

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2024

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 in Euros, unless otherwise stated. Any monetary calculations should be made to the nearest whole Euro. Any necessary time apportionments in your calculations should be made to the nearest whole month.
- 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. Dr Zaoui, aged 66, is a French citizen who sold his veterinary practice in Paris and retired from work in January 2022. Between February and August 2022, Dr Zaoui travelled to more than ten countries, including Cyprus, before deciding that he wished to live in Cyprus. He took up permanent residency in Cyprus in September 2022.

Dr Zaoui resided at a rented seafront villa in Pernera from September 2022 to December 2022, with the exception of the last week of the year which he spent in France with his wife and daughter.

From November 2022, Dr Zaoui was employed by a veterinary clinic in Paralimni earning a monthly salary of €2,000. Dr Zaoui's daughter is a medical student in Paris and is fully supported by rental income which her father earns from properties in Germany.

Dr Zaoui received the following income and gains during 2022:

	<u>Gross income (€)</u>	<u>Tax paid at source (€)</u>
French social insurance pension	6,000	2,000
French private pension	20,000	3,500
Rental income from German property	20,000	4,000
Trading goodwill from sale of French practice	150,000	50,000
Bank deposit interest (German bank accounts)	15,000	3,000
Salary	4,000	
Bank deposit interest (Bank of Cyprus)	1,000	
Dividends from various EU listed companies	100,000	15,000
Gains from trading in European listed shares and bonds	150,000	
Income from the letting of tourist apartments in France	30,000	10,000

You may assume that Cyprus maintains double tax agreements with France and Germany, both of which are fully in line with the OECD Model Tax Convention.

You are required to:

- 1) **Explain Dr Zaoui's Cyprus tax residency position for 2022, stating any assumptions you make.** (4)
- 2) **Explain the Cyprus Income Tax, Special Defence Contribution and GeSY treatment of each source of income, with reference to all available elections and reliefs.** (21)

Total (25)

2. Mr Lux, a resident of Luxembourg, owns 100% of shares in LuxCo SA, a Luxembourg limited holding company. LuxCo SA holds 90% of shares in GrecCo AE, a Greek importer company; 40% of shares in EngCo Ltd, a United Kingdom importer company; and 60% of shares in CypCo Ltd, a Cyprus tax resident holding company. The remaining 40% of shares in CypCo Ltd are held by Mr Costas, a Cyprus resident individual.

CypCo Ltd holds 70% of shares in CypManCo Ltd, a plastic furniture manufacturer, with the remaining 30% of shares held by Ms Aishen, Mr Costas's ex-wife. CypCo Ltd also has a 10% shareholding in CypS1 Ltd and a 20% shareholding in CypS2 Ltd; both of these companies are Cyprus tax resident.

During the year ending 31 December 2023, the following transactions took place:

- a) CypCo Ltd took out a loan from LuxCo SA of €1 million at an annual interest rate of 3%.
- b) CypCo Ltd granted a loan of €500,000 to CypS1 Ltd at an annual interest rate of 7%, a loan of €250,000 to CypS2 Ltd at an annual interest rate of 6%, a loan of €150,000 to CypManCo Ltd at an annual interest rate of 5%, and loans of €50,000 each to Mr Costas and Ms Aishen, at an annual interest rate of 3%.
- c) CypManCo Ltd sold goods to GregCo AE for a total of €2.5 million, at a unit price of €5.
- d) CypManCo Ltd sold goods to other clients in Greece for a total of €7.5 million at a unit price of €6.50.
- e) CypManCo Ltd sold goods to EngCo Ltd for a total of €5.5 million at a unit price of €7.
- f) CypManCo Ltd sold goods to EngCo Ltd for a total of €22.5 million at a unit price of €8.50.

You are required to:

- 1) **Identify which of the above parties are related, under the provisions of Section 33 of the Cyprus Income Tax Law (Law 118/2002 as amended), and explain the basis in each case.** (8)
- 2) **Determine, with reasoning, which of the six transactions are 'controlled' transactions according to the Section 33 provisions of the Cyprus Income Tax Law.** (8)
- 3) **Calculate the amounts, if any, that the Cyprus Tax Department may reasonably additionally assess in relation to the transactions involving CypManCo Ltd.** (4)
- 4) **Explain, in relation to each of the loan transactions, whether an arm's length annual interest rate can be determined, and whether there are any safe harbour rules which CypCo Ltd may utilise.** (5)

Total (25)

PART B

You are required to answer ONE question from this Part.

3. The Cyprus Income Tax Law (Law 118/2002 as amended) provides for a special mode of taxation for certain types of businesses and sources of income.

You are required to explain the taxing provisions of the Cyprus Income Tax Law, in relation to:

- 1) **The profits of shipping and aircraft businesses;** (9)
- 2) **Profits from the provision of ship management services; and** (4)
- 3) **Royalty income and film rentals earned from Cypriot sources by a non-Cyprus resident who does not maintain a permanent establishment in Cyprus, and the income of foreign resident scientists and performing artists for services rendered in Cyprus.** (7)

Total (20)

4. Derek is the business development director of ENSF, a financial services firm headquartered in Switzerland. ENSF registered a branch in Cyprus in early 2023, which employs six local employees. Due to the unsatisfactory results achieved by the Cyprus branch in the first few months of operations, the company's board of directors decided that Derek should be stationed in Cyprus. Derek's employment contract was subsequently amended accordingly.

During the course of 2023, Derek spent 100 days on holiday in Cyprus, 95 days in Switzerland, 60 days in Macau, 90 days in France and 20 days in Tahiti. Derek is happily married in Switzerland, where his family are permanently resident, but his wife and children spent 45 days in Cyprus during the summer with his children attending a Cypriot summer school during this time.

Derek owns immovable property in the form of his family home in Switzerland and a holiday home in Tahiti. He also holds Swiss and Cyprus bank accounts with modest balances, but the most substantial of his assets consists of stocks traded in the United States.

During 2023, the ENSF Cyprus branch paid Derek a salary of €80,000. Under his contract of employment, Derek was also provided with a house in Cyprus which the company acquired in 2023 for €300,000 (the house had been valued at €320,000 in January 2019) and a new saloon car costing €65,000, which Derek used to travel from home to the office as well as for weekend trips to the mountains and seafronts of Cyprus.

The company also paid €9,000 for Derek's house bills in Cyprus, including €360 for internet and cable TV connections; paid for all upkeep, insurance and fuel for his car; and provided €3,200 for his children's summer school. Derek's salary and bonuses from ENSF during 2023, including his Cyprus branch income, totaled €500,000, but Derek also made profits of €600,000 from trading in US stocks and received gross dividend income of €80,000 which was subject to withholding taxes of 15%.

You may assume that Cyprus and Switzerland maintain a double tax agreement, which is fully in line with the OECD Model Tax Convention.

You are required to:

- 1) **Analyse Derek's tax residency position, with reference to the relevant legislative provisions, noting that, in accordance with the relevant Swiss tax law provisions, Derek is treated as tax-resident in Switzerland.** (8)
- 2) **Compute Derek's Cyprus taxable income for 2023, explaining the basis on which he will be taxed in Cyprus.** (12)

Total (20)

PART C

You are required to answer TWO questions from this Part.

5. **You are required to define the term ‘residence’ as it applies from the tax year 2017 onwards, under the provisions of The Income Tax (Amendment) Law 2017. Analyse the implications of this law, both for Cypriot citizens working abroad and for non-Cypriot citizens who spend substantial time in Cyprus.** (15)

6. Section 11(15) of the Income Tax Law (Law 118/2002 as amended) restricts the tax deductibility of interest on credit obtained by Cyprus tax resident companies for ‘certain’ purposes, including the acquisition of ‘certain’ non-business assets (Interest Limitation).

You are required to list the purposes and the non-business assets to which Section 11(15) applies. Explain briefly how interest is restricted, with reference to the ‘cost of borrowing’ and the anti-avoidance provisions in operation from 1 January 2019. (15)

7. Your guidance has recently been sought with regard to a number of cases involving the application of VAT in Cyprus.

- 1) Angelica, a wealthy real estate owner, organised the construction of a commercial building which she then leased to Beta Ltd with subleasing rights. Beta Ltd subleased the building to Cee Ltd, a trading company. In 2023, Angelica also leased a building plot to Xi Ltd. Xi Ltd used the plot to build shops, which were in turn leased to several tenants who conduct various VAT-taxable trading activities.

Angelica also owns three residential flats which she inherited from her parents in 2011, and which she 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) Xenon Ltd constructed a small shopping mall in 2016 which it leased out to various traders in 2017. Input VAT on the construction totaled €30,000. In 2023, Xenon Ltd renegotiated and signed new contracts with its tenants.

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

- 3) A construction company, Con Ltd, erected a building consisting of four shops and ten flats. The building was completed in 2021 and input VAT of €240,000 was claimed by Con Ltd. The total floor area of the ten flats amounted to 1,000m², and each shop had a floor area of 50m². All ten flats were sold over the course of 2021 and 2022.

As the shops remained unsold, Con Ltd decided instead to lease them out. Two shops were leased to a pharmacist, the third to a dentist and the fourth to a physiotherapist, during 2023.

You are required to explain the VAT treatment of each of these transactions. Your answer should determine whether there will be any restriction on the input VAT previously claimed. (8)

Total (15)

8. ABC Holdings Ltd (ABC) is a company registered and tax resident in Cyprus. During 2023, ABC recorded the following income:

	<u>Note</u>	<u>€</u>
Dividends from AB Ltd	(1)	22,000
Dividends from CD Ltd (net)	(2)	40,000
Interest from EF Ltd (net)	(3)	12,000
Branch 1 dividends (net)	(4)	30,000
Branch 2 dividends (net)	(5)	28,000
Branch 3	(6)	0
Tourist apartments in Spain (EU)	(7)	36,000

Notes

- 1) AB Ltd is a tax resident of another EU member state. ABC holds 20% of equity shares in AB Ltd. No tax was withheld at source.
- 2) CD Ltd is a tax resident of a non-EU state. ABC holds 25% of convertible shares in BC Ltd. BC Ltd has elected for the dividends payable to holders of convertible shares to be treated as a finance cost in its country of tax residence. Tax was withheld at source at a rate of 5%.
- 3) EF Ltd is a 100% subsidiary of ABC and a tax resident of a non-EU state. Tax was withheld at source at a rate of 25%.
- 4) Branch 1 is a registered branch of ABC in another EU member state. The company withdraws all post-tax profits generated by Branch 1. Branch 1 paid income tax on its profits of €3,000.
- 5) Branch 2 is a registered branch of ABC in a non-EU state. During 2023, Branch 2 made a net profit of €80,000 but only remitted €28,000 to ABC, after a deduction of branch remittance tax at source at a rate of 20%.
- 6) Branch 3 is a registered branch of ABC in a non-EU state. Branch 3 incurred losses of €80,000.
- 7) The tourist apartments in Spain are duly licensed tourist apartments. During 2023 ABC realised a pre-tax profit of €44,000 and paid taxes of €8,000 in Spain.

You are required to calculate ABC's Corporate Income Tax and Special Defense Contribution liabilities for 2023, stating any assumptions you make. (15)