

# **THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION**

December 2023

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## **MODULE 2.03 – CYPRUS OPTION**

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**SUGGESTED SOLUTIONS**

## PART A

### Question 1

#### Part 1

The amount of the Loan waived by the company prior to its assignment to Hyper Solvency Seychelles Limited, amounting to €20 million will constitute a non-tax deductible loss for the company, in accordance with the provisions of Article 11 of the Income Tax Law.

The loss incurred by the company as a result of the transfer of the shares held in Hyper Solvency Seychelles Limited to Financial Services Cyprus Limited will constitute a non-tax deductible loss for the company, in accordance with the provisions of Article 8(22) and Article 13 of the Income Tax Law.

The interest expense incurred by the company in order to acquire the rights to the Loan Receivable from the US bank shall constitute a tax deductible expense, subject to the following restrictions:

If the terms of the loan obtained from the German group company are not based on arm's length principles, the provisions of Article 33 of the Income Tax Law will apply and the tax deductible amount will be restricted to the arm's length based amount.

If Hyper Solvency Cyprus Limited owns assets not used in the business, any interest expense incurred by the company will be tax deductible to the extent of the amount that is not directly, or indirectly attributed to the said non-business assets, in accordance with the relevant provisions of Article 11(15) of the Income Tax Law and Tax Circular 2010/8 dated 7/6/2010 .....(new circular on ILR).

The tax deduction will further be restricted in accordance with the provisions of Article 11(16) of the Income Tax Law.

#### Part 2

The in-kind liquidation proceeds (Loan Receivable) to be received by the company as a result of the liquidation of its subsidiary Hyper Solvency Seychelles Limited do not constitute taxable income for the purposes of the Income Tax Law, nor for the purposes of the Special Contribution for the Defence of the Republic Law.

Any dividends to be received by the company from Hyper Solvency Seychelles Limited prior to the latter's liquidation, shall be exempt from income tax in accordance with the provisions of Article 8(20) of the Income Tax Law, and shall also be exempt from 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 Hyper Solvency Seychelles Limited is a trading company.

The company shall be eligible to claim Notional Interest Deduction (NID) in respect of the new equity to be issued to Hyper Solvency Cyprus Limited, which qualifies as "new capital", in accordance with the provisions of Article 9B of the Income Tax Law and Tax Circular 2016/10, dated 18/7/2016, subject to the following:

- 1) The NID will be available for as long as the new capital remains in place and the assets in which the funds obtained from the share issue produce and continue to produce taxable income.
- 2) The amount of NID is equivalent to the lower of:
  - "new capital" multiplied by the "reference rate", and
  - 80% of the taxable income produced by the assets in which the new capital is invested.
- 3) The NID shall be reduced by an amount equivalent to the interest expense claimed by Hyper Solvency Cyprus Limited, since the amount contributed by the latter to Financial Services Cyprus Limited, being the Loan Receivable, was financed by a loan.

The amount of the Loan outstanding which is to be written off by the company, will constitute a non-tax deductible loss for the company, in accordance with the provisions of Article 11 of the Income Tax Law.

Alternatively, if the outstanding amount of the Loan is settled by way of issue of shares by Hyper Solvency Russia, any gain, to be realised by Financial Services Cyprus Limited upon settlement, effectively this representing interest income, shall be subject to income tax and shall be exempt from special contribution for the defence, on the basis that it represents income generated from or closely related to the trading activities of the company.

## Question 2

### Part 1

Cyprus opted to follow “Model B” approach of ATAD I, which aims to tax undistributed income from non-genuine arrangements of a Controlled Foreign Company (the “CFC”), to the extent of the Cyprus tax resident company’s effective % participation interest therein. Losses of the CFC are also included in the tax base accordingly.

A CFC is an exempt foreign permanent establishment or a foreign company (in which a Cyprus tax resident company has, directly or indirectly, alone or with associates, more than 50% interest in share capital, voting rights or profits), and whose actual corporate tax burden is lower than 50% of the tax that would have been charged on the company or PE under the applicable Cyprus corporate tax system.

The permanent establishment of a controlled foreign company that is not subject to tax or is exempt from tax in the jurisdiction of the controlled foreign company shall not be taken into account.

Undistributed income of a CFC is equivalent to the amount of its accounting profits after tax, as depicted in its financial statements which must be prepared in accordance with accounting principles accepted by the Commissioner of Taxation, and which have not been distributed during the tax year to which they relate or within the 7 months following the said tax year.

Non-genuine arrangements, are those arrangements which have been put in place for the essential purpose of obtaining a tax advantage.

Such arrangements shall be considered to be in place, if in the light of the “significant people functions test”, the CFC would not own the assets or would not have undertaken the risks which generate all or part of its income if it were not controlled by the Cyprus company where the significant people functions relevant to the CFCs assets and risks are carried out.

In the following cases, the profits of a CFC shall not be subject to the CFC rule:

- 1) with accounting profits of no more than EUR 750 000, and non-trading income of no more than EUR 75 000; or
- 2) of which the accounting profits amount to no more than 10 percent of its operating costs for the tax period. The operating costs do not include the cost of goods sold outside the country where the CFC is tax resident, nor it includes payments to associated enterprises.

For the purpose of avoiding double taxation, the distributed profits of the CFC or the proceeds from the disposal of the CFC which have already been taxed under the CFC rule, shall not constitute taxable income for the Cyprus tax resident company.

Likewise, any tax paid by the CFC in respect of the income which is subject to tax in Cyprus, is allowed as a credit against the tax paid in Cyprus, subject to the relevant provisions of the ITL.

### Part 2

On the basis that:

- Fundamental Investments Cyprus Ltd holds more than 50% interest in the share capital, voting rights or profits of Levante BVI Ltd (since its actual holding interest is 100%)
- Levante BVI Ltd’s actual corporate tax burden is lower than 50% of the tax that would have been charged on the company under the applicable Cyprus corporate tax system (since the company pays 3% corporate tax in the BVI)
- The “significant people functions”, are in Cyprus (since the decisions of the Board of Directors of Levante BVI Ltd are effectively the significant functions of the latter, whilst the activities of the employees do not constitute significant functions)
- Financial and operational risks are undertaken by Fundamental Investments Cyprus Ltd (ie, the latter provides financial guarantees in order to assist Levante BVI Ltd to obtain finance for the purposes of funding its operations)

- In the light of the “significant people functions test”, Levante BVI Ltd would not own the cargos and vessels and would not have undertaken the risks which generate all or part of its income if it were not controlled by Fundamental Investments Cyprus Ltd
- Levante BVI Ltd has undistributed profits as at 31/12/2022

Fundamental Investments Cyprus Ltd shall be subject to corporate income tax in Cyprus with respect to the undistributed profits generated during 2022, as per the provisions of Article 36A of the Income Tax Law.

Fundamental Investments Cyprus Ltd shall be entitle to claim a tax credit in respect of the taxes paid by Levante BVI Ltd in the British Virgin Islands.

## PART B

### Question 3

On 30th June 2022, the Cyprus Parliament approved amendments to the Cyprus tax legislation to introduce a holistic set of Transfer Pricing rules, in order to ensure alignment of the pricing of transactions between related parties (the “controlled transactions”) with the “arm’s length” principle, in line with the OECD/G20 plan targeting the erosion of the tax base and the shifting of profits to jurisdictions with low or zero taxation.

#### Article 33 of the Income Tax Law is amended

It re-defines the companies which are deemed to be related between them for the purposes of the application of transfer pricing rules, as well as the companies which are deemed to be related with other persons, for the purpose of the application of the same rules.

Effectively, this re-defining exercise restricts the scope of the application of transfer pricing rules to transactions effected between and with companies, exclusively where the connection is achieved by means of a minimum holding, profit participation or voting threshold of 25%.

It explicitly points to the OECD Transfer Pricing Guidelines for due interpretation and application of the rules.

It lays down minimum documentation compliance obligations for Cyprus tax resident persons and permanent establishments in Cyprus belonging to non-Cyprus tax resident persons. A taxpayer is required to maintain a Cyprus Local File where the value of any category of controlled transactions exceeds the threshold of €750.000, a Master File if the taxpayer is the Ultimate Parent Entity of the group, or a Surrogate Parent Entity, and a Summary Table of controlled transactions containing, inter alia, the value of controlled transactions per category/line of business (goods, services, financial transactions, intellectual property, other) . It sets the deadlines for submission, (Summary Table – not later than the due date of submission of the relevant Income Tax Return, Master and Local files – within 60 days from date of request), and sets relevant documentation update obligations.

Allows the enactment of Regulations and Notifications which govern the documentation and other relevant transfer pricing matters.

#### New Article 33C of the Income Tax Law is enacted, which establishes a formal procedure for concluding Advance Pricing Agreements (APAs)

It allows companies which are resident in Cyprus for tax purposes, as well as permanent establishments in Cyprus belonging to non-Cyprus tax resident companies, to conclude bilateral and multilateral Advance Pricing Agreements with parties related to them.

The new provisions allow the Council of Ministers to issue Regulations which define the regulatory framework regarding the procedural details to be adhered to by the parties to the APA and the Commissioner of Taxation, and also allow the latter to issue Notifications to further regulate the APA environment.

#### New Article 50F of the Assessment and Collection of Taxes Law

It introduces penalties, as follows:

- €500 where the Summary Table is not submitted
- €5,000 where the Master and Local files are not submitted between 61-90 days from the date of request for submission
- €10,000 where the Master and Local files are not submitted between 91-120 days from the date of request for submission
- €20,000 where the Master and Local files are submitted anytime after the 120th day from the date of request for submission

#### New Regulations 273/2022 of the Income Tax Law

Contain further details with respect to the environment regulating the above mentioned documentation requirements and set relevant due diligence standards. Inter alia, the Regulations stipulates that a person holding a professional

practising certificate issued by ICPAC (or a similar body) should undertake an assurance quality review of the Local File, not later than the submission deadline of the Income Tax Return of the relevant tax year.

Detail the procedure relating to the conclusion of APAs, which defined the agreed transfer pricing methodology for a related party transaction for a certain period of time. The tax department is required to examine an APA application and reach a decision which needs to be communicated to the taxpayer within 10 months from the date of the relevant application, with the possibility of extending the 10 month period up to a 24 month period. In the case of bilateral or multilateral APAs, a taxpayer should also submit the application to the competent authorities of all relevant foreign tax authorities. The validity of an APA should in principle last for a period not exceeding 4 years, if not revoked or cancelled by the Tax Department under certain circumstances.

Describe the conditions under which an APA may be revised, revoked or cancelled.

#### Notification per New Regulations 314/2022 of the Income Tax Law

It stipulates:

- In detail the minimum content of the documentation requirements
- The form of the said documentation requirements (manual or electronic)
- The language in which the documentation must be maintained – an internationally accepted language, preferably the English language, with an obligation to submit a Greek language translation, if so requested (not later than 60 days from the date of request)
- Relevant maintenance and updating requirements
- Form and contents of the Summary Table
- Acknowledgement of OECD Transfer Pricing Guidelines as a yardstick for determining the arm's length pricing of controlled transactions.

Question 4

Part 1

Tax residency of physical persons is determined by reference to physical presence according to Cyprus Tax Law.

As Mr Lo was physically present in Cyprus for more than 183, he is deemed as Cyprus tax resident for the 2022 tax year.

The question does not tell us as to how Tergal law determines tax residence of physical persons.

And therefore, Mr Lo could find himself in a dual tax residency position, which means that the tie-breaker rules of Article 4 OECD MC will have to be applied between the Cyprus and Tergal competent authorities in such a case.

According to the tie-breaker rule, if both States consider an individual as their tax resident based on physical presence or any other criterion,

The next stage is to examine where the individual's centre of vital interests is found.

From the facts of the case, Mr Lo's centre of economic interests remains in Tergal, as he is still the managing director and controlling shareholder of a Tergal company.

However, his family (personal) ties during 2022 were with Cyprus.

As personal (family) ties were in Cyprus during 2022, on balance Mr Lo will most probably be treated as a Cyprus tax resident.

Assuming that the centre of vital interests cannot easily be agreed between the competent authorities, the final test is that of citizenship.

If the test comes down to citizenship, then Mr Lo will be finally deemed as citizen of Tergal.

Part 2

Capital gain on sale of first private residence (House in Foinikaria) is specifically exempt as acquisition and disposal took place before the end of year 2022.

Hotel rental income – Rent accruing in 2022 less 20% less annual capital allowances will be taxed at standard personal income tax rates, irrespective of where tax residence will be determined. Re: income sourced from Cyprus immovable property.

The Deemed divestment in real estate company Xo Ltd (investment of Mr Lo's friend in October 2022, to the extent of Mr Lo's dilution of ownership (75% to 60%) will be subject to CGT at 20% re: deemed disposal of shares in a company with underlying assets being Cyprus real estate.

Despite the analysis in part 1 above re: Mr Lo's tax residency, Mr Lo's salary is taxable in Tergal, as Mr Lo had spent more than 90 days there during 2016 (Art.6 OECD MC).

If Mr Lo is finally deemed a Cyprus tax resident, his salary from the Tergal Company will also be taxable in Cyprus. (Worldwide income basis of taxation).

However, Mr Lo will be able to claim the 90-day rule exemption, as he was employed by a foreign employer abroad and therefore 4/12ths of his salary will be exempt from income tax in Cyprus.

Mr Lo will also be able to claim DTR on his Tergal salary on 8/12 of the tax withheld at source from his salary in that country (ordinary credit relief s.23 Law 118/2002).

## PART C

### Question 5

#### Income Tax implications

In accordance with Article 2 of the Income Tax Law, Ms Zantilova shall be considered to be resident in Cyprus for the year 2022, given that, during 2022:

- She has resided in Cyprus for at least 60 days, and
- She was not tax resident in any other country, neither she resided in any other country for a period or more which in aggregate they exceed 183 days, and
- She has been employed as an internal legal advisor by the Cyprus tax resident company Semeli Funds Ltd, without cessation of the employment prior to the end of 2022 and till now, and
- She maintained a permanent private residence in Cyprus.

As a Cyprus tax resident individual, Ms Zantilova shall be subject to income tax in respect of his worldwide income, in accordance with Article 5(1) of the Income Tax Law.

Her remuneration resulting from her employment in Cyprus shall be subject to income tax, and any exemptions stipulated by Article 8 of the income Tax Law may be available to her, provided she fulfils any relevant stipulated criteria.

Any dividends distributed to her by the company shall be exempt from income tax, in accordance with Article 8(20) of the Income Tax Law.

In accordance with Article 2 of the Income Tax Law, the business activities carried on by Ms Zantilova as described, create a permanent establishment (PE) in Kazakhstan, given that:

- The relevant activities are carried on through a fixed place of business, and
- The activities attributed to the PE are not of an ancillary/supportive nature.

and provided that the said PE does not constitute a disregarded PE per Kazakhstan's national legislation.

Given also that, the PE does not engage, directly or indirectly, more than 50% in activities which lead to investment income, Ms Zantilova may opt to be exempt from income tax in respect of the profits generated by the PE.

Any income earned by her in the form of interest as a result of the bank account maintained in Kazakhstan, constitutes trading income, as assessed in the light of the badges of trade, that is it constitutes income which is considered to be closely connected with the ordinary course of trade of the PE, therefore, it shall be subject to income tax.

#### Special Defence Contribution implications

Given that Ms Zantilova's domicile of origin is not Cyprus and that she was for more than 20 consecutive years a non-Cyprus tax resident individual, any income earned by her in the form of dividends, shall be exempt from special contribution for the defence.

In the event that Ms Zantilova shall maintain a Cyprus tax residency status for tax year 2022 and subsequent tax years, she shall be eligible to claim a non-Cyprus domicile status for the tax years 2022-2038 inclusive, she shall be exempt from special contribution for the defence throughout these years, in respect of the above mentioned dividend income.



Question 6

Part 1

Mr J Jones is eligible to claim the 50% exemption stipulated by the provisions of Article 8(23A) of the Income Tax Law, on the basis that:

- 1) He was eligible to claim and actually claimed the 20% exemption provided under Article 8(21) of the Income Tax Law, with respect to his annual remuneration as from tax year 2018.
- 2) Prior to tax year 2017 he was not a Cyprus tax resident.
- 3) Prior to the commencement of his employment in Cyprus on 1/1/2017, he had not previously exercised any employment in Cyprus.
- 4) His total remuneration package earned from Cy Holdings Ltd between 27/1/2022 and 26/1/2023 is in excess of €55.000.
- 5) As from the date of commencing employment in Cyprus, he has been recruited by companies which are part of the same group for accounting consolidation purposes, as stipulated by Article 2 of the Income Tax Law.

Mr J Jones will not be eligible to claim both exemptions provided under Articles 8(21) and 8(23) of the Income Tax Law in the same tax year.

In the event that the 50% exemption per Article 8(23) of the Income Tax Law is claimed in tax year 2022, the 20% exemption per Article 8(21) of the Income Tax Law will not be available and vice versa.

The total remuneration package of Mr J Jones, subject to the exemptions described about, shall be subject to the relevant PAYE regulations.

Part 2

Irrespective of the tax year of commencement of employment in Cyprus, the provisions of article 8(23A) of the Income Tax Law shall apply as from the tax year of commencement of employment, which might be any tax year as from 1/1/2022 and for the next 17 tax years, as the case maybe, provided that for at least 10 consecutive years prior to the commencement of the said employment, the individual was not resident in Cyprus for tax purposes, and:

- 1) The individual had already claimed the exemption stipulated by article 8(23) of the Law, and was continuously employed in Cyprus as from the tax year of commencement of employment up until tax year 2021, or
- 2) The individual's first employment in Cyprus commenced anytime between tax years 2016-2021, and his/her total annual remuneration exceeded the amount of €55.000, or
- 3) The individual's first employment in Cyprus commenced anytime between tax years 2016-2021, and his/her total annual remuneration did not exceed the amount of €55.000, and within 6 months from the date of enforcement of the provisions of Article 8(23A), his/her total annual remuneration exceeded the amount of €55.000.

Question 7Income tax liability

Income from salaried services	50,600
Other overseas income	13,102
Overseas dividends	60,000
Income from UK lettings	30,000
Total income	153,702
Less: Dividends (exempt Art. 8)	-60,000
UK lettings (exempt Art. 36)	-30,000
Donations	-300
Net Income	63,402
Less: Social Insurance (50,600 @ 8.3%)	-4,200
GeSy [1,341 + 1,590 + (30,000 + 13,102) x 2.65%]	-4,073
<u>Taxable Income</u>	<u>55,129</u>

Income tax computation

19,500 @ 0%	
8,500 @ 20%	1,700.00
8,300 @ 25%	2,075.00
<u>18,829 @ 30%</u>	<u>5,648.70</u>
	9,423.70
<u>Less: PAYE</u>	<u>-8,835.00</u>
Residue of income tax due	588.70
<u>Additional tax @ 10%</u>	<u>58.87</u>

Amount payable 529.83

\* no provisional tax paid

Special Defence Contribution

Buzz is not domiciled in Cyprus and even though he is a tax resident during year 2022 he is exempt from SDC.

GeSy Computation

	<u>Salaries</u>	<u>Dividends</u>	<u>Other Income</u>	<u>Total</u>
Income in year	50,600	60,000	43,102	153,702
GeSy @ 2.65%	1,341	1,590	1,142	4,073
Less: deducted at source/self-ass	<u>-1,341</u>	<u>-1,590</u>		<u>-2,931</u>
<u>Balance due</u>	<u>0</u>	<u>0</u>	<u>1,142</u>	<u>1,142</u>

## Question 8

### Part 1

Distance selling occurs when a supplier in one EU member state supplies goods, and is responsible for their delivery, to any person in another EU member state who is not registered for VAT. This may include not only private individuals but public bodies, charities and businesses too small to register or with activities that are entirely exempt.

VAT on such distance sales to non-VAT registered customers in Cyprus from another EU member state are normally subject to VAT in that other member state. However, once the value of distance sales in Cyprus exceeds an annual threshold (€10,251.61), then:

- the supplier is automatically liable to register for VAT in Cyprus;
- Cyprus becomes the place of supply; and
- VAT on any further sales is taxed in Cyprus.

### Part 2

Supplies of goods to other EU member state can be zero-rated provided the following conditions are satisfied:

- The supply involves the removal of the goods from Cyprus.
- The goods are acquired by a customer who is registered for VAT in another EU member state.
- The supplier obtains his customer's VAT registration number and shows this on his VAT invoice and the supplier obtains and keeps valid commercial documentary evidence that the goods have been removed from Cyprus within three months of the time of supply.
- The goods must not be second-hand goods or works of art, etc. which the supplier has opted to tax on the profit margin.

### Part 3

The term 'triangulation' is the term used to describe a chain of supplies of goods involving three or more parties where, instead of the goods physically passing from one party to the next, they are delivered directly from the first party to the last party in the chain.

This may occur, for example, when goods are moved directly from a supplier in an EU member state to the final customer in another EU member state on the instruction of an intermediate party located in another EU state.

Under the normal VAT arrangements for movement of goods between EU member states, the intermediate supplier may have a potential liability to register for VAT in the country of destination of the goods to account for VAT on their acquisition and the onward supply of the goods there.

To avoid imposing this additional burden, all EC countries have agreed to a simplified procedure which means that businesses registered for VAT in one EC country may no longer be required to register for VAT in another EC country purely as a result of these triangular transactions.

Instead, the intermediary supplier can opt to have his customer in the country of destination of the goods, account for the VAT due there on his behalf provided the intermediary supplier is not registered or otherwise required to be registered in that country and the customer is VAT registered there.

If the intermediary supplier opts for the simplified procedure, the customer must account for the VAT on the supply of goods made to him (i.e. the simplification procedure is compulsory if intermediary supplier so opts) and the acquisition of the goods by the intermediary supplier is disregarded both in his own country and the country of destination. The initial supplier must treat his transaction in the same way as any other intra community supply i.e. he may zero-rate the supply subject to the usual conditions and should record the supply on an EC sales list (recapitulative statement) in the normal way.

Intermediate suppliers from outside the EC may also use the simplification procedure provided they are registered for VAT in one EC country (otherwise they will not be able to comply with the requirement to issue a VAT invoice to their customer and include the supply on a EC sales list (recapitulative statement)).