

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2022

MODULE 2.03 – CYPRUS OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

- Determination of tax residence is vital re: establish each State's taxing rights.
- Tax residence is determined by domestic legislation.
- Situations arise where domestic legislation of both States determine tax residence in both States (dual residence).
- The dual residence issue is resolved through DTA's provisions, as taxpayer can only have one State's residence.
- Use tie-breaker rule under Art 4(3) OECD MC.
- Alex was tax resident of Sweden per its domestic legislation as well as resident of Cyprus per the 183 day rule. Hence dual residency issue.
- Tie-breaker rule prescribes a list of tests to be taken in order listed to determine residence in only one State as follows:
 - Existence of permanent home.
 - If permanent home in both States, place of centre of vital interests (economic and personal).
 - If vital interests in both States, habitual abode (physical presence).
 - If habitual interest in both or none of the States, Nationality.
 - If National of both or none of the States, by mutual agreement of the competent authorities.
- Andrew has a permanent home in Sweden. In Cyprus, accommodation is provided by her employer.
- Therefore Andrew is resident of Sweden.
- In the case where Cyprus claims that Alex has a permanent home in Cyprus, the next step is the determination of his centre of vital interests.
- Alex has economic interests in both Countries.
- However she has personal interests in Sweden only re: her family lives there.
- Therefore on balance, Andrew will be treated as tax resident of Sweden
- As such, Cyprus can only tax Alex on income arising in Cyprus
- As a non-resident individual

Part 2

- From Part 1 above, Alex being a tax resident of Sweden, will be taxed in Cyprus on income arising in Cyprus only.

- Accordingly, salary from X Plc taxed in Sweden only.
- Salary from CypCo Ltd is taxed in Cyprus due to the fact that:
 - Alex's salary is borne by a Cyprus taxpayer employer;
 - Alex is paid by a Cyprus taxpayer employer; or
 - Alex spent more than 90 days in Cyprus.
- Note: Satisfaction of just one of the above gives Cyprus taxing rights. If none of the above apply, Sweden has exclusive taxing rights. (Art 15 OECD MC).
- Sweden has residual taxing rights on Alex's CypCo Ltd salary.
- Non-executive director fees taxed in Sweden only (Art 16 OECD NC).
- Rental income taxed in Sweden. Not Cyprus Taxing rights.
- Gains in Cyprus company shares taxed in Sweden only, unless.
- Company's underlying assets include immovable property situated in Cyprus which account more than 50% of its total assets. If this is the case, the gains will be subject to capital gains tax in Cyprus.
- Sweden to provide DTTR for any tax paid in Cyprus.
- Gains on disposal of Tourist apartments will be taxed in Sweden. If tax was paid in Ghana, Sweden to provide DTR for such tax paid.
- Cost of accommodation and car leasing are taxed as benefits in kind and form part of Alex's employment income in Cyprus (see above for treatment)
- It is irrelevant where bank accounts are maintained, as Cyprus does not apply the remittance basis of taxation re: remittance to Cyprus of Ghana income and gains.
- For 2021, 50% exemption if salary in Cyprus exceeds 100.000 Euro.
- In addition to above exemption, 20% exemption with maximum of 8.550 Euro p.a for 3 years commencing from 2022
- BUT if Alex is finally determined, a not tax resident of Cyprus, above reliefs will not apply.

Question 2

Part 1

A merger under a scheme of re-organisation, may be achieved as follows:

- One or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to another existing company in exchange for the issue to their shareholders, of shares or shares and cash, representing the capital of that other company. The cash element of the consideration must not exceed 10% of the nominal value of the shares issued, or in the absence of a nominal value, 10% of their accounting par value, or
- One or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to a new company in exchange for the issue to their shareholders, of shares or shares and cash, representing the capital of that new company. The cash element of the consideration must not exceed 10% of the nominal value of the shares issued, or in the absence of a nominal value, 10% of their accounting par value, or
- A company, on being dissolved without going into liquidation, transfers all of its assets and liabilities to the company holding all the shares representing its share capital.

In an approved scheme of re-organisation, the transferring companies and their shareholders are exempt from any income tax (that may arise through a balancing adjustment as no balancing statement is required to be submitted by the transferring company) and capital gains tax, land transfer fees and stamp duty by reference to immovable property situated in Cyprus, that would have otherwise arose due to the transfer of assets.

It must be noted however that where part of the consideration is in cash, any capital gains which may accrue due to the transfer of immovable property situated in Cyprus will be taxable on the shareholders which will receive cash to the extent that this gain is attributable to the cash element. In addition, any undistributed accumulated profits of the five years preceding the year of dissolution of the acquired company, to the extent attributable to the cash consideration will be subject to 17% special defence contribution.

Assuming that no new company will be formed, Super Ltd will be required to increase its share capital. One chunk of the additional shares will be issued to the minority shareholders of Sikma Ltd in exchange for the later company's assets and liabilities transferred to Super Ltd. Sikma Ltd will then be dissolved. The rest of the additional shares issued by Super Ltd will be issued to Ms Makis and the 1% minority shareholder of Failure Ltd, in exchange for the later company's assets and liabilities transferred to Super Ltd. Failure Ltd will then be dissolved.

Part 2

The accumulated losses of Failure Ltd will be transferred to Super Ltd. As such, they have a value which equals the amount of the losses multiplied by the corporate income tax rate i.e. €10.000 (€80,000 at 12,5%). There is no other value attached to these losses in terms of special defence contribution, as they cannot reduce future accounting profits for deemed distribution purposes. Note however that the cash payment to Ms Makis cannot exceed 10% of the nominal value of the shares that will be issued to her by Super Ltd. Assuming that Ms Makis will receive the above amount, then she will be liable to capital gains tax at 20%, on 10% of the 99% capital gain accruing to the company's immovable property situated in Cyprus, on transfer of Failure Ltd's net assets to Super Ltd.

Part 3

Currently, overseas operations are carried out through foreign branches. This means that foreign branch losses may be aggregated with Cyprus operations profits. In future years however, when foreign branches turn profitable, these losses will be recaptured, although

double tax relief in respect of overseas taxes may be available. In order to mitigate this, it may be advisable to convert these foreign branches into foreign subsidiaries. Although some countries levy a branch remittance withholding tax, which leaves the 'foreign' investor indifferent between having a branch or a subsidiary in that country, one has to examine the withholding tax rates applicable to dividend payments to Cyprus from each country of operations. One can therefore conclude that each country of operations will have to be considered separately by reference to the existence or non-existence of a double tax treaty with Cyprus and applicability of the EC Parent-subsidiary directive, before any further advice is given to Mr Taras on this issue.

PART B

Question 3

Part 1

Exchange with Great Britain property

In this case, the disposal through the exchange will not be subject to capital gains tax in Cyprus, as the property is situated outside of Cyprus. It may however be subject to capital gains taxation in Great Britain.

Exchange with plot in Nicosia

In this case, as the cost of the plot is lower than the market value of the house to be acquired and no cash receipt is involved in the transaction, the capital gain arising on the disposal through the exchange of properties may be rolled over and deducted from the base cost of the villa on its future disposal. The computation is as follows:

	€
Disposal proceeds (villa value)	600,000
Less: indexed cost €300,000x130%	<u>(390,000)</u>
Indexed gain	210,000
Less: general exemption	<u>0</u>
	210,000
Gain rolled over	<u>(210,000)</u>
Taxable capital gain	<u>0</u>

Exchange with agricultural land

In this case, with reference to the Pafos land, as this land's 1.1.1980 value is lower than the 1.1.1980 value of the villa to be acquired (part) and as the cost of the Pafos land is lower than the market value of the villa to be acquired (part) and no cash receipt is involved in the transaction, the whole of the capital gain arising on the disposal through the exchange of properties may be rolled over and deducted from the base cost of the villa on its future disposal.

The computation is as follows:

Land in Pafos

	€
Disposal proceeds (villa part value)	320,000
Less: indexed cost €110,000x130%	<u>(143,000)</u>
Indexed gain	177,000
Less: general exemption	<u>0</u>
	177,000
Gain rolled over	<u>(177,000)</u>
Taxable capital gain	<u>0</u>

Land in Lythrodontas

	€
Disposal proceeds (villa part value)	280,000
Less: indexed 1.1.1980 value €50,000x130%	<u>(65,000)</u>
Indexed gain	215,000
Less: general exemption	<u>0</u>
	215,000
Gain rolled over	<u>(215,000)</u>
Taxable capital gain	<u>0</u>

Part 2

The base cost of the house of Paralimni in a future disposal will be as follows:

If exchanged for Great Britain property

	€
Agreed value	600,000
Less: gain rolled over	<u>0</u>
Revised cost	<u>600,000</u>

If exchanged for the plot in Nicosia

	€
Agreed value	600,000
Less: gain rolled over	<u>(210,000)</u>
Revised cost	<u>390,000</u>

If exchanged for agricultural land in Pafos

	€
Agreed value	600,000
Less: gains rolled over (177,000+215,000)	<u>(392,000)</u>
Revised cost	<u>208,000</u>

On a future disposal of the villa, Kenneth may be entitled to the principal private residence exemption of €85,430, provided he owns and resides in that house for at least five years and the disposal of the house takes place within twelve months from the date of the disposal.

Part 3

Rental income generated from the villa will be taxable in Cyprus irrespective of Kenneth's tax residence as this is income arising from immovable property situated in Cyprus.

Kenneth will however be outside the scope of special defence contribution and GeSy as he will not be a resident of Cyprus, as special defence contribution applies to Cypriot residents only, and so is GeSy in this case.

PART C

Question 4

BEPS refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax jurisdictions.

Cyprus has signed the following Multilateral agreements within the framework of the BEPS project:

- The OECD Multilateral automatic exchange of information agreement or Common Reporting Standard (CRS) for the automatic exchange of tax related information held by its financial institutions (order of the Minister of Finance 477/2015 as replaced by order 161/2016, through which the Cyprus competent authorities will communicate information to 81 participating jurisdictions.
- The Multilateral Competent Authority Agreement of Country by Country reports (CbC MCAA), on the basis of which, Cyprus competent authorities will be communicating tax related information to the tax jurisdiction of the parent company of a Multinational Group, which addresses Action 13 of the OECD action plan of the BEPS project.
- On 25 May 2018 the DAC was amended by Council Directive (EU) 2018/8222 ('DAC 6') regarding the mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements. DAC 6 entered into force on 25 June 2018.

In addition to the above Multilateral Conventions, Cyprus introduced an anti-avoidance provision in s 8(20) of the Income Tax Law 118/2002, which provides for the non-exemption of foreign dividend income in cases where the underlying profits of the remitter company have reduced that company's taxable base. This addresses Action 2 re: to neutralize the effects of hybrid mismatch arrangements.

The CFC issue also comes in action 4 which addresses base erosion via interest deductions and other financial instruments. In fact, tax practices in Cyprus allowing triangular interest relationships with zero-tax jurisdictions, encourage this type of avoidance schemes. However the 2015 addition of s 9B Law 118/2002, allowing a deemed interest deduction seems to effectively limit the "usefulness" of such triangular loan and interest relationships.

Another aspect of the OECD action plan (actions 8-10 and 13) relates to transfer pricing. Cyprus addresses this issue with just s 33 Law 118/2002, without any further legislation or regulation in relation to this.

Cyprus has made a few steps in relation to harmful tax practices and the prevention of Treaty abuse (actions 5 and 6), in that the Cyprus Tax Department has taken some practical measures, but which only rely on self-certification by a company's directors. Measures will have to be implemented for a more active procedure in examining taxpayers' requests for the issue of tax residency certificates which is in the center of Treaty abuse and harmful tax practices.

Question 5

The concept of “domicile” is defined in the Wills and Succession Law, CAP. 195, as amended.

Under section 6 of CAP. 195, an individual has at any given time:

- a domicile of origin, or
- a domicile of choice, or
- an incidental domicile of where an individual is found/located.

In the case of a genuine child born during the lifetime of the father, the domicile of origin of the child, is the domicile of the father at the time of the child's birth.

An individual acquires domicile of choice by establishing his/her residence in any place in the Republic of Cyprus with the intention of a lasting or indefinite residence on the island.

The domicile of origin is kept until a domicile of choice is acquired.

Based on the above, a person born outside Cyprus, of a father whose domicile of origin was outside Cyprus retains such domicile of origin of the father. A person whose father had his domicile of origin in Cyprus, retains his domicile in Cyprus.

As from 16.7.2015, for special defence contribution purposes, the term resident individual means a Cyprus tax resident individual as applied for income tax purposes who also has a domicile of origin in Cyprus

A domicile of origin in Cyprus means a domicile under the provisions of CAP. 195, as amended, subject to the following exceptions:

- (i) An individual who has acquired and maintains a domicile of choice outside Cyprus, provided that he has not been resident in Cyprus, for any period of at least 20 consecutive years before the tax year. In such a case, no SDC is payable on incomes of such person whether arising in Cyprus or outside Cyprus.
- (ii) An individual who was not tax resident in Cyprus for at least 20 consecutive years immediately before 16.7.2015. In such a case, no SDC is payable on incomes of such person whether arising in Cyprus or outside Cyprus.

Regardless of the domicile of origin, any individual resident in Cyprus, for at least 17 of the last 20 years before the tax year, that person will be deemed to have his domicile in Cyprus.

The concept of “domicile” has no bearing on an individual’s income tax status.

Question 6

Income Tax

The taxation provision on trusts is section 31 of the Income Tax Law 118/2002.

The income of a trust is assessed in the name of the trustee, in like manner and to the like amount as such person would be chargeable if he had received such income personally.

For income tax purposes, the beneficiaries are the persons liable for the income tax but the assessment is raised in the name of the trustee in a representative capacity, like any other representative or agent.

The beneficiary is entitled to any exemptions or deductions provided for the specific income, which is the subject matter of the assessment, even though the assessment is raised in the name of the trustee.

The income of an international trust, which is derived from sources within or outside the Republic is subject to any tax imposed in the Republic where the beneficiary is Cyprus tax resident.

The income of any other offshore trust, (having non-resident beneficiaries and income arising overseas) is exempt from income tax.

If any income arises in Cyprus to a trust whose beneficial owner is non-resident, such income is exempt from tax if the exemption applies to non-resident persons.

Tax residency of the Trustee is irrelevant. For example, rents arising from property situated in Cyprus or business profits from a permanent establishment in Cyprus are subject to income tax in Cyprus, even if the beneficial owner is not resident in Cyprus. When the monies are then distributed to the beneficial owner, they are exempt from Cyprus income tax.

The income of trustee companies is taxable at the normal corporate income tax rate of 12.5%.

Special Contribution for the Defense

Beneficiaries of a trust who are residents in Cyprus, are subject to special defense contribution in respect of dividends at 17% and interest at 30% (lower rates of 3% on interest applies in certain cases) in the name of the trustees, in respect of income arising in Cyprus or abroad.

If beneficiaries are resident or domiciled outside Cyprus, they are not taxable in Cyprus with respect to dividends, interest or rents.

Capital Gains Tax

In case of disposal of immovable property situated in Cyprus, gains will be subject capital gains tax per the provisions of Law 52/1980. Any gains from the sale of shares in companies represented by immovable property situated in Cyprus is also subject to capital gains tax.

However, certain gains are exempted, including gains from the sale of shares of companies quoted in a recognized stock exchange e.g. the Cyprus Stock Exchange.

Stamp Duty

The provisions of the Stamp Duty Law of 1963, Law 19/63 as amended apply to International Trusts.

All instruments executed in Cyprus are subject to Stamp Duty. All instruments relating to immovable property situated in Cyprus are subject to Stamp Duty irrespective of whether executed in Cyprus or overseas.

Question 7

Part 1

Computation of profits of a non-life insurance company

In the case of a non-life insurance company a deduction in respect of head office expenses not exceeding 3% of premiums in the Republic less premiums paid on re-insurances is allowed, where the head office is outside the Republic.

Set-off of losses against all other profits including profits from life insurance business is allowed as in the other types of business.

Unrelieved losses can be carried forward indefinitely under section 13 of Law 118(I)/2002

Lay-out of computation

<u>Income</u>	
Gross insurance premiums	X
Interest	X
Commissions	X
Other income	X
(a) Total	X
<u>Less (b)</u>	
Return of insurance premiums	(X)
Premiums for re-insurances	(X)
(X)	
Balance [(a) - (b)]	X
<u>Less</u>	
Reserves for unexpired risks:	
At the end of the year	(X)
Less at the beginning of the year	(X)
(c)	X
<u>Less</u>	
Net claims	(X)
Expenses	(X)
Other allowances under the law	(X)
Net profit/(loss)	X/(X)

Interest income is deemed to be derived from the ordinary course of business.

Computation of profits of a life insurance company

In the case of a life insurance company a deduction in respect of head office expenses not exceeding 2% of premiums in the Republic less premiums paid on reinsurances is allowed, where the head office is outside the Republic.

Set-off of losses against all other profits including profits from life insurance business is allowed as in the other types of business.

Unrelieved losses can be carried forward indefinitely under section 13 of Law 118(I)/2002.

Lay-out of computation

Income

Gross insurance premiums	X
Net income from investments (including profits from sale thereof)	X
(a)	X

Less

Premiums for re-insurances	(X)
Net claims	(X)
Surrenders	(X)
Expenses	(X)
Other allowances under the law	(X)
(b)	(X)
Balance [(a) - (b)]	X

Less

Reserves for unexpired risks:	
At the end of the year	(X)
Less at the beginning of the year	(X)
Net profit/(loss)	X

But, life insurance companies are subject to a minimum tax of 1,5% of the gross premiums
Interest income is deemed to be derived from the ordinary course of business.

Part 2

Gross premiums for the year	1,800,000
Chargeable income	212,000
Corporation tax at 12,5%	26,500

But tax payable will be the minimum of 1,5% of gross premiums = €1,800,000x1.5%=€27,000.