

# **THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION**

June 2025

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## **MODULE 2.03 – CYPRUS OPTION**

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### **SUGGESTED SOLUTIONS**

## PART A

### Question 1

#### Part 1

The total of the 'controlled' financing transactions exceeds the 5 million Euro threshold and as such simplification procedures cannot be claimed.

A Transfer Pricing (TP) Study will need to be prepared for each of the four loans, given that safe harbor rules cannot be applied (see A. above)

The loans granted were granted to 3 different subsidiaries operating in 3 different countries. From the Sovereign Bond yields published by the Cyprus Ministry of Finance and which range from 3.042% (Greece) to 22.845% (Ghana), it is obvious that overall default risk differs dramatically from country to country.

From A. and B. above, it can therefore be concluded that the 11% p.a. Loan Interest Rate applied on all 'connected' loan transactions cannot be deemed as satisfactory for all 3 loans, given also the fact that total loans exceed the 5 million Euro threshold and therefore the 2.5% margin that can be used as a safe harbor rule is not available in the case of the CypCo Ltd Group.

Finance science and the CAPM model, teach that the Risk-free interest rate is taken as the 10-year Sovereign Bond Yield.

#### GhanCo Ltd Loan

The 10-year Sovereign Bond Yield for Ghana is given as 22.845%. The 11% interest rate charged which includes default risk cannot be deemed as an arm's-length loan interest rate and would therefore not be acceptable by the Cyprus Tax Authorities. A more realistic loan interest rate would be 22.845% plus a margin of say 3%-5% = circa 26%-28%.

A transfer pricing (TP) upwards adjustment by the Cyprus Tax Department will most certainly be triggered in this case.

The Ghana Tax Department may react negatively to a TP adjustment, as the taxable profits of GhanCo Ltd will be reduced by the TP adjustment.

Given that Ghana does not have a DTA with Cyprus, it will be difficult to assess as to whether the Group as a whole will be incurring double taxation which is probable.

Saying this, if GhanCo Ltd is loss-making already, what could possibly happen is that the Ghana Tax Department, may 'agree' to such TP adjustment, as it could well increase its tax collection through Withholding Tax on Interest payments overseas, given that no DTA is in place in this case.

#### GreCo Ltd Loan

The 10-year Sovereign Bond Yield for Greece is given as 3.042%. The 11% interest rate charged which includes default risk may be deemed as an arm's-length loan interest rate and could therefore be acceptable by the Cyprus Tax Authorities.

However, a more realistic loan interest rate would be 3.042% plus a margin of say 3% - 5% = circa 6%-8%.

If a transfer pricing (TP) adjustment downwards is not made by the Cyprus Tax Department, a reaction may come from the Greek Tax Department, as the latter may deem the interest expense as excessive and given the fact that the Greek corporate income tax rate is higher than the Cyprus corresponding rate, this could also be deemed as a Profit Shifting exercise.

However, the loan interest cost of CypCo Ltd is 8.5% and in commercial terms, CypCo Ltd cannot be paying more interest than it charges. Therefore, on balance, an interest rate of 8.5%+ may be mutually acceptable by both the Cyprus and Greek Tax Authorities. Whether this mutually agreed loan interest rate of 11% will be acceptable is another question, but what is certain is that the Group will not be incurring double taxation due to the operation of the Cyprus-Greece DTA provisions.

### GeoCo Ltd Loan

The 10-year Sovereign Bond Yield for Georgia is given as 8.425%. The 11% interest rate charged which includes default risk may be deemed as an arm's-length loan interest rate and could therefore be acceptable by the Cyprus Tax Authorities, provided the 2.575% default risk margin (11%-8.425%) is considered as satisfactory by the interest benchmarking part of the TP Study that CypCo Ltd is obliged to prepare and keep in place.

On the other hand, this margin of 2.575% may not be considered satisfactory by the Cyprus Tax Department and an upwards TP adjustment may be made.

It must be noted however that any potential TP adjustment made by the Cyprus Tax Department will need to be also agreed by the Georgian Tax Department for a corresponding downward TP adjustment on the profits of GeoCo Ltd within the provisions of the Cyprus-Georgia DTA, which will ensure that the Group will not incur any double taxation.

### Part 2

The conversion of the BULL#2 loan to new share capital in CypCo Ltd constitutes an equity capital increase, per the provisions of s.9B.

This increase took place on 01/07/2023 and therefore, the new share capital of CypCo Ltd will be 10 million Euros at 01/01/2023 and  $10 + 20,85 = 30,85$  million Euros from 01/07/2023.

The average new share capital eligible for section 9B calculation will therefore be  $10 \times 6/12 + 30,85 \times 6/12 = 20.425$  million.

The 'reference' interest rate is the 10-year Sovereign Bond yield plus 5%. So is the Cyprus yield of 3.25% is used, this interest rate will be  $3.25\% + 5\% = 8.25\%$ .

However, the income tax law, allows this reference rate to be determined per the yield or yields on the Sovereign Bonds in the States where the Cyprus company invested its capital.

In the case of CypCo Ltd, it would make sense to use the weighted average foreign Governments' bond yield which ranges from 3.042% to 22.845% (plus the 5% of course).

Finally, the deemed interest deduction cannot exceed 80% of taxable profits.

## Question 2

### Part 1

During 2023, Peter spent more than 183 days in Cyprus and therefore he is considered as a Cyprus tax resident on the 183-days rule.

During 2024, Peter spent less than 183 days in Cyprus but more than 60 days.

He therefore does not satisfy the 183-days rule and on this basis, he cannot be deemed as a Cyprus tax resident. Peter may satisfy the 60-day rule however, as he physically spent more than 60 days in Cyprus, has a place of permanent abode in Cyprus and income from Cyprus.

However, he spends most of his time in the UK, and as such he will be deemed as a UK resident for year 2024 and therefore cannot be deemed a Cyprus tax resident as well.

### Part 2

For year 2023, as Peter is a Cyprus Tax resident, he will be taxed in Cyprus on his Worldwide income.

Although he was Cyprus tax resident in 2023, Peter will be exempt from SDC as he is a non-dom of Cyprus.

Short-term homestay income will be subject to Income tax as trading income i.e. rental income less expenses incurred = taxable trading income.

This income will also be subject to VAT as it is income deriving from a trading activity carried out in Cyprus at the reduced rate of 9% re: tourist business.

Peter will also be obliged to pay GeSY at 4% on his trading profit but exempt from Social Security Contributions as he is over 65.

Income from agricultural activities will also be subject to income tax, Gesy at 4% re: trading income, and VAT within the special scheme for farmers.

Income from Dividends from Cyprus companies is specifically exempt from Income tax but will be subject to GeSY at a rate of 2.65%, which is deducted at source by the payer company.

Dividends and Interest from overseas are specifically exempt from income tax, but will be subject to GeSy contributions at 2.65%. Any taxes suffered overseas will be credited against Peter's Cyprus GeSy liability.

Peter's UK Pension will be taxed in Cyprus at either the normal income tax rates or if Peter so elects, this will be taxed at a special mode of taxation of a flat rate of 5% for amounts above 3,420 Euros which are taxed at 0%.

Note GeSY contribution limit of 180.000 Euro total income.

For year 2024, Peter is not a Cyprus tax resident and therefore will be subject to taxation on his Cyprus sources of income only.

Short-term homestay income will be subject to Income tax as trading income i.e. rental income less expenses incurred = taxable trading income, as this is income arising from a Permanent Establishment situated in Cyprus.

This income will also be subject to VAT as it is income deriving from a trading activity carried out in Cyprus, at the reduced rate of 9% re: tourist business.

Peter will not be subject to GeSY as he is not resident in Cyprus.

Income from agricultural activities will also be subject to income tax re: Trading income through a Permanent Establishment situated in Cyprus and also subject to VAT within the special scheme for farmers as it is a trading activity carried out in Cyprus.

Income from Dividends from Cyprus companies is specifically exempt from Income tax, GeSY and SDC.

### Part 3

When Peter decides to sell his assets in Cyprus, he will be subject to Capital Gains Tax at 20%, in respect of any gains arising from the disposal of his Immovables i.e. the 15 flats and his agricultural land.

Gains on disposal of Cyprus companies' shares are outside the scope of Capital Gains Tax, unless the assets of those companies comprise also immovable property situated in Cyprus, in which case any capital gains attributable to those immovable will be subject to capital gains tax at 20%.

In respect of his short-term homestay business, if that is sold as a business, any gain attributable to trading goodwill will be subject to Income Tax in Cyprus and exempt from VAT if the business is transferred as a going-concern to the new owner.

Capital Gains Tax Law (N52/1980) provides three lifetime exemptions. A General exemption of 17,100 Euros, an agricultural land exemption of 25,629 Euros and a Principal Private Residence (PPR) exemption of 85,430 Euros.

Peter will not be able to avail himself of the PPR exemption as he has never used his flat as his PPR for at least 5 years.

Peter may avail himself of the agricultural land exemption of 25,629 Euros (or part of it), provided he realises such gains on his agricultural land disposal, OR of the 17,100 Euro General exemption on all of his capital assets disposal collectively.

## **PART B**

### Question 3

#### Scenario A

In this case, the cost of the land is 25,000 Euros i.e. the initial cost to Giannakos' family, as the transfer to Giannakos by reason of inheritance is not a disposal per the definition of disposal of section 9 of Law N52/1980.

As such, the eventual gain of 475,000 Euros (500,000 the July 2024 value less 25,000 initial cost) will be subject to income tax and taxed in the ratio Giannakos 1 : Noor 2 within year 2024.

In other words, Noor will be taxed with 2/3rds of Giannakos Gain, or Giannakos will be taxed on only 1/3rd of his gain, which will be favorable to Giannakos and unfavorable to Noor.

In total, the taxable gain will be  $2,160,000 - 1,000,000 - 25,000 = 1,135,000$  Euros, taxed 378,333 Euros on Giannakos and 756,667 on Noor.

Both Giannakos and Noor will be subject to income tax at rates 0%-35% but mostly 35% as their 2024 income will exceed by far the 60,000 Euro upper tax threshold.

In addition, Giannakos and Noor will be subject to GeSy at 4% on the above amounts but capped to taxable of 180,000 Euros for each. i.e. the Gesy liability will be capped at  $180,000 @ 4\% = 7,200$  Euros for each partner.

There will be no capital gains tax implications in this case.

The partnership is a tax transparent entity and therefore not subject to income tax. Instead, the income is taxed on the partners directly.

#### Scenario B

In this case, Giannakos will be subject to Capital Gains tax on this capital gain disposal of  $500,000 - 104,000 = 396,000$ .

Plus GeSY at 2.65% but capped to 180,000 Euros assessable gain.

Subtracting the general lifetime exemption of 17,100 from the above indexed gain, this gives a CGT liability of  $396,000 - 17,100 = 378,900 @ 20\% = 75,780$  Euros.

The company will realise a profit of  $2,160,000 - 1,000,000 - 500,000 = 660,000$ , which will be subject to corporate income tax at 12.5% or  $660,000 @ 12.5\% = 82,500$  Euros.

Ignoring any overheads (and the NID on 1,500,000 Euro equity capital), the after-tax profit of the company will be  $660,000 - 82,500 = 577,500$  and assuming that all of this will be distributed to the shareholders, then:

- Giannakos' gross dividend will be  $577,500 \times 1/3 = 192,500$  Euros, on which the company will withhold 17% SDC (32,725) and Gesy 2.65% on 180,000 = 7,200 Euros.
- Noor's gross dividends will be  $577,500 \times 2/3 = 385,000$  from which the company will not withhold SDC as Noor is a non-dom, but will withhold Gesy at 2.65% with a maximum of 7,200 Euros.

Question 4

Part 1

A person shall be deemed to have "commenced first employment in the Republic" when for the first time, after a period of fifteen (15) consecutive tax years during which it did not exercise any salaried services in the Republic, begins to perform salaried services in the Republic either to an employer resident in the Republic or to a non-resident employer of the Republic, without taking into account any occasional full-time or part-time employment in the Republic for a period not exceeding one hundred and twenty (120) days in total during a tax year.

Part 2

In accordance with section 8(21A), 20% of the remuneration from taking up first office or first employment exercised in the Republic by an individual who was resident outside the Republic and was in full time employment overseas for a continuous period of at least 36 months by a foreign employer before the commencement of his employment in Cyprus, or €8,550, whichever is the lower, is exempt.

This exemption applies for seven years from 1st January following the year in which employment commences in the Republic and terminates at the expiration of the 7-year period, or the termination of this first employment if earlier.

Part 3

In accordance with section 8(23A), 50% of the income from first employment exercised in the Republic by an individual who was resident outside the Republic prior to commencement of his first employment, for a continuous period of 15 consecutive years, is exempt from tax for a period of 17 years, or the earlier withdrawal of this subsection of the law, or the earlier termination of this first employment, provided that the income from this first employment exceeds 55,000 Euros per annum.

Exemption is granted in any year in which the income from employment in the Republic exceeds 55,000 Euros on an annual basis, irrespective of whether in a year the income from employment is reduced below 55,000 Euros, provided that when the employment in the Republic commenced, the income from employment in the Republic exceeded 55,000 Euros on an annual basis, and the Commissioner is satisfied that the decrease and subsequent increase in the annual income from employment in the Republic is not part of a scheme intended for the grant of the exemption. Furthermore, the exemption provided under section 8(21) does not apply when the exemption of subsection 8(23) applies.

## **PART C**

### Question 5

#### Part 1

Up until tax year 2021, a limited liability company was deemed a tax resident of Cyprus if it satisfied the 'management and control' test.

Although there is no legal definition of the 'management and control' test, this is taken as being satisfied, if all the following three conditions were satisfied:

- the majority of the board of directors are Cyprus tax residents;
- board minutes take place in Cyprus; and
- the strategic decisions of the company are taken in Cyprus.

Therefore, up to and including tax year 2021, the legal situs of a company was not connected in any way with the company's tax residency.

The above changed as from tax year 2022 with the relevant amendment being voted on 31/12/2022.

According to this amendment, a company will be tax resident in Cyprus if it satisfies the 'management and control test' or if it is incorporated in Cyprus and although it may not satisfy the 'management and control' test, it will be deemed tax resident in Cyprus if such Cyprus incorporated company, is not tax resident in another State. This amendment has therefore extended/widened the definitions of a Cyprus tax resident company.

Finally, tax residency for companies is determined by reference to its status as at 31 December of each calendar/tax year.

#### Part 2

A company which is deemed a tax resident of Cyprus is taxed on its Worldwide Income, and takes advantage of Cyprus's DTA relief network

However, if a Cyprus Tax resident company operates from a permanent establishment (PE) overseas, profits generated from that overseas PE receives double tax relief through the exemption method per section 23 of Law 118/2002.

In case the overseas PE makes a loss however, such loss may be aggregated with income of the head office in Cyprus obtaining immediate tax relief, with however such loss relief being reclaimed by the Cyprus Tax Department in future year(s) if the overseas PE becomes profitable to the extend of the whole loss previously claimed.

On the other hand, a non-resident company is taxed in Cyprus if it operates a PE situated in Cyprus and profits arise through the Cyprus PE operations.

In addition, non-residents of Cyprus are taxed in Cyprus through a withholding tax mode in cases of professional athletes/scientists, entertainers which operate casually in Cyprus, and non-residents receiving patent and copyright royalties exploited in Cyprus.



Question 6

Part 1

Section 2 of Law 118/2002 defines a Permanent Establishment (PE) as:

- a) a fixed place of business through which the business of an enterprise is wholly or partly carried on (e.g. an office or a branch);
- b) a building site or construction or installation work or supervisory activities in connection therewith if it lasts for more than three months; or
- c) a dependent representative (Agency PE), where a person, other than an independent agent acting on behalf of an enterprise, has and habitually exercises, in the Republic, explicit authorisation to conclude contracts in the name of the enterprise, such enterprise shall be deemed to have a permanent establishment in the Republic in respect of all of this dependent agent's activities.

Part 2

Section 2 of Law 118/2002 specifically excludes, from the PE definition, the following:

- a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise which belongs to the enterprise.
- b) the maintenance of a stock of goods or merchandise which belongs to the enterprise solely for the purpose of storage, display or delivery.
- c) the maintenance of a stock of goods or merchandise which belongs to the enterprise solely for the purpose of processing by another enterprise.
- d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or for collecting information for the enterprise's business.
- e) the maintenance of a fixed place of business solely for the purpose of carrying out any other activity of preparatory or auxiliary character for the enterprise.
- f) the maintenance of a fixed place of business solely for the purpose of any combination of activities mentioned in subparagraphs (a) to (e) above, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.
- g) offshore activities relating to mining, exploration or exploitation of the seabed, subsoil or natural resources, and the establishment and operation of pipelines and other facilities in the seabed of the Republic of Cyprus.
- h) the fact that a company which is a resident of the Republic controls or is controlled by a company which is not resident in the Republic or carries on business outside the Republic, whether through a permanent establishment or otherwise, cannot by itself make one company a permanent establishment of the other.
- i) an enterprise shall not be deemed to have a permanent establishment in the Republic merely because it carries on business in the Republic through a broker, general commission agent or any other independent agent, provided the latter are acting in the ordinary course of their work. (independent representative).

### Question 7

#### Part 1

Re-organisation through a Division is an operation where a company, on being dissolved without going into liquidation, transfers all its assets and liabilities, to two or more existing or newly-formed companies, in exchange for the pro-rata issue to its shareholders, of shares representing the capital of the companies which receive the assets and liabilities of the old company, and, if applicable, in exchange for a cash payment not exceeding 10% of the nominal value or, in the absence of a nominal value, of the accounting par value of those shares.

Under a partial division the split-up company continues in existence (i.e. it does not go into liquidation) having kept at least one branch of activity.

#### Part 2

Re-organisation through a 'Transfer of assets' is an operation where a company transfers, without being dissolved, one or more branches of its activity to another company in exchange for the transfer of shares to it, representing the capital of the company receiving the assets.

This is different than a merger or division, as under this method the transferring company is not dissolved, as it is able to transfer one branch of activity only and keep the rest.

The company receiving the assets, issues shares to the transferring company as it is also the case in a merger or in a division.

#### Part 3

Re-organisation through an 'Exchange of shares' is an operation where a company (being the existing shareholder of the target company), acquires a majority holding in the capital of the acquirer company, in exchange for the transfer of the shares of the target company to the acquirer company and in certain cases an additional cash payment not exceeding ten per cent (10%) of the nominal value or, in the absence of a nominal value, of the accounting par value of the shares issued in exchange.

Question 8

- 1) Services are physically provided in Cyprus and therefore the place of supply is Cyprus.

The recipient of the service is a non-taxable person, which may apply to the VAT Department for a VAT exemption.

The Tax office will need to charge VAT at the reduced rate of 9%, unless the recipient of the service provides the former with a VAT exemption certificate.

- 2) The place of supply of civil engineering services for a building site is the country in which the building site is located. However, the service is provided by a Cyprus taxable person to another Cyprus taxable person and as such the place of supply will be Cyprus and the Civil engineer will need to charge VAT at the standard rate of 19%.
- 3) The service is carried out outside the EU and therefore its place of supply would have been outside the EU. However, the fact that the recipient is an EU taxable person, the place of supply is Italy and under the simplified procedure, the Cyprus entity will charge 0% VAT and declare the service on a VIES return, whereas the Italian party will account for the service per the reverse charge provisions.
- 4) The place of supply is where the service is physically provided i.e. Larnaca. The Israeli organiser will need to register for VAT in Cyprus either directly or through a VAT representative, charge VAT at 5% reduced rate and account for it to the VAT Department.
- 5) The place of supply of ancillary services to a building site is where the site is physically situated i.e. Cyprus. The Italian developer will need to register for VAT in Cyprus either directly or through a VAT representative.

As a subcontractor, the quantity surveyor will charge 0% VAT and the Italian developer will account for VAT under the reverse charge provisions under section 11B.

- 6) The place of supply is where the recipient of the service is situated i.e. Cyprus. The recipient will have to account for the service received on the reverse charge provisions and account for VAT to the VAT Department in this case paying the applicable VAT as the bank provided VAT exempt services and therefore not in a position to claim VAT input.
- 7) The place of supply is where the recipient of the service is situated i.e. Cyprus. The recipient will have to account for the service received on the reverse charge provisions and account for VAT to the VAT Department, claiming the input VAT against the output VAT that will arise on the application of the reverse charge provision.