1 above re: Me Xing's tax residency, Mr Xing's salary is taxable in Tigral, as Mr Xing had spent more than 90 days there during 2016 (Art.6 OECD MC).

As Mr Xing is a Cyprus tax resident, his salary from Xing Aviation Co Ltd, will also be taxable in Cyprus (Worldwide income basis of taxation).

Mr Xing will be able to claim the 90 day rule exemption, as he was employed by a foreign employer abroad.

Therefore 4/12ths of his salary will be exempt from income tax in Cyprus.

Mr Xing will also be able to claim DTR on his Tigral salary on 8/12 of the tax withheld at source from his salary in that country (ordinary credit relief s.23 Law 118/2002).

Question 2

Part 1

As project 1 will last for less than 6 months, assuming that the company will not register a branch in Cyprus, there are no income tax obligations in Cyprus.

The company will however be providing services to Cyprus and will have to register for VAT in Cyprus through a VAT representative and charge and account for VAT.

Part 2

Project 2 will last for more than 6 months and according to Cyprus income tax law, this will constitute a construction Permanent Establishment (PE). As such income attributable to this PE will be taxed in Cyprus at the standard corporate income rate of 12.5%.

However, in accordance with Art 7 of the OECD MC, a construction PE is only formed if the construction exceeds 12 months. As project 2 will last for 11 months only, this provision will override the Cyprus income tax law and therefore the income tax treatment of project 2 will be the same as that of project 1 (assuming that the company will not register a branch in Cyprus)
The VAT position of the company is exactly the same as for project 1 above.

Part 3

As project 3 will last for more than 12 months a construction PE will be formed, irrespective of the company registering or not registering a branch in Cyprus. As such income attributable to this PE will be taxed in Cyprus at the standard corporate income rate of 12.5%.

Grevandia will have to grant DTR to the company for corporate income tax paid in Cyprus per the OECD MC Art. 23 provisions.

The VAT position of the company is exactly the same as for projects 1 and 2 above.

Part 4

The company may either register a branch (or do not register a branch as the tax effect will be the same as registering a branch) or a subsidiary in Cyprus.

The profits of the Cyprus branch (or construction PE) will be taxed at the standard corporate tax rate of 12.5% in Cyprus.

They will also be taxed at 26% in Grevandia but DTR at 12.5% (Cyprus tax) will be granted. Marginal tax rate will therefore be 26%.

If a Cyprus subsidiary is registered to undertake the project, the project's profits will be taxed at 12.5%.

The Cyprus subsidiary will then pay out dividends to its holding company. There will be no withholding taxes or SDC withheld on these dividends as the company is a non-Cyprus tax resident.
Dividends received by the company will have to be declared in Greece and taxed at 10% in Grevandia.

The total tax rate will therefore be 22.5% (12.5% Cyprus + 10% Grevandia tax), assuming that all profits will be distributed as dividends, which is lower than the 26% total marginal rate if a branch (or construction PE) are operated.

If not all profits are distributed by the Cyprus subsidiary, the total tax rate will be lower. This gives an additional business tool to the company, as it gives it the opportunity of keeping undistributed profits in its subsidiary for future expansion.

The company should therefore register a subsidiary in Cyprus.

Part 5

Irrespective of which project the company engages in, it will have to register as an employer in Cyprus and pay social insurance contributions in respect to its Cypriot resident employees.

The same obligation exists in respect to its Grevandian employees. However, as the company is an EU company and as its employees are presumably also EU citizens, it may ask for an exemption on the basis that its Grevandian employees are not ordinary residents of Cyprus, unless some of them move their families to Cyprus and therefore become ordinary residents of Cyprus.

If the company applies the above exemption, it will have to continue paying social security contributions in Grevandia in respect of its Grevandian employees.

Part 6

If project 1 is undertaken, the company's Grevandian employees will spend less than 183 days in Cyprus and therefore have no obligation for income tax in Cyprus.

If project 2 is undertaken, the company's Grevandian employees will spend more than 183 days in Cyprus and therefore be liable for tax in Cyprus on their worldwide income. They will therefore have an obligation to register for income tax in Cyprus and pay tax on a self-assessment basis.

If project 3 is undertaken, the company's Grevandian employees will have the same obligations as in the case of project 2. However, the company (its branch or its subsidiary), will have to administer income tax deductions at source through the PAYE system.

PART B

Question 3

Part 1

Cyprus does not have specific CFC legislation. The only test as to whether a company is a Cyprus tax resident is the 'management and control' test.

According to the 'management and control' test (which is not defined by Cyprus tax legislation) it is generally understood that a company is a Cyprus tax resident if:

- The majority of its board of directors are Cyprus tax residents and
- Board meetings take place in Cyprus and
- The company's strategy is formulated in Cyprus.

In the case of Pear Corp., it is clear that the 'management and control' test is not satisfied and as such the company cannot be treated as a Cyprus Tax resident company, irrespective of the fact that its majority owner is a tax resident of Cyprus.

In relation to the company's operations, the profits attributable to the Cyprus Branch, are subject to Cyprus corporate income tax at the standard rate of 12.5%.

The Teshland branch profits are outside the scope of Cyprus income tax (but may be subject to taxation in Teshland).

In respect of the company's dividend payments, Andros has an obligation to declare his dividends and account for SDC at 17% by self-assessment.

Aishe's dividend income is not subject to any form of taxation in Cyprus, as she is not a Cyprus tax resident despite being a Cyprus passport holder.

Part 2

The company's Cyprus and Teshland branches are taxed on the arising profit basis, whereas at the same time the Urland branch is incurring losses as it has no income attributed to it.

In order therefore to have a fair balance of profits at each taxable profit center (Cyprus and Teshland branches), the production costs incurred in the Urland branch will have to be reallocated to the other two branches.

This can be achieved by either the Urland branch invoicing the other two branches of the company, or by setting up a subsidiary company in Urland to invoice the Cyprus and Teshland branches.

In either case, invoicing from Urland (Branch or subsidiary) will have to be done at arm's length per Art. 9 OECD MC and the OECD Transfer Pricing Guidelines.

According to the arm's length principle, connected parties must invoice between them at a transfer price that is determined if market conditions between unconnected parties were imposed.

If the arm's-length principle is not observed, tax adjustments may arise (in our case in Urland), and tax likages arise especially in light of the fact that Teshland and Urland are non-EU members and corresponding adjustments to the taxable profits of the Cyprus and the Teshland branches, may not be possible.

Part 3

Pear Corps Cyprus branch has an obligation to register for VAT in Cyprus and submit quarterly returns, as it makes taxable supplies of services.

It also has an obligation to submit recapitulative monthly statements under the VIES system in respect of its sales to EU counterparties.

Sales to EU counterparties who submit a valid VAT number are zero rated.

Sales to EU counterparties who do not provide a valid VAT number, are standard rated and Cyprus VAT at the standard rate will have to be charged and accounted for to the Cyprus VAT/Tax department.

PART C

Question 4

BEPS refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax jurisdictions.

Although Cyprus has been slow in amending its legislation, it has signed the following Multilateral agreements within the framework of the BEPS project:

1. The OECD Multilateral automatic exchange of information agreement or Common Reporting Standard (CRS) for the automatic exchange of tax related information held by its financial institutions (order of the Minister of Finance 477/2015 as replaced by order 161/2016, through which the Cyprus competent authorities will communicate information to 81 participating jurisdictions and
2. The Multilateral Competent Authority Agreement of Country by Country reports (CbC MCAA), on the basis of which, Cyprus competent authorities will be communicating tax related information to the tax jurisdiction of the parent company of a Multinational Group, which addresses Action 13 of the OECD action plan of the BEPS project.

In addition to the above Multilateral Conventions, Cyprus introduced an anti-avoidance provision in s 8(20) of the Income Tax Law 118/2002, which provides for the non-exemption of foreign dividend income in cases where the underlying profits of the remitter company have reduced that company's taxable base. This addresses Action 2 re: to neutralize the effects of hybrid mismatch arrangements.

A number of actions identified in the OECD action plan, evolve around the Controlled Foreign Company (CFC) issues, which is specifically included as action 3. Cyprus does not have any CFC legislation as at 31/12/2016.

The CFC issue also comes in action 4 which addresses base erosion via interest deductions and other financial instruments. In fact, tax practices in Cyprus allowing triangular interest relationships with zero-tax jurisdictions, encourage this type of avoidance schemes. However the 2015 addition of s 9B Law 118/2002, allowing a deemed interest deduction seems to effectively limit the "usefulness" of such triangular loan and interest relationships.

Another aspect of the OECD action plan (actions 8-10 and 13) relates to transfer pricing. Cyprus addresses this issue with just s 33 Law 118/2002, without any further legislation or regulation in relation to this.

Cyprus has made a few steps in relation to harmful tax practices and the prevention of Treaty abuse (actions 5 and 6), in that the Cyprus Tax Department has taken some practical measures, but which only rely on self-certification by a company's directors. Measures will have to be implemented for a more active procedure in examining taxpayers' requests for the issue of tax residency certificates which is in the center of Treaty abuse and harmful tax practices.

Question 5

The concept of “domicile” is defined in the the Wills and Succession Law, CAP. 195, as amended.

Under section 6 of CAP. 195, an individual has at any given time:

(a) a domicile of origin, or
(b) a domicile of choice, or
(c) an incidental domicile of where an individual is found/located.

In the case of a genuine child born during the lifetime of the father, the domicile of origin of the child, is the domicile of the father at the time of the child's birth.

An individual acquires domicile of choice by establishing his/her residence in any place in the Republic of Cyprus with the intention of a lasting or indefinite residence on the island.

The domicile of origin is kept until a domicile of choice is acquired.

Based on the above, a person born outside Cyprus, of a father whose domicile of origin was outside Cyprus retains such domicile of origin of the father. A person whose father had his domicile of origin in Cyprus, retains his domicile in Cyprus.

As from 16.7.2015, for special defence contribution purposes, the term resident individual means a Cyprus tax resident individual as applied for income tax purposes who also has a domicile of origin in Cyprus

A domicile of origin in Cyprus means a domicile under the provisions of CAP. 195, as amended, subject to the following exceptions:

1. An individual who has acquired and maintains a domicile of choice outside Cyprus, provided that he has not been resident in Cyprus, for any period of at least 20 consecutive years before the tax year. In such a case, no SDC is payable on incomes of such person whether arising in Cyprus or outside Cyprus.
2. An individual who was not tax resident in Cyprus for at least 20 consecutive years immediately before 16.7.2015. In such a case, no SDC is payable on incomes of such person whether arising in Cyprus or outside Cyprus.

Regardless of the domicile of origin, any individual resident in Cyprus, for at least 17 of the last 20 years before the tax year, that person will be deemed to have his domicile in Cyprus.

The concept of “domicile” has no bearing on an individual’s income tax status.

Question 6

Part 1

Place of supply is outside the EU and therefore outside the scope of Cyprus VAT. There is no obligation for VAT in Cyprus.

Part 2

Place of supply is the country where the client is established. If client established outside EU, the supply is outside Cyprus VAT scope. If client established in EU, supply is zero rated for Cyprus. VIES system declaration required

Part 3

Place of supply is the EU State in which the exhibition took place. No obligation for VAT declaration in Cyprus.

Part 4

Place of supply will be proportionate to the distance covered in Cyprus and outside Cyprus. Cyprus taxable person will therefore have to charge VAT at the standard rate in proportion to the distance cover.

Part 5

Place of supply is the State in which the building site is situated. No obligation for VAT in Cyprus.

Part 6

Place of supply is the State in which the building site is situated. No obligation for VAT in Cyprus.

Part 7

Place of supply is Italy (EU). No obligation for VAT in Cyprus.

Part 8

Place of supply is Cyprus, as the recipient of the service is situated in Cyprus. Supplier of the service has an obligation to charge VAT at the standard rate and account for it to the Cyprus VAT/Tax department.

Question 7

DGH Holdings Ltd Corporation Tax computation

All figures are in euros.

Dividends from A Ltd – exempt	0
Dividends from B Ltd (re-characterized as interest) 30,000/95%	31.579*
Interest from C Ltd (15,000/75%)	20,000
Branch 1 dividends/profits (exempt s.36 Law 118/2002)	0
Branch 2 dividends/profits (exempt s 36 Law 118/2002)	0
Tourist apartments – Italy (exempt s 36 Law 118/2002)	0
Branch 3 losses	(51.579)
Taxable income	0
Corporation Tax liability	0
SDC liability	0

* Application of new s8(20) of Law 188/2002

Assumptions

The nature of the company's activities relate to investments and therefore interest income is treated as active income.

Notes

- Foreign branch profits are exempt from taxation. Reference to dividends from foreign branches is not applicable.
- Tourist apartments in Italy are deemed as a permanent establishment overseas (s.5(s) Law 119/2002 definition) and exempt from taxation per s 36 Law 118/2002.
- Tax relief for foreign branch losses may be claimed under s13 Law 2002. The unutilized branch losses of 2016 (80,000-51.579), cannot be carried forward to year 2017. If in future years Branch 3 turns profitable, the amount of losses of €51.579 will be taxed in that future year or years (recapture of losses).
- If interest from B Ltd or C Ltd or both B Ltd and C Ltd are treated as passive interest income, they will be exempt from income tax. Hence more of the Branch 3 losses of €80,000 will remain unutilized. Such income will therefore be subject to SDC at a rate of 30% which is applicable to interest income.

Cyprus option
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