

# THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2021

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## MODULE 2.03 – CYPRUS OPTION

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### ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

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TIME ALLOWED – 3¼ HOURS

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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)
- **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.
- As you are using the online 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.
- 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. Sidetrack Ltd is a Cyprus tax resident company and its ultimate beneficial owners are two non-Cyprus tax resident individuals. The principal activities of Sidetrack Ltd are the holding of investments and the provision of finance to other group companies.

Sidetrack Ltd is the 100% shareholder of Sidetrack Treasury Ltd (STL), a company which is tax resident in the British Virgin Islands. STL's principal activity is the provision of finance to other group companies. STL does not own, directly or indirectly, any immovable property in Cyprus.

Both Sidetrack Ltd and STL are members of the Sidetrack Group, a leading global supplier of high quality solutions in the sector of stainless steel medical equipment.

STL has an interest-bearing loan receivable, due from a group company in Ukraine, Sidetrack Medical Ukraine (SMU). The initial lender was an independent European bank, EUB, which granted the loan to SMU in 2007 for a principal amount of €60 million.

In 2008, Sidetrack Ltd obtained an interest-bearing loan from another group company in France, in order to acquire the rights to the loan from EUB for a discounted amount of €15 million, due to the distressed conditions in the Ukrainian economy. Sidetrack Ltd then assigned the loan to STL for €11 million and the remaining amount of €4 million was waived prior to the assignment of the loan. No repayment has ever been made by SMU to the initial lender.

The Sidetrack Group is contemplating a restructuring, involving the creation of a financing centre in Cyprus to manage the group's intra-group loan activities.

Under this plan, Sidetrack Ltd will set up a new Cyprus tax resident financing company, Finance Company Ltd (FCL), and will contribute the shares in STL to FCL in exchange for shares in FCL. The value of the shares to be issued by FCL will be below the fair market value of the loan, which is the main asset held by STL.

STL will then be liquidated, and will distribute the loan to FCL in the form of liquidation proceeds. However, immediately prior to liquidation, STL shall declare and pay dividends.

Following the distribution of the loan, the outstanding loan amount may be either written off, or settled via the issue of shares by SMU to FCL. The outstanding loan amount to be written off or settled will be equivalent to the principal amount plus the amount of interest accrued between:

- a) the date of contribution of STL's shares to FCL; and
- b) the date on which the loan will be transferred to FCL in the form of liquidation proceeds.

**You are required to analyse the Income Tax and Special Defence Contribution implications of the transactions described, including the proposed restructuring, for:**

- |    |          |            |
|----|----------|------------|
| 1) | STL; and | (10)       |
| 2) | FCL.     | (15)       |
|    |          | Total (25) |

2. Santafe Ltd, a company incorporated and tax resident in Cyprus, has been set up to acquire and hold a particular immovable property located in Portugal. The current owner of the property, Ms Damien, a non-Cyprus tax resident and non-Cyprus domiciled individual, has contributed the property to Santafe Ltd in exchange for shares in the latter. A third party, Ms Sheffield, who is also non-Cyprus tax resident and non-Cyprus domiciled, will acquire 100% of the share capital of Santafe Ltd.

It is expected that the property in Portugal will be held by Santafe Ltd solely for the personal use and enjoyment of Ms Sheffield and her family, all of whom are non-Cyprus tax residents and non-Cyprus domiciled. Santafe Ltd will primarily act as a vehicle through which the legal ownership of the property will be held.

However, the company is also considering how to profit from or commercially exploit the property in the future.

For the purpose of facilitating the daily running and maintenance of the property, the services of support personnel including housemaids, gardeners and butlers will be necessary. Santafe Ltd considers outsourcing the provision of support personnel either to an independent Portuguese tax resident professional service provider, or to a related party in Portugal which shall act as a professional service provider.

The everyday running and maintenance of the property will be financed via either Ms Sheffield's cash contribution in exchange for the issue of shares, a loan from Ms Sheffield, or a combination of the two.

- 1) **Assuming that Santafe Ltd will not exploit the property held, you are required to describe any Income Tax and Special Defence Contribution implications of the proposed activities, for Santafe Ltd, Ms Sheffield and her family.** (6)
- 2) **Assuming that Santafe Ltd will exploit the property held, you are required to describe any Income Tax and Special Defence Contribution implications which may arise for Santafe Ltd, Ms Sheffield and her family.** (11)
- 3) **What Income Tax or Capital Gains Tax obligations may arise upon the future disposal of the property?** (8)

Total (25)

**PART B**

**You are required to answer THIS question.**

3. In recent years, global efforts have been made towards safeguarding the taxing rights and tax revenues of jurisdictions, by attempting to ensure that multinational enterprises pay taxes where value and profits are generated.

The OECD's Base Erosion and Profit Shifting (BEPS) initiative, which has also been endorsed and built upon by the EU, includes rules intended to capture the profits of Controlled Foreign Companies (CFCs).

**You are required to explain the rationale behind such rules, and to analyse the main CFC provisions of the Cyprus Income Tax Law.** (20)

**PART C**

**You are required to answer TWO questions from this Part.**

4. Mr Zubyk was born in Russia in 1973 to Bulgarian parents. Mr Zubyk holds Bulgarian nationality and, since September 2010, has also held a Cyprus passport. During 2020 he did not reside in another country for more than 183 days, nor was he tax resident in any other country.

Since August 2020, Mr Zubyk has been employed as chief executive officer by Astir Ltd, a company tax resident in Cyprus. He maintains a beach villa in Limassol, which he uses as his permanent private residence. During 2020 Mr Zubyk resided in Cyprus for 70 days; he had not been resident in Cyprus during any other previous tax year.

Mr Zubyk also conducts business activities in Bulgaria through an Individual Entrepreneurship (IE), which effectively constitutes a simple mechanism for an individual to do business in Bulgaria without setting up a legal corporate entity. The IE has its registered address, a fully-fledged office and owned office premises, in Bulgaria.

The IE engages in real estate activities in Bulgaria, specifically the management of properties located in Bulgaria. The properties are jointly held by Bulgarian citizens who are also tax resident in Bulgaria. The properties generate rental income from third parties. The IE also provides consultancy services to third party clients, for whom it locates commercial and other properties in Bulgaria for the clients to rent or buy. The income generated by the IE is subject to tax in Bulgaria.

Mr Zubyk maintains two bank accounts in Bulgaria, one denominated in US dollars and the other in Bulgarian lev. The US dollar account is used for the placement of funds in the form of long-term deposits, while the Bulgarian lev account is used for accumulating Mr Zubyk's share of income from the IE, covering personal expenses, and occasionally converting funds into US dollars and transferring them to the US dollar account. Neither of the bank accounts is used to fund the activities of the IE.

**For the 2020 tax year, you are required to determine:**

- |    |  |      |
|----|--|------|
| 1) | <b>Mr Zubyk's Income Tax position; and</b>               | (12) |
| 2) | <b>Mr Zubyk's Special Defence Contribution position.</b> | (3)  |

Total (15)

5. Sublime Italy Ltd (Sublime IT) is a company which is tax resident in Italy, and the ultimate beneficial owner of an international group of companies trading in iron products. The ultimate beneficial owners of the group are also tax resident in Italy. The group is currently in the process of restructuring, which is expected to be finalised in 2022.

Sublime IT is the major shareholder of Sublime SA Ltd (Sublime SA), a company tax resident in South Africa. In 2018, Sublime SA acquired 100% of the share capital of Versuse CY Ltd (Versuse CY), a company tax resident in Cyprus, from its previous shareholder, Mr Versuse, a Cyprus tax resident and Cyprus domiciled individual who had held the shares since inheriting them upon his father's death in 1998.

The acquisition was done through the issue of shares in Sublime SA to Mr Versuse, as well as bonds issued by Sublime SA.

The share purchase agreement between the parties stipulates that Mr Versuse has the right to sell, via a 'put option', the shares he holds in Sublime SA to Sublime IT, or even cancel the agreement in return for compensation to be paid to Sublime SA, prior to the finalisation of the group restructuring in 2022. The agreement also stipulates that the employment status of Mr Versuse by Versuse CY will remain unaltered in any scenario.

Mr Versuse was not tax resident in Cyprus during the tax years 2004-2020. During this period, he worked in Dubai where he was considered to be tax resident.

From 1 January 2021, Mr Versuse will take up permanent residence in Cyprus and will be appointed as the chief financial officer of Versuse CY. The employment agreement provides for two salary components: an annual gross salary amounting to €96,000, and a gross daily allowance to cover for travelling and entertainment expenses within Cyprus amounting to €200.

**You are required to:**

- 1) **Assess the Income Tax implications for Mr Versuse for the tax year 2021:**
    - a) **As chief executive officer of Versuse CY; and** (8)
    - b) **relating to his options to exercise the put option or cancel the share purchase agreement in 2021.** (4)
  - 2) **Determine any Special Defence Contribution implications for Mr Versuse for the tax year 2021.** (3)
- Total (15)

6. Asamic Ltd, a Cayman Islands tax resident company, holds the entire share capital of a group of companies also tax resident in the Cayman Islands. One of these companies, Leslic Ltd, owns immovable property in Cyprus which it acquired in 2018; this constitutes Leslic Ltd's only asset. Asamic Ltd acquired all shares in Leslic Ltd in 2015.

The management of Asamic Ltd and Leslic Ltd are considering a group reorganisation which will involve, among other things, the transfer of the shares held by Asamic Ltd in Leslic Ltd to a third, newly established non-related company, Zevodiac Real Estate Investment Fund Ltd (ZRE).

ZRE is a Cyprus tax resident company, which takes the form of an open-ended Alternative Investment Fund (AIF) regulated by the Cyprus Securities Exchange Commission. The AIF is not currently listed on any stock exchange and is owned by three non-Cyprus tax resident investors.

The objective of ZRE is to maximise annual investment returns for its participating shareholders, by investing in real estate around the world, including in Cyprus, as well as investing in various financial instruments relating to the real estate sector. New investors are expected to participate in ZRE in the very near future.

**You are required to analyse the Capital Gains Tax implications of the following transactions, with particular reference to the relevant provisions of the Capital Gains Tax Law (Law 52 of 1980, as amended):**

- |    |   |            |
|----|---|------------|
| 1) | <b>The envisaged transfer of shares to ZRE.</b> | (9)        |
| 2) | <b>The entrance of new investors in ZRE.</b>    | (6)        |
|    |   | Total (15) |

7. The VAT Amendment Law 122/2020 imposes an obligation for VAT registration in Cyprus, either directly or through an appointed VAT representative, of Non-Established Persons (NEPs) who supply goods or services in Cyprus, of which the place of supply is Cyprus, from 20 August 2020.

**You are required to:**

- |    |   |            |
|----|---|------------|
| 1) | <b>Explain the nature of transactions which give rise to the obligation of NEPs to register for VAT in Cyprus, identify which situations and NEPs are exempt from these provisions, and describe the procedure to be followed for VAT registration.</b> | (8)        |
| 2) | <b>Provide examples of the types of transaction which are captured by these VAT provisions.</b>   | (7)        |
|    |   | Total (15) |