

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2026

MODULE 2.03 – CYPRUS OPTION

SUGGESTED SOLUTIONS

PART AQuestion 1Qualifying assets and income

Qualifying IP assets include patents and copyrighted software. Marketing-related IP (e.g. trademarks) does not qualify.

CypSoft Ltd owns (i) copyrighted software and (ii) a patent, therefore it holds qualifying intangible assets.

Qualifying profits may include royalties, license fees, compensation/insurance proceeds relating to the qualifying IP and embedded IP income in the sale of products/services/processes.

Trading income from the sale of qualifying IP may be included as qualifying income; however, capital gains on disposal of IP are outside the IP Box and are generally exempt from Cyprus income tax.

Nexus fraction and qualifying profits**Overall income (OI) calculation**

	<u>EUR</u>
Royalty income	900,000
Embedded IP income	400,000
Upfront license fee	200,000
Insurance/compensation	40,000
Total gross IP income	1,540,000
Less: customer support (direct)	-220,000
Less: other direct costs	-80,000
Less: amortisation/capital allowances (direct)	-100,000
Overall income (OI)	1,140,000

Determine cumulative expenditure brackets for the nexus fraction.

Qualifying expenditure (QE) includes in-house R&D costs and R&D outsourced to unrelated parties. QE excludes acquisition costs, interest, and R&D outsourced to related parties.

Uplift expenditure (UE) is the lower of: (i) 30% of QE, and (ii) acquisition costs plus related-party outsourcing.

Overall expenditure (OE) equals QE plus acquisition costs plus related-party outsourcing (cumulative).

Nexus fraction – cumulative to 31 Dec 2025

Qualifying expenditure (QE): $300,000 + 50,000 + 300,000 + 110,000 = 760,000$

Acquisition costs of IP (excluded from QE): 400,000

Related-party R&D outsourcing (excluded from QE): 80,000

Overall expenditure (OE) = QE + acquisition + related outsourcing: $760,000 + (400,000 + 80,000) = 1,240,000$

30% of QE: 228,000

Uplift expenditure (UE) = lower of 30% of QE and (acquisition + related outsourcing) = lower of 228,000 and 480,000

Nexus fraction = $(QE + UE) / OE = (760 + 228) / 1,240 = 0.7968$

Qualifying profits for 2025 = OI × nexus fraction

Qualifying profits = $1,140,000 \times 0.7968 = 908,352$ Euros

Question 2

Employment income and benefits in kind

Under the Cyprus Income Tax Law, employment income is taxable on an arising basis where it is derived from services rendered by a Cyprus tax resident individual.

Benefits in kind provided by reason of employment are treated as taxable employment income. The taxable value is generally determined according to prescribed valuation rules.

A company car available for private use constitutes a taxable benefit. Specific percentage-based valuation rules apply depending on the vehicle's characteristics. The benefit is included in gross employment income.

Employer-provided accommodation is likewise treated as a taxable benefit equal to the value of the accommodation provided or rent paid by the employer.

Employer contributions to approved pension funds are generally not treated as taxable income of the employee at the time of contribution, subject to statutory limits and conditions.

Pension contributions and donations

Personal contributions to approved pension or provident funds are deductible from taxable income subject to overall percentage limitations of remuneration.

Donations to charitable organisations are deductible provided statutory requirements are met. Such deductions reduce taxable income but do not affect Special Defence Contribution.

Dividend, interest and rental income – SDC and Gesy

As a Cyprus domiciled individual, Ms. F is subject to Special Defence Contribution (SDC) on dividend income, passive interest income and rental income.

Dividends are subject to SDC at the applicable rate. Interest income is also subject to SDC unless it qualifies as business income.

Rental income is subject to SDC on a statutory proportion of gross rental receipts.

In addition, General Healthcare System (Gesy) contributions apply to employment income, dividend income, interest income and rental income, subject to the annual contribution cap of 180,000 Euros.

Disposal of listed shares

Gains from the disposal of listed shares are exempt from Cyprus income tax and capital gains tax.

The policy rationale for this exemption is to enhance Cyprus's attractiveness as an international investment and holding jurisdiction and to promote capital market activity.

Note that Gains on disposal of unlisted shares may be subject to capital gains tax to the extent that the gain relates to increase in value of immovable property situated in Cyprus which form part of a company's assets.

Differences in taxation of domiciled v non-domiciled individual.

If Ms F was non-domiciled in Cyprus, she would still be subject to income tax in Cyprus as well as Gesy, on her Worldwide income .

However, as non-domiciled individuals are not subject to Special Defence Contribution (SDC), Ms F would not have been liable to SDC on her Dividend, Interest and Rental income.

PART BQuestion 3Corporation Tax computation

	EUR
Trading profit per accounts:	600,000
Add back non-deductible expenses:	
- Accounting depreciation:	100,000
- Directors' entertainment (non-deductible):	25,000
Adjusted profit before capital allowances:	725,000
Less: Capital allowances:	
- Opening WDV $\text{€}300,000 \times 20\% = \text{€}60,000$	
- Additions $\text{€}200,000 \times 20\% = \text{€}40,000$	
Total capital allowances:	-100,000
Adjusted trading profit:	625,000
Rental income:	
- Gross $\text{€}50,000$ - expenses $\text{€}6,000$	€44,000 tax rental profit
- Dividend income: Exempt (see part b)	
- Profit on disposal of shares: Exempt from corporation tax	
Total taxable income before losses:	669,000
Less: Brought forward tax loss (2024):	-200,000
Taxable income:	469,000
Corporation tax at 12.5%	58,625

Dividend and share disposal treatment

Dividend income is generally exempt from corporation tax in Cyprus. It may be subject to Special Defence Contribution unless participation exemption applies. Given the subsidiary is taxed at 25% (greater than 6.25%) and does not derive more than 50% passive income, the dividend is exempt from both corporation tax and SDC.

Profits from the disposal of shares are fully exempt from corporation tax in Cyprus, irrespective of whether the shares are trading or capital in nature.

SDC and Gesy on rental income

Rental income earned by a Cyprus tax resident company is subject to Special Defence Contribution at 3% on 75% of gross rental income.

Gesy contributions apply on rental income at the applicable rate but Legal Persons are not subject to Gesy.

Question 4

Cyprus domestic residence

Mr E does not satisfy the 183-day rule (150 days only). However, he may meet the 60-day rule provided that he:

- Spends at least 60 days in Cyprus (met);
- Does not spend more than 183 days in another single state (Colombia 160 days – condition met);
- Is not tax resident in another state (condition not met as Colombia treats him as resident);
- Maintains a permanent home in Cyprus; and
- Carries on business or employment in Cyprus.

Because he remains tax resident in Colombia, the 60-day rule is not satisfied.

Therefore, he is NOT Cyprus tax resident under domestic law.

Treaty tie-breaker – Article 4 OECD MTC

If both states consider him resident under domestic law (NOT THE CASE HERE), the treaty tiebreaker applies sequentially.

Permanent home

He has a permanent home available in Colombia (owned property where family resides) and rented accommodation in Cyprus. The Colombian home appears more permanent and enduring.

Centre of vital interests

Personal relations (spouse and children) remain in Brazil. Economic relations include directorship and salary from Cyprus company. However, substantial wealth and family connections remain in Colombia. On balance, centre of vital interests likely Colombia.

Habitual abode

160 days Colombia vs 150 days Cyprus – habitual abode Brazil.

Nationality

Brazilian national. If required, this would favour Colombia.

Accordingly, treaty residence would likely be allocated to Colombia.

Cyprus tax consequences depending on treaty outcome

If treaty residence is Colombia, Cyprus may tax only Cyprus-source income (e.g., salary for duties exercised in Cyprus).

Foreign income would not be subject to Cyprus residence-based taxation.

PART C

Question 5

Article 11B – legal framework and policy rationale

Article 11B of the Cyprus VAT Law introduces a domestic reverse charge mechanism for specified construction services supplied between taxable persons.

Under this provision, the liability to account for VAT shifts from the supplier to the recipient where both parties are VAT-registered and the services fall within the defined scope of construction activities.

The policy rationale is to combat VAT fraud, particularly missing trader fraud in the construction sector, and to improve tax collection efficiency.

By shifting the VAT accounting obligation to the customer, the risk of suppliers collecting VAT and failing to remit it is mitigated.

Application of domestic reverse charge

In transaction (1), SubA Ltd should not charge VAT on the €1,200,000 invoice. Instead, ADev Ltd must self-account for output VAT under Article 11B and simultaneously claim input VAT, subject to recovery rules.

Similarly, in transaction (3), where ADev supplies qualifying construction services to InCo Ltd (a VAT-registered taxable person), Article 11B may apply depending on whether the services fall within the statutory definition. If applicable, InCo accounts for VAT under the reverse charge mechanism.

Invoices must state that the reverse charge applies and reference Article 11B must be made. No VAT is charged by the supplier.

Interaction with 5% reduced rate for residential property

The reduced 5% VAT rate applies to the supply of qualifying residential property to eligible individuals for use as their primary and permanent residence.

This reduced rate applies to the final supply of the dwelling, not to supplies between contractors and developers.

Accordingly, Article 11B reverse charge applies to construction services between taxable persons irrespective of the ultimate VAT rate applicable to the completed property. The reduced rate does not disapply the reverse charge.

ADev Ltd must therefore self-account for VAT on construction services received, even though the eventual sale of residential units may be subject to 5% VAT.

EU services and input tax recovery

Under Articles 44 and 196 of the EU VAT Directive (as implemented), architectural services received from the Italian firm are subject to the reverse charge in Cyprus.

ADev Ltd must self-account for VAT on €300,000.

As ADev Ltd makes taxable supplies (both standard-rated and reduced-rated), these are considered taxable supplies for input tax recovery purposes. Therefore, full input VAT recovery is generally available unless the developer also makes exempt supplies (e.g., exempt land transactions).

If exempt supplies exist, partial exemption rules would restrict recovery.

Question 6

Taxation of trust income

Under Cyprus tax principles, a trust itself is not taxed as a separate legal person in the same manner as a company. Taxation depends primarily on the residence of the beneficiaries and the source of income.

Where beneficiaries are Cyprus tax residents, income may be subject to Cyprus taxation depending on its character.

Where beneficiaries are non-residents, only Cyprus-source income is taxable in Cyprus.

Foreign dividends and interest are generally exempt from Cyprus income tax. Rental income from Cyprus immovable property is subject to income tax in Cyprus. Gains on disposal of foreign securities are exempt from Cyprus taxation.

The domicile status of beneficiaries is relevant for Special Defence Contribution (SDC) purposes.

Distributions to Cyprus resident and domiciled beneficiary

Where a Cyprus tax resident and domiciled beneficiary receive a distribution, the tax treatment depends on the underlying nature of the income.

Dividend and interest income may give rise to SDC at the applicable rates. Rental income retains its character and may also be subject to SDC. Capital gains from disposal of securities remain exempt.

Trustees and compliance

Cyprus-resident trustees are responsible for compliance with tax reporting obligations, maintenance of proper records and ensuring appropriate withholding where required.

Trust registration obligations arise under the Cyprus International Trusts Law, and AML compliance must be observed.

Question 7

General principles of taxation

Life insurance companies in Cyprus are subject to corporation tax at the standard rate on their taxable profits. The computation of taxable profit is generally based on accounting profits adjusted in accordance with the Income Tax Law.

Given the specialised nature of life business, taxable profits are determined by reference to underwriting results and investment income, subject to specific rules governing technical provisions and actuarial reserves.

Premiums, claims and actuarial reserves

Gross premiums written form part of trading income. Reinsurance premiums ceded are deductible as incurred wholly and exclusively for the production of income.

Claims paid and payable (net of reinsurance recoveries) are deductible expenses, provided they are properly accrued and relate to the period.

Changes in actuarial reserves (technical provisions) are critical in life insurance taxation. An increase in actuarial reserves represents a charge to the profit and loss account and is generally deductible, provided it is calculated in accordance with regulatory requirements and reflects genuine actuarial liabilities.

Investment income and capital gains

Investment income forms part of taxable profits unless specifically exempt. Dividends received are generally exempt from corporation tax under participation exemption, subject to anti-avoidance provisions.

Interest income forms part of trading income where it arises in the ordinary course of insurance investment activity. Gains on disposal of securities are exempt from corporation tax in Cyprus, including gains realised by insurance companies, unless the assets derive value from Cyprus immovable property.

Special Defence Contribution and sector considerations

As a Cyprus tax resident company, LICO Ltd is generally subject to Special Defence Contribution on passive interest income unless such income is closely connected with its insurance business. Where interest income arises from the core insurance investment activity, it is treated as active business income and subject to corporation tax instead of SDC.

Dividends received are generally exempt from SDC under the participation exemption rules.

Sector-specific considerations include regulatory compliance under Solvency II, the interaction of actuarial reserving methodology with tax deductibility, and cross-border premium taxation rules within the EU.

Question 8

BEPS minimum standards in Cyprus

Cyprus, as an OECD Inclusive Framework member and EU Member State, has implemented the BEPS minimum standards.

Action 5 (Harmful Tax Practices): Cyprus replaced its previous IP regime with a nexus-compliant IP box requiring qualifying R&D expenditure.

Action 6 (Treaty Abuse): Cyprus adopted the Principal Purpose Test (PPT) through the OECD Multilateral Instrument (MLI), modifying many of its double tax treaties.

Action 13 (Transfer Pricing Documentation): Cyprus introduced Country-by-Country Reporting, master file and local file documentation requirements, and strengthened transfer pricing legislation.

Action 14 (Dispute Resolution): Cyprus applies Mutual Agreement Procedures and EU arbitration mechanisms.

ATAD I and II implementation

Cyprus implemented ATAD I and ATAD II, which translate several BEPS Actions into EU law.

Interest Limitation Rule (Action 4): Net borrowing costs are deductible only up to 30% of tax-adjusted EBITDA, subject to a €3 million threshold.

Controlled Foreign Company Rules (Action 3): Cyprus introduced CFC rules where a foreign subsidiary is controlled and taxed below 6.25%. Only income arising from non-genuine arrangements is included in the Cyprus tax base.

Hybrid Mismatch Rules (Action 2): Cyprus denies deductions or neutralises double deduction/deduction-non-inclusion outcomes arising from hybrid instruments or entities.

Exit Taxation: Latent gains are taxed when assets or tax residence are transferred out of Cyprus.

Treaty anti-abuse and MLI

Through the MLI, Cyprus incorporated the Principal Purpose Test into its treaties. Treaty benefits may be denied where obtaining such benefit was one of the principal purposes of the arrangement.

This limits the effectiveness of conduit structures lacking economic substance and requires commercial justification for treaty-based planning.

Post-BEPS competitiveness

Despite BEPS implementation, Cyprus retains a 12.5% corporate tax rate, participation exemption, exemption on disposal of securities, notional interest deduction, and a broad treaty network.

However, substance is now critical. Artificial structures face challenge under CFC rules, GAAR and treaty anti-abuse provisions. Cyprus remains competitive for genuine business activities supported by economic substance.