



THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2016

PAPER 2.03 – CYPRUS OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

TIME ALLOWED – 3¼ HOURS

You should answer **FIVE** out of the seven questions: **BOTH** questions from Part A; the **ONE** question in Part B; and **TWO** questions from Part C.

Part A questions are worth 25 marks each. The Part B question is worth 20 marks. Part C questions are worth 15 marks each.

You should aim to spend approximately half of your exam time answering Part A, and the remaining half answering Parts B and C. The amount of time you spend answering each question should correspond broadly to the number of marks available for that question.

Start each answer on a new page. If you are using the on-screen 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.

All workings should be made to the nearest month and Euro, unless the question requires otherwise.

Marks are specifically allocated for presentation.

PART A

You are required to answer BOTH questions from this Part.

1. You recently held a meeting with the Finance Director of PS SAS, a Frelandian software company. PS SAS licences software and provides support for its software to users either directly, or indirectly through either overseas branches or overseas subsidiaries. The group's operating income therefore comprises the initial licensing fee for selling the software and an annual support fee for end users.

PS SAS wishes to expand its activities in Cyprus, and is also considering restructuring its invoicing strategy by either using a Cyprus subsidiary or a Cyprus branch to invoice end users resident in other states.

You also ascertain the following:

- 1) The Frelandia corporate tax rate is 35%. Frelandia is an EU member state.
- 2) The rate of withholding tax on payment of royalties between Cyprus and Frelandia is 0%.
- 3) Software can either be downloaded from the company's website or purchased in DVD format.
- 4) Support is provided electronically.
- 5) Services provided electronically from one EU member state to another may entail a VAT charge at the applicable VAT rate in the provider's country.
- 6) Patent royalties is interpreted in the Cyprus income tax law as:
"the gross amount of royalty, premium, compensation or other income derived from sources within the Republic by any person not being resident in the Republic, who is not engaged in any business in the Republic, in consideration for the use of, or for the privilege of using any copyright, patent design, secret process formula, trade mark, know-how or any other like property, or in consideration for technical assistance."
- 7) PS SAS estimates that setting up a Cyprus establishment, either a subsidiary or a branch, will require financing of circa €500,000. No immovable property will be acquired in Cyprus.
- 8) PS SAS is considering disposal of its overseas operations within the next five to seven years at considerable gains, as trading goodwill is expected to be generated.

You are required to:

- 1) **Explain whether the initial licensing fee invoiced to Cyprus entities will be treated as royalty income or business income, and how this will be taxed in Cyprus if no Cyprus subsidiary or branch is formed.** (3)
- 2) **Explain whether the annual support fee invoiced to Cyprus entities will be treated as royalty income or business income, and how this will be taxed in Cyprus if no Cyprus subsidiary or branch is formed.** (2)
- 3) **How, if at all, would your responses to 1) and 2) above, differ if a Cyprus branch is formed, in comparison to a Cyprus subsidiary formation?** (2)

Continued

1. Continuation

- 4) **Analyse whether PS SAS will gain greater advantage by setting up a Cyprus subsidiary or a Cyprus branch. You should assume that the profit or loss recorded by overseas branches of Frelandian companies is aggregated with the total income of PS SAS, for Frelandian Corporation Tax purposes.**

You should also comment on the withholding tax implications, if any, of the income flows between the Cyprus company and those entities which are situated outside Cyprus and Frelandia. (9)

- 5) **Explain how the Cypriot tax base will be affected if the Cyprus operations are financed either by equity share capital or with a bank loan obtained from Frelandia by PS SAS and redirected to the Cyprus company; or if the Cyprus company obtains a loan from a Cypriot bank directly.** (5)

- 6) **Explain the tax treatment of the gain on disposal of the Cypriot operations, in the event that either the Cyprus establishment sells the business, or the shares in a Cyprus subsidiary are sold.** (4)

Total (25)

2. You recently had a meeting with Mr Stamas, the 96% shareholder in Success Ltd. Success Ltd controls 60% of Alpha Ltd; the remaining 40% belongs to three minority shareholders. Mr Stamas has already agreed with Mr Loris, the 99% owner of Loss Ltd, to merge his group with Mr Loris's company. He also agreed with the three minority shareholders of Alpha Ltd on behalf of and for Success Ltd, to acquire the Alpha Ltd net assets through an exchange of shares and a small payment in cash. Loss Ltd has accumulated tax losses. All three companies own immovable property, situated mostly in Cyprus. Alpha Ltd is involved in the wholesale distribution of home appliances and furniture, while the other two companies are involved in the retail distribution of the same commodities. Alpha Ltd also operates outside Cyprus, through overseas branches.

The current balance sheets of the three companies are as follows:

	Success Ltd €	Alpha Ltd - Cyprus €	Alpha overseas branches €	Loss Ltd €
Immovable property at net book value	150,000	60,000	30,000	50,000
Other assets	<u>90,000</u>	<u>30,000</u>	<u>20,000</u>	<u>30,000</u>
Total assets	<u>240,000</u>	<u>90,000</u>	<u>50,000</u>	<u>80,000</u>
Share capital	100,000	50,000		30,000
Profit and Loss account	<u>110,000</u>	<u>40,000</u>	<u>(20,000)</u>	<u>(90,000)</u>
Share capital and reserves	210,000	90,000		(60,000)
Liabilities	<u>30,000</u>	<u>30,000</u>	<u>20,000</u>	<u>140,000</u>
Capital and Liabilities	240,000	140,000		80

You have also ascertained the following:

- 1) It is expected that Alpha Ltd's Cyprus operations will continue to be profitable, but most of the overseas branches will continue incurring losses for the next two years, after which all overseas operations are expected to become profitable.
- 2) Although Mr Loris has already agreed to the merger through an exchange of shares, he insists on receiving cash with respect to the value of the company's accumulated tax losses. Mr Stamas and Mr Loris have a disagreement as to how this value should be calculated, as Mr Loris attaches both a corporate tax and a Special Defence Contribution element to this value.
- 3) Loss Ltd's operations are expected to turn profitable after one year, as Mr Stamas anticipates the negotiation of lower prices on the purchase of merchandise, better payment terms, and a reduction in overheads as a result of the merger.
- 4) Accumulated losses as depicted above are the same as the tax losses.

You are required to:

- 1) **Describe the methods under which the merger of the three companies may be achieved, explaining the pre-requisites that must be fulfilled for such a merger to qualify for the tax exemptions under a 'scheme of re-organisation', and state which tax exemptions will be available in this case.** (10)
- 2) **Describe the steps that will need to be taken in order to achieve this merger, assuming that no new company will be formed.** (4)

Continued

2. Continuation

3) Provide a recommendation as to how the value of Loss Ltd tax losses may be determined, stating any limitations in respect of the amount of the cash payment and any personal tax implications for Mr Loris. (5)

4) Advise as to how overseas operations may be structured in order to become more tax efficient in the future, by reference to future profitability expectations. (6)

Total (25)

PART B

You are required to answer THIS question.

3. Kyri is domiciled in Broatania, where he has lived and worked for his entire life. He recently moved permanently to Cyprus, after selling his home and some other immovable property in Broatania. As of 5 December 2015, Kyri owns immovable property as follows:

<u>Description</u>	<u>Market value</u> €	<u>Cost</u> €	<u>1 Jan 1980 value</u> €
Freehold shop in Broatania (acquired on 20 January 2006)	700,000	420,000	100,000
Plot in Nicosia (acquired on 2 February 2008)	500,000	200,000	80,000
Agricultural land in Limassol (acquired on 20 November 2011)	300,000	100,000	40,000
Agricultural land in Nicosia (a gift from Kyri's mother on 20 June 2008, value €160,000, originally acquired on 3 January 1970)	200,000	20,000	40,000

Kyri wishes now to acquire a villa in Paralimni from a land developer, which he plans to use as his main residence for a number of years before selling it; Kyri expects to move back to Broatania at a future point in time, when his children are ready to go to university. However, Kyri has not ruled out the possibility of retaining the villa and renting it out when he moves back with his family to Broatania.

The value of the villa is €500,000 including VAT. The value of the villa on 1 January 1980 was €100,000. Kyri is seeking to exchange one or more of his existing properties for the villa. Kyri has therefore suggested the following options to the land developer:

- 1) Kyri sells the shop in Broatania to the developer, in return for the villa and €200,000 in cash;
- 2) Kyri purchases the villa from the developer in exchange for his plot in Nicosia; or
- 3) Kyri purchases the villa in exchange for the two pieces of agricultural land.

Kyri has not previously sold or exchanged any immovable property in Cyprus.

You are required to advise Kyri on the following questions:

- 1) **What is Kyri's exposure to Capital Gains Tax, under the three property exchange options described above? You should take into account all available exemptions and reliefs, and support your answer with appropriate computations, assuming a 40% indexation allowance where applicable. (11)**
- 2) **For each of the three exchange options above, on what value will the deductible cost be based in a future disposal of the villa? Are any further exemptions or reliefs available, and what conditions will have to be met to qualify for them? (6)**
- 3) **If Kyri decides not to sell his Paralimni villa when he moves to Broatania, will the rental income generated from it be subject to Income Tax and Special Defence Contribution in Cyprus? (3)**

Total (20)

PART C

You are required to answer TWO questions from this Part.

4. A Cyprus International Trust is considered an effective estate and tax planning vehicle. Amendments to the International Trust Law (Law 20/2012) effective from 22 March 2012 have made it possible for Cyprus residents to be settlors and beneficiaries of an International Trust.

You are required to:

- 1) **State the circumstances under which it is allowed that a settlor and/or beneficiary to a Cyprus International Trust, can be Cyprus residents.** (2)
- 2) **Explain the basis on which the income of a Cyprus International Trust is assessable to tax in Cyprus. Your response should refer to Income Tax, Special Defence Contribution, Capital Gains Tax, Immovable Property Tax and Stamp Duty.** (13)

Total (15)

5. Value Added Tax (VAT) is imposed and administered in Cyprus according to the provisions of Law 95/2000 (the Cyprus VAT Law).

You are required to outline the following, in relation to the Cyprus VAT Law:

- 1) **The conditions that must be satisfied, in order for the supply of goods by a Cyprus registered trader to VAT registered traders in other EU member states, to be zero rated.** (4)
- 2) **The definition of ‘triangulation’, the ‘simplified procedure’, and the compliance requirements that must be satisfied should the simplified procedure be unavailable.** (7)
- 3) **The meaning of ‘distance selling’, and the compliance requirements in relation to this type of activity if it takes place in Cyprus.** (4)

Total (15)

6. The Cyprus Income Tax Law (Law 118/2002 as amended), provides for a special mode of taxation of 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 the following:

- 1) **Profits of shipping and aircraft businesses.** (7)
- 2) **Profits from providing ship management services.** (3)
- 3) **Royalty income and film rentals earned from a source in Cyprus by a non-Cyprus resident not maintaining a permanent establishment in Cyprus.** (5)

Total (15)

7. Maltec Ltd, the Maltese parent company of the Maltec group, which holds direct and indirect subsidiaries in Cyprus and the Balkan states, intends to restructure the group shareholding structure. The objective of such restructuring is for the group parent company to ultimately be located outside Malta. The current shareholding structure and the contemplated restructuring are as follows:

- 1) Mr Xerri, who is domiciled and tax resident in Malta, currently holds 90% of the shares in Maltec Ltd. The remaining shares are held by Mr Xerri's sister, a tax resident of Cyprus. They plan to set up Maltec Holdings Ltd in Cyprus, and to hold shares directly in this company at the same ratio.
- 2) Maltec Participations Overseas Ltd, a company currently operating in Cyprus holding shares and trading in electronic equipment, shall transfer 100% of the shares held in its five subsidiary companies, each established in Cyprus, and its trading operations, to Maltec Holdings Ltd. One of the subsidiaries in question (Maltec Cyprus Ltd) owns real estate property situated in Cyprus.
- 3) Maltec Holdings Ltd shall be financed via a bank loan for the purposes of purchasing the above shares. On the day of payment of the share purchase price, Maltec Participations Overseas Ltd (the seller) will fully repay an outstanding bank loan of an equal amount.
- 4) 100% of the shares held in Maltec Ltd shall be transferred to Maltec Holdings Ltd.

Following the above share transfers, Maltec Participations Overseas Ltd shall be liquidated.

You are required to:

- 1) **Explain the tax implications of the proposed share transfers from Maltec Participations Overseas Ltd to Maltec Holdings Ltd, and whether there are any tax issues relating to the share price stated in the share purchase agreements between Maltec Participations Overseas Ltd and Maltec Holdings Ltd.** (7)
- 2) **Explain the tax implications, if any, of the eventual liquidation of Maltec Participations Overseas Ltd.** (2)
- 3) **Explain the VAT implications for Maltec Participations Overseas Ltd in relation to the disposal of its assets and operations.** (2)
- 4) **Explain the tax treatment of the future dividend payments by Maltec Holdings Ltd, as it affects its shareholders.** (4)

Total (15)