

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2023

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 will **not** receive marks for any additional answers.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **One** question from **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.
- 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.
- There is no separate reading time, so you can start typing your answers as soon as the exam begins. However, we recommend that you set aside some time to thoroughly read each question and plan each of your answers.

PART A

You are required to answer BOTH questions from this Part.

1. Mr B is originally from Cyprus. He grew up in Israel but returned to Cyprus in his twenties, where he got married to an Israeli citizen and raised three children. During the period prior to the Turkish invasion of Cyprus in 1974, the B family purchased two building plots in Nicosia and built a house which was used as the family's principal private residence.

In 1976 the family moved permanently to another country, Angulia, where they have been resident ever since. In the subsequent period, Mr and Mrs B have managed to build property in Angulia worth several million euros, as have their children. The members of the B family do not own any property in Cyprus other than the house in Nicosia, which has been rented out since their departure in 1976.

The last tenant of the house in Nicosia passed away last month and, as the house is currently vacant and in a very bad condition, Mr and Mrs B are considering the demolition of the house and the erection of a block of 15 flats. They are considering the following options:

- a) Demolishing the house, building the block of flats using Mr B's own capital, and transferring as a gift five flats to each of the three children.
- b) Demolishing the house, building the block of flats using partly Mr B's capital and partly a bank loan, and selling six flats to repay the bank loan. The remaining nine flats will then be transferred as a gift to the three children, with each child receiving three flats.
- c) Transferring, as a gift, the property as it is now to the three children in equal parts.
- d) Transferring the property, as a gift, to a newly formed family company in which all five B family members will have an equal share. The company will be adequately funded by family capital to finance 40% of the construction, with a long-term loan taken out to finance the remaining 60%. The 15 flats will then be rented out to cover the loan instalments, the taxes due in Cyprus and dividend payments to the five shareholders. Mr and Mrs B will then transfer their shares as a gift to their three children at a future point in time.

A double tax agreement is in place between Cyprus and Angulia, identical to the OECD Model Tax Convention.

You are required to discuss the Cyprus Income Tax, Special Defense Contribution, Capital Gains Tax and Land Transfer Fees for Mr and Mrs B and their children, for each of the four options under consideration. (25)

2. BCo Inc. is an international business company registered in a tax haven outside the EU. The company is beneficially owned by Mr C, through Cypriot nominee shareholders. Mr C is a tax resident in a high-tax EU member state with very strict controlled foreign company (CFC) rules. The directors of BCo Inc. are all Cyprus tax resident individuals, and all board meetings take place in Cyprus at the fully fledged offices of the company in Larnaca. Mr C has signatory powers on the bank accounts of the company, held with a local Cyprus bank and a Liechtenstein bank, and gives instructions on the company's operations and contracting to the Cyprus directors via secure email.

BCo Inc. produces paramedical equipment and supplies from its non-EU factory in Qatar and sells to EU companies through its Cyprus branch, which also sells to companies in the Gulf region through a non-EU wholesale distributor situated in the United Arab Emirates.

Stock is maintained in the company's factory in Qatar and on consignment at the UAE distributor's warehouse. Sales to northwest EU countries are made through subsidiary distributor companies whose main activity is to distribute BCo Inc.'s products, which are all bought on a consignment basis from BCo Inc. for distribution to local markets. An EU warehouse maintaining stock is situated in Malta and used exclusively as a holding place for stock to be delivered to southern EU states.

BCo Inc. has recently concluded a joint venture (JV) agreement with a Maltese company, MaltCo Ltd. Under this agreement, technical support services will be provided to another Maltese company which is in the same line of business with BCo Inc., and BCo Inc. has secured a call option to purchase 49% of this company. Through the JV agreement, BCo Inc. will receive 40% of the contract revenue in respect of the IT development and support which the company will provide, through the work of subcontracted non-EU programmers resident in Kazakhstan, with the remaining 60% received jointly by BCo Inc. and MaltCo Ltd through their JV in Malta.

You may assume that Cyprus maintains double tax agreements (DTAs) with all countries mentioned, in full alignment with the OECD Model Tax Convention. The non-EU tax haven jurisdiction maintains DTAs with Cyprus and Malta only.

You are required to:

- 1) **Discuss the tax residency position of BCo Inc., and its direct tax implications resulting from the arrangements and operations as described.** (19)
- 2) **Outline the tax risks applicable to Mr C and BCo Inc., with reference to the ownership and management structure of the company and Mr C's personal tax residency, and suggest any action that may be taken to mitigate these risks.** (6)

Total (25)

PART B

You are required to answer ONE question from this Part.

3. You are a professional tax adviser, and recently held a meeting with prospective clients. The proposed venture relates to the establishment of a Cyprus company (CypCo) in which a German company and a Kazakhstan company will participate.

The German company (GerCo), 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 Kazakhstan will be operated by an affiliated Kazakhstan company (the Kazakhstan company in the venture, KazCo), which will participate in the share capital of CypCo and will pay royalties to CypCo for exploitation of the rights originally granted by GerCo.

It is estimated that the revenue from the new venture will amount to €50 million during the first year of operation, with profit before tax and payment of IP royalties of €10 million, reflecting a 20% 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 alternatively may be variable and expressed as a percentage of revenues.

The prospective partners are seeking a solution which will most reduce their overall tax liability. This will involve the determination of the IP royalty rate to be paid by CypCo to GerCo, the determination of the IP royalty rate to be paid by KazCo 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), as applicable. The following scenarios are being considered:

- a) GerCo assigns usage of the IP right to CypCo at a fixed cash annual fee. The capital contribution in CypCo will be in cash by both partners.
- b) GerCo assigns usage of the IP right to CypCo at a fixed annual fee, which will be forfeited in exchange for shares issued by CypCo to GerCo. The capital contribution by KazCo will be in cash.
- c) GerCo assigns usage of the IP right to CypCo at a fixed cash annual fee. The capital contribution by GerCo will be in cash. The capital contribution by KazCo will be in the form of a share-for-share exchange, which will involve new issues of shares by both CypCo and KazCo.
- d) GerCo assigns usage of the IP right to CypCo at a fixed annual fee, which will be forfeited in exchange for shares issued by CypCo to GerCo. The capital contribution by KazCo will be in the form of a share-for-share exchange, which will involve new issues of shares by both CypCo and KazCo.

You are required to:

- 1) **Explain the provisions of section 9B of the Income Tax Law 118/2002 (as amended).** (3)
- 2) **Analyse the tax treatment under each of the scenarios under consideration, with reference to the associated tax risks of the proposed transactions.** (17)

Total (20)

4. HoldCo Ltd is a Cyprus registered and tax resident company. It is an intermediary holding and financing company, forming part of a group of companies with varied activities.

HoldCo Ltd has the following subsidiaries:

- HoldCo 2 Ltd, a Cyprus tax resident company providing IT services to companies in non-EU states. HoldCo 2 Ltd operates mainly from owned offices situated in Cyprus. 80% of HoldCo 2 Ltd shares are held by HoldCo Ltd and 20% by ThemaCo Ltd.
- HL Ltd, a Cyprus registered company which is managed and controlled in the Netherlands, in the EU, and is involved in the trading of electronic equipment.
- HHL Ltd, a registered and tax resident company in the Netherlands, whose main activity is the exploitation of patent rights under the ownership of HoldCo Ltd.
- MNE Ltd, a company registered in a non-EU, low-tax jurisdiction, which handles international trading in precious metals.

HoldCo Ltd is wholly owned by ThemaCo Ltd, a company registered and managed in Themaland, a non-EU state.

During 2022, HoldCo Ltd had the following streams of income.

- 1) Dividends from all of its subsidiaries with the exception of HoldCo 2 Ltd, which recorded a loss in 2022;
- 2) Royalty rights from HHL Ltd;
- 3) Interest on intercompany loans from all of its subsidiaries;
- 4) Gains on the sale of shares of HoldCo 2 Ltd to a third-party investor. In the same transaction ThemaCo Ltd also sold its shares in HoldCo 2 Ltd to the same investor; and
- 5) Interest on an intercompany loan from ThemaCo Ltd.

Intercompany loans are provided by HoldCo Ltd, at the following rates of interest:

ThemaCo Ltd	18%
HoldCo 2 Ltd	10%
HL Ltd	5%
HHL Ltd	5%
MN Ltd	0%

HoldCo Ltd paid an interim dividend to ThemaCo Ltd of approximately 60% of its 2022 post-tax profits.

Cyprus does not maintain a double tax agreement (DTA) with any of the countries with which HoldCo Ltd made cross-border transactions during 2022, with the exception of Themaland. The Cyprus/Themaland DTA is identical to the OECD Model Tax Convention.

You are required to:

- 1) **Explain the tax treatment of HoldCo Ltd’s income streams for 2022, and the dividends paid by the company during the same year. You should address Income Tax, Special Defense Contribution and Capital Gains Tax, and refer to all possible exemptions and reliefs arising through Cyprus’s relevant tax legislation, DTAs and EU Directives.** (14)
- 2) **Explain whether ThemaCo Ltd has incurred any tax implications in Cyprus in 2022.** (3)
- 3) **Suggest two possible ways in which HoldCo Ltd could mitigate its tax liability in relation to interest income from intercompany loans.** (3)

Total (20)

PART C

You are required to answer TWO questions from this Part.

5. Lorenza is an Italian citizen residing in Malta. She is a civil engineer, and recently managed to acquire some business in Cyprus where she was awarded contracts to design and supervise the following small construction projects:

Project 1

A small beach restaurant was renovated in Ayia Napa by A Ltd, a company registered in the country of Ayland. Work commenced in March 2022 and lasted for seven weeks. Lorenza visited the site three times during the period of work for supervision purposes, spending 12 days on Cyprus for this project.

Project 2

A showroom was built in Limassol by B Ltd, a company registered in the country of Beeland. Work commenced in November 2022 and lasted for four months. Lorenza visited the site four times during 2022 for supervision, spending a total of 15 days in Cyprus. She also visited the site twice during 2023, spending six days in total in Cyprus.

Project 3

A 20-year-old residential house in Limassol was renovated by C Ltd, a company registered in the country of Ceeland. Renovation started in June 2022 and lasted for eight weeks. Lorenza visited the site three times for supervision during this period, spending a total of ten days in Cyprus.

Cyprus does not have double tax agreements (DTAs) with Ayland, Beeland or Ceeland, but maintains DTAs with Malta and Italy in line with the OECD Model Tax Convention.

You are required to explain the Cyprus Income Tax implications for the 2022 tax year for Lorenza, A Ltd, B Ltd and C Ltd. (15)

6. Andy, a Cypriot citizen, has been living overseas for many years. In December 2021 he returned to Cyprus and took up employment with a Cyprus tax resident employer, Eco Ltd, as a civil engineer.

Eco Ltd is a construction company that traditionally operated in Cyprus. However, during 2021, Eco Ltd managed to secure construction contracts of six to twelve months' duration in two overseas countries. As such, Andy was required by Eco Ltd to spend some time overseas, supervising work at the company's construction sites. During 2022, Andy spent a total of 102 days at Eco Ltd's overseas sites. Andy was paid a daily subsistence allowance for the days he spent overseas, in addition to his normal salary.

Cyprus maintains double tax agreements with both overseas countries, which are aligned with the OECD Model Tax Convention.

You are required to:

- 1) **Discuss Andy's Income Tax position for 2022, with reference to any available allowances and reliefs.** (7)
- 2) **Explain Eco Ltd's Cyprus tax position, in relation to any profits arising from the company's overseas activities and the tax deductibility of Andy's salary from the company's taxable profits.** (8)

Total (15)

7. Dr K, a United Kingdom citizen, took up permanent residency in Cyprus in February 2022, soon after she sold her medical practice in the UK. During 2022, she physically spent most of her time in Cyprus with her husband.

Dr K had the following income and gains during 2022:

	<u>Gross income (€)</u>	<u>UK tax withheld/paid (€)</u>
UK social security pension	30,000	3,000
UK private pension plan	40,000	12,000
Rental income from UK property	24,000	6,000
Rental income from Cyprus property	9,000	
Gain on sale of medical practice in UK (goodwill)	300,000	120,000
UK bank deposit interest (gross)	5,000	1,000
Cyprus bank deposit interest (net of Special Defense Contribution (SDC))	2,000	
Dividends from UK companies	50,000	7,500
Gross income from renting on short-term basis tourist apartments in Greece. These are duly licensed by the Greek Tourist Organisation.	12,000*	

* Expenses totalled €5,000. Tax paid in Greece totalled €2,000.

You may assume that Cyprus and the UK maintain a double tax agreement which is identical to the OECD Model Tax Convention.

You are required to calculate Dr K's payable Cyprus Income Tax, SDC and General Healthcare System (GeSY) contributions for 2022, if she utilises all available elections, exemptions and reliefs. (15)

8. You have been presented with the following transactions:

- 1) IT services undertaken by a Cyprus taxable person, to an EU branch of another Cyprus taxable person.
- 2) Services provided by a Cyprus civil engineer to a taxable Cyprus person, relating to a building site located outside the EU.
- 3) Carriage of passengers from Cyprus to an EU destination by a Cyprus taxable airline, on a contract signed by a non-EU person.
- 4) Entrance to a European football match in Larnaca between a Cypriot team and an English team, paid by an English fund.
- 5) Services provided by a Cypriot quantity surveyor to a taxable EU person, relating to a building site located in Cyprus.
- 6) Actuarial services provided by an EU-taxable person to a Cyprus insurance company.
- 7) Bookkeeping services undertaken by a non-Cypriot EU taxable person to a Cyprus taxable person.

You are required to determine the place of supply of the service in each of these transactions for VAT purposes, and to identify the corresponding VAT compliance obligations of the Cyprus tax-registered persons. (15)