



THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

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Suggested Solutions

PART A

Question 1

Part 1

The initial licensing fee invoiced from PS SAS to Cyprus entities will be treated as royalty income paid from Cyprus to a foreign beneficiary as this falls within the definition of Cyprus tax law. As such, this income will be subject to tax in Cyprus under the special mode of 10% withholding tax at source. However, as the double tax treaty between Cyprus and France provides for 0% withholding, no tax will be withheld in Cyprus.

Part 2

As the annual support fee is a fixed amount and has the character of the initial licensing fee (i.e. payment overseas), this will most certainly be treated as royalty income. The tax treatment will be exactly the same as described in Part 1 above.

Part 3

If a Cyprus branch (permanent establishment) is formed through which licensing and support fees will be invoiced, such income will be treated as trading income less tax deductible expenses in the hands of the branch and will be taxed in Cyprus at the corporation tax rate of 12.5%. If a Cyprus subsidiary is formed instead, the tax treatment will be the same as with a Cyprus branch, but must be noted that as the Cyprus subsidiary is a separate legal entity, the withholdings tax provisions as described in Parts 1 and 2 above will apply.

Part 4

The suggested course of action would be that a Cyprus subsidiary is used for the intended activities as there are tax advantages, compared with using a Cyprus branch. With reference to taxation, the profits of a Cyprus branch will be taxed in Cyprus at a corporate tax rate of 12.5%. However, these profits will also be taxed in Frelandia at a corporate tax rate of 35% with the Cyprus tax credited against the Frelandia corporation tax. If on the other hand a Cyprus tax resident subsidiary is formed, as this is a separate legal entity, its profits will be taxed in Cyprus only at 12.5% corporate tax rate. It should be noted however that any dividends paid by the Cyprus subsidiary to the Frelandia parent company, although there are no withholding taxes imposed on dividends paid from Cyprus to overseas, such income may be taxable in Frelandia in the hands of the Frelandia parent company, if no participation exemption is available per the EC Parent-Subsidiary Directive.

With reference to withholding taxes on the receipt of payments for licensing fees, it must be noted that payments between connected entities within the European Union (EU) are exempt from withholding taxes. Receipts from non-EU countries may be subject to withholding taxes according to the relevant provision in double tax treaties between Cyprus and each one of the non-EU countries (in both cases i.e. subsidiary or branch).

Part 5

With regards to the method of financing the Cyprus operation (equity or loan), one has to consider the cost of equity as compared with the after tax cost of the loan. If the cost of equity is higher than the after tax cost of the loan, then a loan should be obtained and vice versa. Although this is not a tax decision to make, the following must be noted in respect of the tax treatment of loan interest:

- Loan interest will only be allowable if it relates to the acquisition of trading business assets.
- It does not make a difference for tax purposes whether a branch or a subsidiary are formed, or whether the loan is obtained from a bank either in Frelandia or in Cyprus or whether the loan is obtained by PS SAS and re-directed to Cyprus.
- There are no withholding taxes in Cyprus on interest payments from Cyprus to Frelandia whether such interest accrues to a Frelandia bank or PS SAS.

In terms of using equity financing (in the subsidiary option only), the provisions of s.9B of Law 118/2002 may apply if new share capital is injected during 2015. According to these provisions an amount of

deemed interest deduction will reduce the Cyprus subsidiary profits. This deduction will be calculated on 80% of the new share capital at the Frelandia state bonds yield plus 3%.

Part 6

Disposal of trading goodwill is taxable profit for corporation tax purposes. Therefore, if either the PS SAS Cyprus branch or the Cyprus subsidiary sells its operations, this gain will be subject to corporation tax at 12.5% with the taxability of this gain in Frelandia being as analysed in Part 4 above. If however the Cyprus subsidiary's shares are sold, no tax will arise in Cyprus, as such gain (on sale of the shares) will be deemed as a capital gain, which will be exempt in Cyprus, as the company will not hold immovable property in Cyprus. It must be noted however that such gain may be taxed in Frelandia.

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;
- 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 .

Part 2

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

Part 3

The accumulated losses of Loss Ltd will be transferred to Success Ltd. As such, they have a value which equals the amount of the losses multiplied by the corporate income tax rate i.e. €11,250 (€90,000 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 Mr Loris cannot exceed 10% of the nominal value of the shares that will be issued to him by Success Ltd. Assuming that Mr Loris will receive the above amount, then he will be liable to capital gains tax at 20% on 10% of 99% the capital gain accruing to the company's immovable property situated in Cyprus, on transfer of Loss Ltd's net assets to Success Ltd.

Part 4

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 Stamas on this issue.

PART B

Question 3

Part 1

Exchange with London 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 the UK.

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 house in Paralimni on its future disposal. The computation is as follows:

Disposal proceeds (Paralimni house value)	€ 500,000
Indexed cost (€200,000 x 140%)	(280,000)
Indexed gain	220,000
General exemption	<u>0</u>
	220,000
Gain rolled over	(220,000)
Taxable capital gain	<u>0</u>

Exchange with agricultural land

In this case, with reference to the Nicosia land, as its 1/1/1980 value lower than the 1/1/1980 value of the house to be acquired (part) and as the cost of the Limassol land is lower than the market value of the house to be acquired (part) 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 house in Paralimni on its future disposal. The computation is as follows:

<u>Land in Limassol</u>	€
Disposal proceeds (Paralimni house part value)	300,000
Indexed cost (€100,000 x 140%)	(140,000)
Indexed gain	160,000
General exemption	<u>0</u>
	160,000
Gain rolled over	(160,000)
Taxable capital gain	<u>0</u>

<u>Land in Nicosia</u>	€
Disposal proceeds (Paralimni house part value)	200,000
Indexed 1/1/1980 value (€40,000 x 140%)	(56,000)
Indexed gain	144,000
General exemption	<u>0</u>
	144,000
Gain rolled over	(144,000)
Taxable capital gain	<u>0</u>

Part 2

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

<u>If exchanged for London property</u>	€
Agreed value	500,000
<u>Less:</u> gain rolled over	<u>0</u>
Revised cost	500,000

<u>If exchanged for the plot in Nicosia</u>	€
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Agreed value	500,000
Gain rolled over	<u>(220,000)</u>
Revised cost	280,000
<u>If exchanged for agricultural land</u>	€
Agreed value	500,000
Gains rolled over (160,000 + 144,000)	<u>(304,000)</u>
Revised cost	196,000

On a future disposal of the Paralimni house, Kyri 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 Paralimni property will be taxable in Cyprus irrespective of Kyri's tax residence as this is income arising from immovable property situated in Cyprus. Kyri will however be outside the scope of special defence contribution as he will not be a resident of Cyprus, as special defence contribution applies to Cypriot residents only.

PART C

Question 4

Part 1

A Cyprus International Trust may have a Cyprus resident settlor and/or beneficiary if:

- The settlor must not have been a Cyprus resident in the year preceding the year of creating the Cyprus International Trust. The settlor may become tax resident subsequently;
- The beneficiaries, except a charity, must not have been Cyprus tax residents in the year preceding the year of creating the Cyprus International Trust. They may become tax resident subsequently;
or
- Immovable property in Cyprus can be included in the trust fund/trust property.

Part 2

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.

Special Contribution for the Defence of the Republic

Beneficiaries of a trust who are residents in Cyprus, are subject to special defence 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 and 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 recognised stock exchange e.g. the Cyprus Stock Exchange.

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

Question 5

Part 1

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 2

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))

Part 3

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.

Question 6

Part 1

The calculation of taxable profits or benefits of an owner of a ship or aircraft, are based on a proportion of the sales of services in the Republic (in respect of fares or freight for passengers, goods or mail shipped in Cyprus).

The proportion is based on a certificate by the taxing authority of the country in which the principal place of business of the owner of a ship or aircraft is situated.

The certificate must state:

- that the owner of a ship or aircraft has furnished, to the satisfaction of that authority, an account of the whole of his business; and
- the ratio of the profits or benefits for the relevant accounting period to the gross income of the owner of a ship or aircraft for that period, as computed according to the income tax law of that country, after deducting interest on any monies borrowed and employed in acquiring the profits or benefits.

If the profits or benefits of an owner of a ship or aircraft have been computed on any basis other than the ratio of the profits or benefits, shown by a certificate as explained above, at any time within 2 years from the end of the year of assessment the owner of a ship or aircraft is entitled to such revision as may be necessary to give effect to the said certificate and to have any tax paid in excess refunded.

Profits or benefits arising from the business of operating ships or aircraft carried on by a person who is not resident in the Republic, shall be exempted from tax, provided that the Minister of Finance is satisfied that an equivalent exemption from income tax is granted by the country in which such person is resident to persons resident in the Republic.

As from tax year 2010, on coming into force of the Merchant Shipping (Fees and Taxing Provisions) Law of 2010, Law 44(I)/10 eligible ship owners of Cyprus ships continue to be exempt from income tax in respect of their Cyprus ship profits, as well as dividends paid directly or indirectly out of those profits.

Any expenses relating directly or indirectly to this activity which is tax exempt as well as a proportion of indirect expenses are deductible from these profits and cannot in any way reduce other income which is taxable at normal rates.

The shipping profits of owners of Community ships are subject to Cyprus income tax like any other business, unless they have elected to be subject to tonnage tax under the Merchant Shipping (Fees and Taxing Provisions) Law 44(I)/10. In such case they are exempt from income tax.

Part 2

Ship managers are subject to income tax and/or special defence contribution like any other person who is a Cyprus tax resident.

However if a qualifying ship manager has opted to be taxed under the tonnage tax system in accordance with the Merchant Shipping (Fees and Taxing Provisions) Law 44(I)/10, such option being subject to remaining in force for at least 10 years, such a ship manager is eligible to tax exemptions (income tax and special defence contribution) in respect of the ship management profits, and in respect of interest income on bank accounts used in paying ship management expenses.

Furthermore, any dividends paid directly or indirectly out of such ship management profits are also exempt from special defence contribution

Part 3

The gross amount of any 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 or formula, trade mark, know-how or any other like property or in consideration of technical assistance are subject to tax withholding at 10% at source (but see below).

Royalties paid to non-resident associated companies

Royalties paid are not subject to withholding tax if the beneficial owner receiving such royalties is an associated company of another EU Member state or a permanent establishment of such company situated in another Member state where such royalties are paid:

- by a company which is resident in the Republic, without taking into account incomes paid through its permanent establishment situated in a state other than a Member state; or
- by a permanent establishment in the Republic of a company which is not a resident in the Republic and where such income represents a tax deductible expense for such permanent establishment.

The exemption as set out above as well as the film rental exemption applicable to film rentals is in conformity with the Royalties Directive 2003/49/EC of 3/6/2003 and applies to payments made on or after 1/5/2004 by virtue of the Income Tax (Amendment) Law 195(I)/2004.

Royalties arising outside the Republic in respect of rights granted by a Cyprus tax resident person to a non-Cyprus tax resident person for use outside the Republic are not subject to withholding tax, as such royalties are not deemed to be income derived from sources within the Republic.

Question 7

Part 1

Profit or gain from the sale of shares is exempt both from income tax and capital gains tax unless the company whose shares are traded (Maltec Participations Overseas Ltd) holds immovable property situated in Cyprus, in which case a capital gain would arise by reference to the capital gain on the indirect disposal (of its subsidiary holding the property) of the immovable property by reference to its cost of acquisition and the market value of the property.

In the case of Maltec Participations Overseas Ltd, the company's assets are shares held in subsidiaries and as such no chargeable capital gains arise, except from the gain on Maltec Cyprus Ltd shares which holds immovable property situated in Cyprus.

The tax issue of the share price stated is twofold. Firstly, the price of the shares of the subsidiaries of Maltec Participations Overseas Ltd, determines the stamp duty due on the share purchase agreement and secondly, the accounting profits of Maltec Participations Overseas Ltd for Special Defense Contribution (SDC) (re: actual or deemed distribution) purposes. As however, the shareholder of the company is a company resident abroad (Maltec Ltd), SDC will not be an issue in this case.

Part 2

At the point of eventual liquidation, the company will not hold any assets except from cash. The only tax implications (apart from possible capital gains tax as discussed in part (a) above) would therefore be the eventual distribution of this cash as dividend.

Any accumulated accounting profit of the current period and the five accounting that precede the current period, will be subject to SDC at 17%. As however, the company's shareholder is a company resident abroad (Maltec Ltd), SDC will not be imposed.

Part 3

The disposal of shares is not within the scope of VAT and there will be no VAT implications on the transfer of shares from Printed Participations Overseas to Maltec Holdings Ltd.

The transfer of the trading activity will be treated as a transfer of a business on a going concern basis. This kind of transaction is exempt from VAT and no VAT implications will therefore arise.

Part 4

Payment of dividends by a Cyprus company to Cyprus resident and domiciled individuals are subject to SDC at 17%. As however, one of the company's shareholders holding 90% of the Company's shares (Mr Xerri) is not resident/non domiciled in Cyprus, 90% of the dividend payments will be exempt from SDC.

Furthermore, Mr Xerri will have to declare his dividend income to the Maltese tax authorities and this income may be taxed in Malta.

Dividends received by Mr. X's sister in Cyprus will be exempt from income tax and SDC as Mr X's sister although resident, is not a Cyprus domicile.