

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2019

MODULE 2.03 – CYPRUS OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

TIME ALLOWED – 3¼ HOURS

This exam 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 clarity of presentation of your answers.
- 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 questions in Parts B and C.
- The first 15 minutes of the exam is 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. 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. Cayman SEC Holdings Ltd is a company incorporated in the Cayman Islands that operates in Cyprus, through a fully fledged Cyprus branch which has been registered with the Department of the Registrar of Companies and Official Receiver. The company is wholly owned by USA SEC Inc., a company which is tax resident in the United States. The ultimate beneficial owner of the corporate group structure is a non-Cyprus tax resident individual.

The main activity of the Cyprus branch is the holding of equity investments in companies listed on the London Stock Exchange and the provision of financing to other companies in the SEC Group. The branch owns its own office premises in Cyprus, acquired at a price of €350,000 in February 2005, which are also fully fledged, employing eight people which carry out its activities.

The SEC Group intends, in the near future, to proceed with the disposal of the Cyprus branch and then plans to proceed with the liquidation of Cayman SEC Holdings Ltd. The group has already disposed of the Cyprus office premises belonging to the branch in October 2018 at a price of €500,000 and currently the branch is renting the same premises from the purchaser until the finalization of the business disposal and the resolution of all relevant legal and administrative matters.

The Cyprus branch has had a 2% interest bearing loan payable to USA SEC Inc., amounting to €250 million, since 2005. The loan was used partly to finance the equity investments, at a cost of €150 million, and partly to finance the provision of a 2.25% interest bearing loan, amounting to €100 million, to another group company in the British Virgin Islands, SEC BVI.

The branch has been declaring a minimum taxable profit margin of 0.25% in respect of the €100 million back-to-back loan arrangement, which has been duly approved by the Cyprus tax authorities.

The branch has been accruing interest expense since the inception of the payable loan term; however, due to its financial, economic and commercial distress, it has only been able to repay half of the principal and interest element of the loan. The branch has been incurring tax losses in the last five tax years, including tax losses of €620,000 in the 2018 tax year. The branch owners are seeking to use the group loss relief provisions of the Income Tax Law, prior to the branch disposal.

It is also the intention of USA SEC Inc. to waive the loan payable amount, prior to the above mentioned disposal and liquidation.

Cayman SEC Holdings Ltd also has a Cyprus tax-resident subsidiary, Cyprus SEC Holdings Ltd, a profitable group company with a taxable income of €1,980,000 in 2018. Upon the liquidation of Cayman SEC Holdings Ltd, Cyprus SEC Holdings Ltd will be transferred to USA SEC Inc. as part of the relevant liquidation proceeds. USA SEC Inc. intends to increase the investment in the Cyprus company in return for shares equivalent to €20 million, aiming to enable the Cyprus company to fund its trading activities, these being the provision of loans to related companies in the Russian Federation of an amount equivalent to €20 million. Of the total loan amount, €10 million will be 3% interest bearing and the remainder will be interest-free. The Russian Federation 10-year government bonds are issued at a coupon rate of 7.59%.

In addition, the Cyprus company intends to capitalise an amount shown in its financial statements, payable to USA SEC Inc., of €8 million. The funds were originally used to finance the acquisition of equity investments equivalent to €5 million, with the remainder used to invest in bonds carrying a coupon rate of 3.85%.

Continued

1. Continuation

You are required to critically analyse the direct tax implications concerning the Group's proposed course of action in relation to the Cyprus branch, in particular distinguishing between the relevant implications prior to the branch disposal, including the group loss relief implications for the tax year 2018, and the implications at the time of the branches disposal. Where applicable, support your answer with relevant computations. Relevant RPI indices were 225,57 (September 2018) and 88,16 (February 2005). (25)

2. Mr Abdul, his wife Fatima and their 12-year-old daughter are all Qatari citizens. They relocated to Cyprus in September 2015, renting a house in Limassol. As Mr Abdul travels extensively around the world, he was never a tax resident of any state, nor did he reside for a period of more than 183 days in any state during any of the years below.

Mr Abdul spent the following time in Cyprus:

<u>Year</u>	<u>Number of days</u>
2016	95
2017	56
2018	84 (including 31 December)

Mr Abdul commenced employment with MA Security Services Ltd, which he founded, in 2017.

In accordance with the Cyprus Wills and Succession Law, Mr Abdul has a Qatari domicile of origin.

MA Security Services Ltd offers security consultancy services around the globe, primarily in Switzerland, Norway, Luxembourg, India and Hong Kong.

Mr Abdul earned the following income in 2018:

- Salaried income as an executive of MA Security Services Ltd, amounting to €150,000. The salaried income earned during 2017 was €110,000.
- Fees of €10,000 relating to his participation on the board of directors of the Cyprus company.
- Dividend income of €30,000 distributed by MA Security Services Ltd from profits generated by the company in 2017.
- Interest income from fixed deposit accounts maintained with a bank in Hong Kong, amounting to €90,000. This income was subject to withholding tax at the rate of 10% in the country of source.

You are required to:

- 1) **Analyse the Cyprus income tax implications for Mr Abdul for the 2018 tax year, with reference to the relevant legislative provisions.** (18)
- 2) **Compute the taxable income of Mr Abdul for the 2018 tax year.** (5)
- 3) **Analyse the implications of the Special Contribution for the Defence law for Mr Abdul for the 2018 tax year, with reference to the relevant legislative provisions.** (2)

Total (25)

PART B

You are required to answer THIS question.

3. You are a professional tax advisor and you recently held a meeting with prospective clients. The proposed venture relates to the establishment of a Cyprus company (CypCo) in which an Austrian company and a Russian company will participate.

The Austrian company (AusCo), the registered owner of intellectual property (IP) rights relating to an industrial process for the construction of crude oil storage tanks, will assign the exploitation rights resulting from use of the IP to CypCo for a period of ten years. Construction in Russia will be operated by an affiliated Russian company in Russia (the Russian company in the venture, RusCo), which will participate in the share capital of CypCo and will pay royalties to CypCo for exploitation of the rights originally granted by the Austrian shareholder.

It is estimated that the revenue from the new venture will amount to €40 million during the first year of operation, with profit before tax and payment of IP royalties of €6 million, reflecting a 15% gross operating margin. Over the ten-year life-cycle of the project, revenues will grow at an annual rate of 5%. Payment of IP royalties may be fixed over the project's life-cycle or may be variable and expressed as a percentage of revenues.

The prospective partners are looking for the optimal solution in terms of reducing the overall tax liability. This will involve the determination of the IP royalty rate to be paid by CypCo to AusCo, the determination of the IP royalty rate to be paid by RusCo to CypCo, and structuring the transaction in an appropriate way in order to enable CypCo to claim the deemed interest expense on new capital under section 9B of the Cyprus Income Tax Law 118/2002 (as amended).

You are required to:

- 1) **Explain the provisions of section 9B of Income Tax Law 118/2002 (as amended).** (3)
- 2) **Analyse possible scenarios of how this proposed venture may be structured, indicating the tax treatment in each case as well as the associated tax risks of the above transactions.** (17)

Total (20)

PART C

You are required to answer TWO questions from this Part.

4. “Cyprus grants Double Taxation Relief (DTR) on the basis of both the ordinary credit relief method, and the exemption method in line with Article 23 of the OECD Model Tax Convention.”

Critically examine the above statement, with reference to the relevant sections of the Cyprus Income Tax Law. (15)

5. “Section 2 of the Cyprus Income Tax Law 118/2002 (as amended) defines the various types of a permanent establishment.”

Identify the types of permanent establishment recognised by the Cyprus Income Tax Law, highlighting differences with Article 5 of the OECD Model Tax Convention. (15)

6. Law 157/2017 amended the Value Added Tax (VAT) Law 95/2000, with the effect that from 2 January 2018 some immovable rentals and sub-rentals were brought within the scope of VAT.

For each of the following transactions, you are required to explain the VAT treatment:

- 1) Andreas, a wealthy real estate owner, constructed a commercial building which he then leased to B Ltd with subleasing rights. B Ltd subleased the building to C Ltd, a trading company. In 2018, Andreas also leased a building plot to X Ltd. X Ltd used the plot to build shops, which were in turn leased to a number of tenants who conduct various VAT-taxable trading activities. Finally, Andreas owns three residential flats which he inherited from his parents in 2001, and which he rents out on 12-month leasing contracts to families. The families use these flats as their principal residences.

You are required to explain the VAT treatment of each of these transactions. (4)

- 2) XY Ltd constructed a small shopping mall in 2016 which it leased out to various traders in 2017. Input VAT on the construction totalled €30,000. In 2018, XY Ltd renegotiated and signed new contracts with its tenants.

You are required to explain the VAT treatment of each of these transactions. (3)

- 3) Con Ltd is a construction company which constructed a building consisting of four shops and ten flats. The building was completed in 2016 and input VAT of €240,000 was claimed by Con Ltd. The total floor area of the ten flats was 1,000 square meters and each shop had a floor area of 50 square meters. All ten flats were sold in 2016 and 2017. As the shops were not sold, Con Ltd decided to lease them out. Two shops were leased to a pharmacist, the third one to a dentist and the fourth to a physiotherapist, during 2018.

You are required to explain the VAT treatment of each of these transactions. Your answer should determine whether or not there will be any restriction on the input VAT previously claimed. (8)

Total (15)

7. “The Cyprus Income Tax Law 118/2002 (as amended) had, among other provisions, incorporated the provisions of the EU Merger Directive.”

Explain to which provisions of the Cyprus Income Tax Law the above statement refers, and how the provisions of the EU Merger Directive were incorporated. (15)

Total (15)