THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

December 2022

MODULE 2.03 – CYPRUS OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

The interest income generated by XML Holdings Cyprus Ltd from the loan receivable assigned to the latter by XML Belgium Ltd, for as long as the receivable remains pending, is subject to income tax and it is exempt from special contribution for the defence, on the basis that, one of the main activities of XML Holdings Cyprus Ltd is the provision of financing.

Given that the loan receivable is due from a related party, XML Dutch Ltd, the interest income must be based on arm's length principles, in accordance with Article 33 of the Income Tax Law. The arm's length basis of the interest income must be supported by an appropriate Transfer Pricing study.

Any gain to be realized by XML Holdings Cyprus Ltd upon the settlement of the loan receivable, in-kind, by XML Dutch Ltd via the transfer of the investment in XML France Ltd, will constitute taxable income for the Cyprus company. The taxable gain shall be equal to the interest income element embedded in the difference between the fair market value of the investment and the amount of the receivable at the date of settlement.

The new paid-up share capital and share premium to be issued by XML Holdings Cyprus Ltd, in settlement of the loan receivable from XML Dutch Ltd which was contributed by XML Belgium Ltd, will constitute "new equity" for the purposes of Article 9B of the Income Tax Law.

The said new equity will be matched with the loan receivable from XML Dutch Ltd, in accordance with Tax Circular 2016/10.

Annual NID, not exceeding 80% of the net taxable income generated from the loan receivable from XML Dutch Ltd, will be granted to XML Holdings Cyprus Ltd on such new equity, in accordance with the provisions of Article 9B (3) (c) of the Income Tax Law.

The annual NID will be:

- treated as an interest expense in accordance with the provision of Article 9B (3) (e) of the Income Tax Law;
- available as from the date the "new equity" is issued; and
- calculated each tax year using as reference interest rate the yield of the 10-year government bond of the Netherlands as at 31 December of the previous year, increased by 5%.

The shares held by XML Belgium Ltd in XML Holdings Cyprus Ltd, which were contributed to the Swiss UBO of the Group constitute "titles" in accordance with the provisions of article 2 of the Income Tax Law, therefore, any gain generated upon the said contribution is exempt from income tax in accordance with the provisions of article 8(22) of the Income Tax Law.

Likewise, any gain generated by the UBO in relation to the shares held in XML Holdings Cyprus Ltd which were subsequently contributed to the BVI Trust is exempt from income tax in accordance with the provisions of article 8(22) of the Income Tax Law.

However, the transfer of shares held in XML Holdings Cyprus Ltd by XML Belgium Ltd might trigger capital gains tax implications, on the basis that the company whose shares are transferred owns immovable property (office premises) in Cyprus, and as such the said shares constitute "property", for the purposes of Article 2 of the Capital Gains Tax Law.

The capital gain shall be computed by reference to the increase, if any, in the market value of the property owned by XML Holdings Cyprus Ltd, between:

- the time of the transfer of the shares; and
- the time XML Belgium Ltd acquired the shares of XML Holdings Cyprus Ltd, or at the time at which XML Holdings Cyprus Ltd acquired the property, whichever of the two transactions occurred later.

The transfer of the shares held in XML Holdings Cyprus Ltd contributed to the BVI Trust by the UBO, will not trigger any capital gains tax implications, since the BVI trust is a tax transparent entity and the beneficiary of the trust is the UBO himself/herself; hence, in substance there is no change in the ownership of the shares transferred.

Part 2

Any dividends to be received by XML Holdings Cyprus Ltd from XML Poland Ltd, will be exempt from:

- income tax, in accordance with the provisions of article 8(20) of the Income Tax Law, provided that such dividends will not be tax deductible for XML Poland Ltd; and

- special contribution for the defence, in accordance with the provisions of article 3(2)(a) of the Special Contribution for the Defence of the Republic Law, on the basis that such dividends will originate from the trading profits (the letting of the property, as a line of business) of XML Poland Ltd.

In the event that XML Poland Ltd is liquidated instead, any liquidation proceeds will not constitute taxable income, either for the purposes of the Income Tax Law or the Special Contribution for the Defence of the Republic Law.

Question 2

Test 1

Cyprus Group Equity/Total Assets	Consolidated Group Equity/Total Assets
2,000,000 / 4,500,000	18,000,000 / 24,000,000
44.44%	75%

The Cyprus group is not eligible to claim the Equity Escape provision, therefore the Cyprus Group, as a single taxpayer, is subject to the Interest Limitation Rule.

Test 2

Exceeding borrowing cost which is subject to the Interest Limitation Rule	SPI Holdings Ltd €	Services Cyprus Ltd €	Highlands Ltd €	Cyprus Group €
Tax deductible interest expense	2,000,000	350,000	1,250,000	3,600,000
Less interest expense in relation to loans concluded prior to 17/6/2016)	(500,000) 1,500,000	(0) 350,000	(100,000) 1,150,000	(600,000) 3,000,000
Taxable interest income	900,000	300,000	100,000	1,300,000
Exceeding borrowing cost which is subject to the Interest Limitation Rule	600,000	50,000	1,050,000	1,700,000

EBITDA	SPI Holdings Ltd €	Services Cyprus Ltd €	Highlands Ltd €	Cyprus Group €
Taxable income/(Tax loss)	2,100,000	250,000	3,500,000	5,850,000
Add:				
- wear & tear allowances	80,000	20,000	500,000	600,000
- deductions claimed in accordance with Article 9(l)	200,000			200,000
- Exceeding borrowing cost	600,000	50,000	1,050,000	1,700,000
EBITDA	2,980,000	320,000	5,050,000	8,350,000
30% of EBITDA	894,000	96,000	1,515,000	2,505,000

Tax deductible exceeding borrowing cost	SPI Holdings Ltd €	Services Cyprus Ltd €	Highlands Ltd €	Cyprus Group €
(1) Higher of:				
- 30% EBITDA	894,000	96,000	1,515,000	2,505,000
- Safe harbor threshold				3,000,000
(2) Lower of:				
- EBC which is subject to the Interest Limitation Rule	600,000	50,000	1,050,000	1,700,000
- Result as per (1) above			3,000,000	3,000,000

The tax deductible exceeding borrowed cost of the Cyprus Group, which is €1,700,000, shall be apportioned between each company within the Cyprus group, on a basis of a Tax Circular issued by the Cyprus Tax Department.

PART B

Question 3

A hybrid mismatch, including a reverse hybrid mismatch, is the result of differences in the tax treatment of a payment (financial instrument) or an entity, under the laws of two or more jurisdictions; thus, the mismatches have a cross-border nature.

The Anti-Tax-Avoidance Directive (ATAD) gives an exhaustive list of situations or transactions that constitute mismatches and covers the following hybrid mismatch arrangements:

- Hybrid financial instrument mismatches;
- Hybrid entity mismatches;
- Hybrid transfers;
- Hybrid PE mismatches;
- Imported mismatches; and
- Tax residency mismatches

A hybrid mismatch is limited to situations arising between:

- associated enterprises (as defined);
- a taxpayer and an associated enterprise;
- a head office and its PE;
- two or more PEs of the same company; or
- under a structured arrangement (as defined).

A hybrid mismatch outcome may take the form of:

- A double tax deduction of the same payment, expense or loss, both, in the jurisdiction of the payer and the jurisdiction of the payee; or

- A tax deduction of a payment or deemed payment effected between a HO and a PE or between two or more PEs, in the payer's jurisdiction, without the inclusion of a corresponding amount of taxable income in the payee's jurisdiction due to mismatches/differences.

The aim of the ATAD hybrid mismatches rules adopted by the EU Commission is to neutralise the tax effects of hybrid mismatch arrangements. Effectively, they aim to ensure that, tax deductions or credits in relation to the above mentioned payments are only available in one jurisdiction and that there are no incidences of deductions of a payment in one country without taxation of the corresponding income in the other country concerned.

The Income Tax Law endorses the hybrid mismatches rules with effect as from 1 January 2020 and the reverse hybrid mismatches rule with effect as from 1 January 2022.

The main anti-abuse measures which apply, include the following:

- To the extent that a hybrid mismatch results in a double deduction, and Cyprus is the jurisdiction of the investor, the deduction shall be denied in Cyprus. Where Cyprus is the jurisdiction of the payer, the deduction shall be denied in Cyprus if it is not denied by the investor jurisdiction. A double deduction may be set off against dual inclusion income whether arising in a current or subsequent tax period.

- To the extent that a hybrid mismatch results in a deduction without inclusion, the deduction shall be denied in Cyprus under the primary rule, if Cyprus is the payer jurisdiction. If Cyprus is the jurisdiction of the payee and the deduction is not denied in the payer jurisdiction, the amount of the payment will be included in Cyprus.

- The Law also provides that, to the extent that any payment directly or indirectly funds deductible expenditure giving rise to a hybrid mismatch through a transaction between associated enterprises or a transaction entered into as part of a structured arrangement, shall not be tax deductible, unless one of the jurisdictions relevant to the transaction has made an equivalent adjustment in respect of such hybrid mismatch.

- Where a hybrid mismatch involves disregarded PE income, which is exempt from tax in Cyprus, the income that would otherwise be attributed to the disregarded PE shall constitute part of the taxable income of the Cyprus taxpayer will have to include in its net income, unless the income from the PE is exempt from tax under a double taxation treaty entered into by Cyprus with a third country.

- Where a hybrid transfer aims to give rise to a relief for tax withheld at source on a payment derived from a transferred financial instrument to more than one of the parties involved, Cyprus shall limit the benefit of such relief in proportion to the net taxable income regarding such payment.

- Whereby payments, expenses or losses are deductible in two jurisdictions because a taxpayer is resident for tax purposes in two or more jurisdictions, Cyprus shall deny the deduction for such amounts, unless they relate to dual-inclusion income, or unless the other jurisdiction is an EU member state with which Cyprus has concluded a double taxation treaty under which the taxpayer is deemed to be a Cyprus resident.

- A reverse hybrid is an entity which is treated as transparent under the laws of the jurisdiction where it is established but it is treated as an opaque entity under the laws of the jurisdiction of the investor. Under the rules, Cyprus shall regard such hybrid entity (other than a collective investment scheme entity) as a resident of Cyprus and tax its income accordingly.

- Grandfathering rules are applicable up to 31 December 2022 with regard to hybrid mismatches resulting from a payment of interest under a financial instrument to an associated enterprise where certain conditions are met.

- In addition, where Cyprus is the payee jurisdiction and the deduction is not denied by the payer jurisdiction, Cyprus may not include the income in the taxable income of the Cyprus payee, in certain specific cases, when the mismatch outcome is the result of differences in the allocation of payments.

PART C

Question 4

Part 1

In tax year 2021 Ms Soyer is considered to be tax resident in Cyprus in accordance with the '60 day rule', on the basis that she, cumulatively, satisfies the following criteria in 2021:

- she does not reside in any other single state for a period exceeding 183 days in aggregate;
- she is not considered tax resident by any other state;
- she resided in Cyprus for at least 60 days;
- she carries out business in Cyprus such business is not terminated during the tax year 2021; and
- she maintains and uses a residential property in Cyprus.

For the purposes of the '60 day rule', days in and out of Cyprus are calculated as follows:

- the day of departure from Cyprus counts as a day of residence outside Cyprus;
- the day of arrival in Cyprus counts as a day of residence in Cyprus;
- arrival and departure from Cyprus in the same day counts as one day of residence in Cyprus; and
- departure and arrival in Cyprus in the same day counts as one day of residence outside Cyprus.

Part 2

As a Cyprus tax resident individual in 2021, Ms Soyer shall be taxed in Cyprus in respect of worldwide income, subject to the provisions of the Double Tax Agreement between Cyprus and Poland.

- The activities in Poland relating to the renting and leasing out of residential and commercial real estate, prima facie, seems to constitute activities attributed to a permanent establishment in Poland. Provided the said permanent establishment is not treated as a disregarded permanent establishment by Poland, the income attributed to the said permanent establishment may, subject to Ms Soyer’s option, be exempt from income tax in Cyprus, under the provisions of Article 36(3) and 36(4) of the Income Tax Law.
- With respect to the pension income generated by Ms Soyer, she may opt to be taxed at the rate of 5%, and such income will not be added to any other income, in accordance with the provisions of Article 20 of the Income Tax Law.
- Any fees to be generated from her role as a director of the Cyprus company shall be taxed at the personal income tax rates, subject to any deductions allowed by the Income Tax Law.

Question 5

As a Cyprus tax resident in tax year 2021, Mr Andreou shall be taxed in respect of worldwide income, in accordance with Article 5(1) of the Income Tax Law.

This is on the basis that:

- he was not tax resident in Cyprus in the tax year presiding the year of his employment in Cyprus (i,e. 2020), nor he was tax resident in Cyprus in any 3 out of the last 5 years presiding the tax year of employment (i.e. 2015-2019);

- his employment contract provides for a base salary and a performance related bonus; and

- his gross emoluments (including the performance related bonus) for the first year of employment (the first 12 months, being November 2020 to October 2021, as well as the benefit in kind arising from the shares allotted to him as a result of the share option rights package, exceeds the amount of €100,000 ((€75,000 + €80,000) × 12/14 = €132,857).

Mr Andreou shall be eligible for the 50% tax exemption of the above mentioned emoluments, in accordance with Article 8(23) of the Income Tax Law.

The said exemption shall be available to Mr Andreou in each tax year in which his gross emoluments exceed €100,000 and for a period of 10 years, starting from the year of commencement of employment in Cyprus.

The benefit in kind to be taxed in 2021 shall be equal to the market value of the shares on the date of exercise of the share options after allowing for the cost of exercise.

Assuming the option package covers the period between 1 November 2020 and 31 December 2021, the amount to be taken into account for the purpose of the 50% tax exemption stipulated by Article 8(23), the amount of the benefit shall be equal to ((€5.75 - €0.75) × 5,000) × 12/14 = €21,428.

4. The total emoluments for the purposes of Article 8(23) of the Income Tax Law amount to €154,285 (€132,857 + €21,x428).

Question 6

Part 1

The MBT is an objective test and does not take into account subjective assessments which would take into account the purpose or intentions of the participants to the cross-border arrangement.

Therefore, the fact that a person does not actively seek to obtain a tax advantage will not be a determining factor when considering whether a cross-border arrangement meets the MBT.

To determine whether the obtaining of a tax advantage is the main benefit or one of the main benefits one would need to compare the value or significance of the expected tax advantage with any other commercial non-tax benefits arising as a result of the arrangement.

The MBT would be satisfied where based on this objective comparison it is determined that the tax advantage constitutes a significant element of the benefits a person may reasonably expect to derive from the arrangement and is not merely incidental.

In practice, the obtaining of a tax advantage is likely to be the main benefit or one of the main benefits where:

- the tax advantage is the decisive factor in the arrangement, without which the arrangement would not be implemented or continue to exist; or

- the arrangement contains steps that have been added in order to obtain the tax advantage and which arrangement could have equally worked out had these additional steps not been added or included.

Part 2

Hallmark category A: Generic hallmarks linked to the MBT

A cross-border arrangement containing a category A hallmark will not be reportable unless the MBT is satisfied.

Hallmark A1: Confidentiality

This hallmark will apply where a condition of confidentiality places a limit on a taxpayer's or participant's ability to disclose information on how the arrangement could secure a tax advantage to other intermediaries or to tax authorities.

Hallmark A2: Compensation related to a tax advantage

This hallmark will apply where any form of compensation (monetary or non-monetary) that may be derived by an intermediary in relation to a cross-border arrangement is linked to a tax advantage potentially/actually being obtained.

Hallmark A3: Standardised documentation and/or structures

Documentation and/or structures will be considered to be 'substantially standardised' where they require very little adaptation to suit a particular client i.e. ready-to-sell schemes.

Hallmark category B: Specific hallmarks linked to the MBT

A cross-border arrangement containing a category B hallmark will not be reportable unless the MBT is satisfied.

Hallmark B1: Acquiring a loss-making company

Arrangement is pre-planned and, having regard to all facts, it is reasonable to conclude that it is artificial and have no evident commercial reason.

Hallmark B2: Conversion of income into other categories

This hallmark will be met where there is a conversion of income into capital or into any other category of revenue which attracts a lower rate of tax or is tax exempt.

Hallmark B3: Circular transactions

This hallmark captures arrangements involving the use of circular transactions resulting in the round tripping of funds facilitated through the use of either interposed entities without primary commercial function, or transactions that offset or cancel each other (or have similar features).

Question 7

Part 1

Services connected to immovable property

B2B and B2C services connected to immovable property are taxed where the immovable property is located.

Passenger transport

B2B and B2C passenger transport is taxed according to the distances proportionately covered in each country.

Short-term hiring of means of transport

B2B and B2C short-term hire of means of transport is taxed at the place where the means of transport is actually put at the disposal of the customer. Short term covers the continuous possession or use of a means of transport throughout a period of not more than 30 days or, in the case of vessels, not more than 90 days.

Cultural, artistic, sporting, scientific, educational, entertainment and similar activities

B2B and B2C services relating to cultural, artistic, sporting, scientific, educational, entertainment and similar activities are taxed at the place where those services are physically carried out. However, as from 1.1.2011, the general rule B2B applies to taxable persons receiving such services, except in the case of services necessitating admission, in which case the place of supply continues to be where the services are physically carried out.

Restaurant and catering services on board ships, aircraft or trains

When B2B and B2C restaurant and catering services are supplied on board ships, aircraft or trains during the section of a passenger transport effected within the EU, tax is paid at the place of departure of the transport.

Part 2

Services provided by intermediaries

B2C services provided by an intermediary are taxed at the location where the main transaction, in which the intermediary intervenes, is taxable.

Transport of goods: general

B2C transport of goods, other than intra-Community transport, is taxed according to the distances proportionately covered.

B2C intra-Community transport of goods

B2C intra-Community transport of goods (goods departing from one Member State and arriving in another) is taxed at the place of departure.

Ancillary services to the transport of goods

B2C ancillary services to the transport of goods, such as the loading and unloading services, are taxed in the Member State where those services are physically carried out.

Services consisting of valuations of or works on movable tangible property

B2C services consisting of valuations of or works on movable tangible property are taxed at the place where the services are physically delivered.

Electronically supplied services

Electronically supplied services, provided by suppliers established in a third country to non-taxable persons (B2C) established in the EU, must be taxed at the place where the customer resides or has a permanent address.