

Answer-to-Question-_1_

1) Cyprus Income Tax & Capital Gains Tax Implications for XML Holdings group Companies for 2021

a) Loan receivable for XML CY

Income tax implications

XML CY is a Cyprus tax resident Company, therefore is taxed in Cyprus on its worldwide income.

XML CY has received from XML BE a loan receivable that will be outstanding from XML Netherlands. For the actual transfer of the loan there are no income tax implications in Cyprus.

The only implications is that the interest income generated from this loan will, from the date of the transfer, be taxed by XML CY under corporation tax at 12.5% since its principal activities are financing. Therefore interest income for XML CY is not considered as investment income but as business income arising from its ordinary activities.

Also as per the information provided in the scenario, the interest income is at arms length which is in accordance to the Article 33 of Cyprus income tax law cap 118/2002. Therefore most probably no adjustment will be made by the Cyprus Tax Department upon the review of XML CY tax return for the respective year. However XML CY in the absence of a transfer pricing study, needs to ensure that a reasonable margin is earned from all of its related parties back to back loans including this one, a minimum margin of 2.33% (after tax) in order to be in line with the simplification measures as per circular dated 30.6.2017 issued from Cyprus Tax Department,

However is up to the discretion of the Cyprus Tax Commissioner if a Transfer pricing study, as per circular 30 June 2017 issued

from the Tax Department, is requested since the loan is from a related Company and the principal activities of the XML CY to the financing activities both to related and unrelated parties.

Capital gains tax implications

No capital gains implications arise from the contribution of the loan receivable to XML CY since this is out of scope of capital gains.

b) new issue of share capital and share premium

Income tax implications

XML CY has issued new share capital to XML BE.

As per Article 9b of Cyprus income tax legislation, as of 1 January 2015 any company that issues new share capital, premium (either from ordinary or preference shares) and which capital is contributed to generate business income, is allowed to a notional interest deduction (NID) to be deducted from its taxable income under corporation tax.

Therefore since XML CY issued new share capital during 2021, that was contributed in order to generate business income i.e the loan from XML Netherlands that generates interest income that is considered business income for XML CY, then XML CY is allowed to this NID Deduction from its corporation tax.

The NID is calculated by taking the total amount of the share capital issued multiplied by the reference rate of the 10 year government bonds of the country in which the fund have been invested (i.e Netherlands in this case) or Cyprus in case that country did not issued 10 year government bond plus 5%. The

reference rate is the rate issued by 31 December of the preceding year of the relevant tax year.

The above result is restricted to the 80% of the taxable income of the Company for the specific tax year.

In case the Company is loss making then no NID deduction can be claimed.

The NID deduction is allowed to be claimed for all the relevant years from the year of share capital issued until the share capital is decreased.

Therefore for XML CY if its profitable for 2021, will be allowed to the NID deduction for 2021.

Capital gains implications

No capital gains implications arise from this transaction.

c) contribution of shares by the Companies

Income tax implications

No income tax implications arise for the contributions of the shares of XML CY to any of the Companies or to UBO since gain from disposal of shares is exempted from Cyprus Income tax.

Capital gains tax implications

However even though the gain from the disposal of shares is exempted from capital gains as per Cyprus tax legislation, since XML CY owns an immovable property in Cyprus, capital gain tax is triggered.

Therefore upon the disposal of the shares of XML CY from XML BE to the UBO, XML Be will be imposed to capital gain tax at 20% in Cyprus since the property is situated in Cyprus (office premises).

XML BE will pay capital gains tax based on the % of the shares owned, calculated on the market value of the property less the indexed cost of the acquisition of the property less any direct cost from its acquisition. This will be multiplied by the % owned by XML BE and any gain arising, capital gains will need to be paid to Cyprus Tax Department. No exemptions are applicable for companies only for individuals are applicable.

Now if Cyprus and Belgium have a double tax treaty (DTT), as per Article 13 of OECD, there is also one more condition that needs to be examined, whether the immovable property is more than 50% of XML CY total assets. If yes then there will be capital gains on the disposal of the shares. If not then the capital gain will be exempted.

The same capital gains implications in Cyprus will apply for the transfer of the shares from the UBO to the BVI Trust.

The UBO will be imposed to capital gains tax based on the procedure mentioned above, however the only difference is that because he is an individual he is allowed to the lifetime exemption of €17,086 to be deducted from the capital gain that will arise.

Again if Switzerland and Cyprus have a DTT then the 50% exemption will be applicable to this transaction as well.

2) Income tax and Special Defence Contribution implications for

XML CY of the proposed dividend distribution and liquidation proceedings.

a. Dividend distribution

Income tax

As per Cyprus income tax law cap 118/2002, dividend income is exempted from income tax. Therefore no income tax implications for XML CY in this case.

SDC implications

As per Cyprus tax law for the special defence contribution cap 117/2002, overseas dividend income is exempt from SDC.

However the exemption does not applies of both of the following 2 conditions apply:

- a. the principal activities of the Company providing the dividends is more than 50% investing activities and
- b. the foreign tax burden is less than 6.25% (50% of the Cyprus corporation tax).

If both apply then no exemption is provided and there will be SDC for XML CY at 17%.

If SDC is applied then any withholding tax paid in Poland will be given as a double tax relief to XML CY in Cyprus.

b. Liquidation

In case of liquidation then all the income generated from the

disposal of the asset will need again to be distributed to XML
CY.

Therefore the same conditions will apply as above for the
dividend distribution.

-----ANSWER-1-ABOVE-----

-----ANSWER-2-BELOW-----

Answer-to-Question-_2_

Calculation of amount tax deductible exceeding borrowing costs (EBC) for all 3 Cyprus Companies.

TEST 1

First of all we need to examine which Companies form part of the Cyprus group for the interest limitation calculation.

In order to form part of the Group they need to be Cyprus tax resident companies and to be owned at least 75% of their share capital, voting rights or profits.

Based on the information provided, all three Companies are Cyprus tax resident Companies (services Cyprus is a Jersey company but is tax resident in Cyprus).

Also SPI Holdings owns more than 75% of the other two companies share capital (79% in Services Cyprus and 80% in Highlands).

Therefore all form part of the group for the interest limitation calculation

TEST 2

Now we need to examined whether the equity escape provision exemption applies for the Cyprus Group.

The equity escape provision is as follows:

We need to compare the total assets of the Cyprus group divided to the total equity of the Cyprus Group with the total assets of the worldwide group divided by the total equity of the worldwide group. If the difference to this two ratios is less than 2% then the Cyprus group is exempted from the interest limitation rule and no calculation of the exceeding borrowing cost will be required.

Cyprus Group ratio = Total assets/Total equity=
 $4.500.000/2.000.000=2.25\%$

Worldwide group ratio= Total assets/Total equity =
 $24.000.000/18.000.000= 1.33\%$

The difference between the Cyprus Group and Worldwide group is 2%
Difference $1.33-2.25 \Rightarrow 0.92\%$

Therefore the Cyprus Group is exempted from the interest limitation for 2021 and we do not need to proceed to calculate the exceeding borrowing cost based on the interest limitation rule.

Therefore all of their interest tax deductible expense is fully allowable for 2021

2.000.000 for SPI Holdings
350.000 for Services Cyprus
1,250.000 for Highland Ltd

If the equity escape did not applied and then we will have proceeded to calculate the exceeding borrowing cost for the Cyprus Group as follows :

a. Tax deductible interest expense for the Cyprus group less

-----ANSWER-3-BELOW-----

Answer-to-Question-_3_

Hybrid and reverse mismatches

Hybrid mismatches refer to the types of income that might be considered as interest in one country (that is tax deductible from income tax) and dividend in the other country (that might be exempted from income tax or other type of tax).

Basically the problem with the hybrid mismatches is that a tax payer can benefit from double deduction or double exemption for the same income/expense/ amount paid i.e if a dividend paid from one company in an X jurisdiction to another company in another jurisdiction then if in X jurisdiction that amount is considered as interest then this will be tax deductible from its taxable income.

If the dividend income received in the other jurisdiction is considered as dividend and is exempt from tax in that jurisdiction then that group of Companies that benefited for the same amount double benefit (deduction of expense and exemption of the income).

Hybrid mismatches is part of Action plan 2 of the BEPS that was issued in order to address this matter and is as well part of the Anti-Tax Avoidance Directive.

Cyprus in order to address the hybrid mismatches has recently introduced as part of his tax legislation and taken some measures like,
in case any dividend received from a Cyprus Company is considered as interest expense in the other jurisdiction and Cyprus has double tax treaty with that jurisdiction then that amount will be considered and taxed as interest income in Cyprus either under income tax (if it is considered business income) or under SCD at 30% if it is considered investment income.

-----ANSWER-3-ABOVE-----

-----ANSWER-4-BELOW-----

Answer-to-Question- _4_

1) Ms Soyer tax residency implications for 2021

As per Cyprus income tax legislation cap 118/2002 in order for an individual to be considered as Cyprus Tax Resident, she needs to spend more than 183 days in Cyprus for the specific tax year. This is the 183 days rule.

Ms Soyer during 2021 has spend 106 days therefore she has not spend more than 183 days in Cyprus.

If the 183 rule does not apply like in Ms Soyer case, there is also the 60 days rule in Cyprus.

However in order for the 60 day rule to apply all of the following 5 conditions must apply :

a. She needs to be in Cyprus for at least 60 days.

She has been in Cyprus for 2021 for 106 days therefore this condition applies for her.

b. She needs to have employment or business income from Cyprus that is active as at 31 December of the relevant tax year.

Ms Soyer has set up Cyprus Company fro which she receives business income. Therefore this condition applies as well for her.

c. She needs to not be considered as a tax resident in any other country.

As per the information provided for 2021 she is not considered a tax resident in any other country. Therefore this condition is also valid for Ms Soyer.

d. She needs to not have spend more than 183 days in any other country.

As per the information provided, she has spend 92 days in Malta, 106 in Cyprus and therefore the remaining days are 167 days for which we have no information. But this is irrelevant since they are 167 days therefore she has not spend more than 183 days in another jurisdiction. Therefore this condition is also applicable for Ms Soyer.

e. She needs to own a house in Cyprus or renting one.
As per the information provided she has a private residence in Limassol.
Therefore this condition is also applicable for Ms Soyer

As a result since all 5 conditions are applicable for Ms Soyer for 2021, she is considered as Cyprus tax resident for 2021 under the 60 days rule.
Therefore she will be taxed in Cyprus for 2021 on her worldwide income.

2) Income Tax Implications for Ms Soyer for 2021

As also mentioned above, Ms Soyer is a Cyprus tax resident for 2021 and will be taxed on her worldwide income, so income received from Cyprus and Poland.

Rental income

Ms Soyer is receiving rental income from Poland.
This type of income is both taxed under income and special defence contribution.

In income tax this income will be included as part of her taxable income.

Since she is an individual she will be allowed to a 20% deduction and capital allowances on the rented properties cost.

Pension from Poland

Overseas pension in Cyprus as per Cyprus income tax cap 118/2002, can be taxed under the standard progressive rates of income tax or under the special mode of 5%.

Standard progressive mode is :

Zero amount up to 19,500
19501- 28,000 20%
28.001-36.300 25%
36.301 up to 60.000 30%
above 60.000 35%

The special mode is as follows :

Zero amount up to the amount of 3,420 Euros and a flat rate of 5% is imposed on the balance above that amount.

Ms Soyer has the option to choose between the two options based on her income and what is more advantageous for her.

Her overseas pension is 15,000. If her rental income from abroad plus any other income is not so high that will be over 19,500 then it is more advantageous for her to choose the standard rates.

Otherwise if its more then the special mode will be more preferential for her.

Director fees or remuneration from Cyprus Company

Based on the information provided, we assume that as a Director mMs Soyer she might be receiving directors fees from the Cyprus Company.

If this the case then for any fees received will need to be included as part of her taxable income. Since this is not employment income, no Social insurance registration will be required and no PAYE will need to be deducted at source from the Cyprus company. All of her income tax will need to be paid via self assessment.

However as a tax resident in Cyprus GESY will need to be paid as well to the Tax Department via self assessment.

Dividend income from Cyprus Company

Also as a shareholder of the Cyprus Company we assume that she will be receiving dividend income.

Dividend income is exempt from income tax as per Cyprus income tax cap 118/2002.

However it is taxed under special defence contribution if she is both Cyprus domiciled and tax resident.

However as we can understand Ms Soyer is not domiciled in Cyprus therefore she will be exempted from SDC until she spends at least

17 years out of 20 in Cyprus.

As a Cyprus tax resident is liable to GESY therefore her dividend income will be liable to 2.65% GESY up to the threshold of income of 180.000euros.

-----ANSWER-4-ABOVE-----

-----ANSWER-5-BELOW-----

Answer-to-Question-_5_

Income tax implications for Mr Andreou for 2021

As per the information provided Mr Andreou as of 2020 he is Cyprus tax resident.

Mr Andreou is receiving employment income during 2021. As per Cyprus income tax legislation Ms Andreou can be allowed of the executive deduction of 50% if the following criteria are applicable for him:

- a. his Cyprus employment income on an annual basis is above 100.000euros
Based on the information provided, his annual salary is 75,000Euros plus 80,000Euros annual bonus. Therefore his total annual remuneration is 155,000 euros above 100.000 per annum since the bonus is considered part of his employment income. (7500+80000=155,000). Therefore this condition is applicable for Ms Andreou
- b. he needs to have been non Cyprus tax resident for 3 out of the last previous years. Mr Andreou left Cyprus during 2012 and return in 2020. Therefore this condition is also applicable for Mr Andreou.
- c. he needs to be non Cyprus tax resident the previous year that his employment started. this is also applicable for Ms Andreou since in 2019 was not a Cyprus tax resident.

Therefore all of the above conditions are applicable for Mr Andreou therefore he is allowed to the 50% deduction to be deducted from his employment income for 10 years starting from the year of employment i.e 2020.

It is irrelevant if Mr Andreou will be considered as Cyprus tax resident for 2020 or any year afterwards in order to be eligible for the 50% deduction as long as he receives Cyprus employment income he is allowed to the deduction an a Cyprus tax resident or not.

The income tax will be deducted from Mr Andreou via PAYE from his employer ABZ Complex and paid on his behalf to the tax department.

Also Social insurance at 8.3% and GESY at 2.65% will be deducted and paid on his behalf by the Company to the relevant authorities up to the relevant thresholds(180,000 of annual income for GESY,)

Income from the share options received

The share options provided to Mr Andreou for his strong performance is considered as benefit in kind and will be considered as part of his Cyprus employment income on which income tax and gesy will be withheld by his employer.

If Mr Andreou exercises the options any dividend income received will be exempted from income tax.

However there will be SDC implications since Mr Andreou is both Cyprus domicile by origin and Cyprus tax resident.

Also on any dividend income GESY at 2.65% will need to be imposed as he is a Cyprus tax resident.