

## THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2017

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### PAPER 2.03 – CYPRUS OPTION

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#### ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

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TIME ALLOWED – 3¼ HOURS

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This paper has **three** parts: **Part A**, **Part B** and **Part C**.

You need to answer **five** questions in total.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **The** question in **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

#### Further instructions

- All workings should be made to the nearest month and in Euros, unless otherwise stated.
- Start each answer on a new page and clearly indicate which question you are answering. 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.
- Marks may be allocated for presentation.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering Parts B and C.
- The first 15 minutes of the exam consists of reading time. You will be allowed to annotate the question paper during this time; however, you will **not** be permitted to start writing or typing your answer, or use a calculator. The Presiding Officer will inform you when you can start answering the questions.

## PART A

**You are required to answer BOTH questions from this Part.**

1. Mr Xing, aged 45, was born and raised in Tigril, a country in East Asia. In July 2015 he visited Cyprus for a holiday with his family and fell in love with the island. In October 2015 Mr Xing returned to Cyprus and applied for citizenship through the Citizenship by Investment program. In the same month, he bought a house in central Limassol for €700,000 and invested €5 million in a Cyprus real estate company (X Ltd), acquiring 55% of its shares.

In February 2016 Mr Xing's application was approved, and Mr Xing became a citizen of Cyprus in March 2016. Between March and July 2016, Mr Xing made a series of visits to Cyprus. During this period, he bought a deserted hotel in Larnaca for €6 million and spent another €1.6 million on its renovation. This was rented soon after to a tour operator, at an annual rent of €400,000. The hotel was built in 2000, at a cost of €900,000 on land which had been purchased two years previously for €400,000. It was rented out to a hotel operator in June 2016.

In July 2016 Mr Xing and his family moved permanently to Cyprus and they soon realised that the house in Limassol was too small for the family's needs. Accordingly, Mr Xing sold the house for €900,000 and bought a larger house in a rural area for €750,000 in September 2016. Mr Xing did not sell any of his property in Tigril, as his wife is not yet sure as to whether she will stay in Cyprus or move back to Tigril.

In October 2016, a friend of Mr Xing also decided to apply for Cyprus citizenship by investment, and accordingly made an investment of €2.5 million in X Ltd, acquiring 15% of X Ltd shares. As a result of this transaction, Mr Xing's holding in X Ltd was reduced to 45%. X Ltd did not have any transactions between October 2015 and October 2016.

Mr Xing is the founder of Xing Aviation Co plc, a company registered in Tigril and listed on the country's stock exchange. He is also the managing director of the company and holds a controlling interest in its share capital. He also holds a substantial amount of corporate bonds in the company. His salary from Xing Aviation plc in 2016 remained at the same level as for 2015, despite the fact that most of Mr Xing's time in 2016 was spent in Cyprus, either alone or with his family. Tax was withheld at source on Mr Xing's salary. Withholding tax in Tigril is at a rate of 10% on both outbound dividends and interest.

During 2016, Mr Xing was physically present in Cyprus for a total of seven months. He spent four months in Tigril, and spent the remaining month on business in other countries.

Cyprus has a double tax agreement (DTA) with Tigril, based on the OECD Model Tax Convention.

**You are required to:**

- 1) **Discuss the tax residency position of Mr Xing for 2016, in light of his dual citizenship and the changes to his personal and economic ties.** (12)
- 2) **Explain the Cyprus Income Tax and Capital Gains Tax treatment of, and application of Special Defence Contribution to, Mr Xing's income for 2016. Your response must refer to all sources of income and transactions mentioned above. Calculations are required, but there is no requirement to compute the taxes payable.** (13)

Total (25)

2. ADC Technical Projects SA (ADC) is a company which specialises in building ports. It is registered in Grevandia, an EU member state. ADC has recently been offered three projects, to build part of a port on the east coast of Cyprus. Project 1 will last for five months, Project 2 for eleven months, and Project 3 for 24 months. The company has the option to accept either one or more of the three projects.

ADC plans to use a number of its Grevandian staff members, but will also employ local staff in Cyprus and will be required to import building materials from Grevandia to Cyprus for use at the site.

The corporate income tax rate in Grevandia is 26%, whereas the tax rate on dividends is 10%. Grevandia applies the ordinary credit method of applying double tax relief on foreign income.

Cyprus and Grevandia have a double tax agreement (DTA), based on the OECD Model Tax Convention.

**You are required to:**

- 1) **Explain the direct and indirect tax implications for ADC in Cyprus if only Project 1 is undertaken.** (2)
- 2) **Explain the direct and indirect tax implications for ADC in Cyprus if only Project 2 is undertaken.** (4)
- 3) **Explain the direct and indirect tax implications for ADC in Cyprus if Project 3 is also undertaken, in addition to Project 1 and/or Project 2.** (4)
- 4) **Notify ADC of the most tax efficient way of structuring its operation in Cyprus if only project 3 is undertaken.** (6)
- 5) **Explain ADC's social security obligations in relation to both its Grevandian and Cypriot employees.** (5)
- 6) **Explain the personal income tax position of the Grevandian employees in each of the three different projects, assuming that Grevandian employees will not be substituted during the project's execution stage.** (4)

Total (25)

**PART B**

**You are required to answer THIS question.**

3. Pear Corp was registered in 2006 as an International Business Company (IBC) in a zero tax, non-EU jurisdiction. Pear Corp is 60% beneficially owned by Mr Andreou, a Cyprus tax resident, and 40% beneficially owned by Ms Murat, a Turkish Cypriot citizen who is tax resident in another EU State but also holds a Cyprus passport. The company's directors are local professional directors. Business strategy is formulated by Andros and Aishe who never participate in board meetings, all of which take place in the country of incorporation of the company.

Pear Corp's business is software development and support. Its main clientele consists of businesses from EU member states, the Middle East and central Asia. It maintains branches in Cyprus, Teshland (a non-EU State) and Urland (a non-EU State).

The Cyprus branch employs mostly administrative staff who undertake invoicing and receipt of money from EU states. The Teshland branch has the same function as the Cyprus branch for the Middle East and the Caucasian republics. Production and software support functions are mainly carried through the Urland branch, which employs some 100 programmers. The Urland branch does not perform any invoicing and therefore records no sales. The company's profit and loss account can be analysed as follows:

Branch	<u>Cyprus</u> €	<u>Teshland</u> €	<u>Urland</u> €	<u>Company Total</u> €
Income	1,000,000	800,000	0	1,800,000
Expenditure	(60,000)	(40,000)	(400,000)	(500,000)
Company's professional fees				(10,000)
Net profit/(loss) before taxation	940,000	760,000	(400,000)	1,290,000

Andros and Aishe do not receive any salary from Pear Corp. Instead they take out 60% of the company's after tax profits as dividends each year.

You are required to:

- 1) Discuss the tax residency position of Pear Corp and the direct tax implications of the company's setup and operations.** (9)
- 2) Discuss any business restructuring options available to Pear Corp which could result in a reduction of its direct tax liability.** (7)
- 3) State the VAT compliance obligations of the Cyprus branch of Pear Corp.** (4)

Total (20)

**PART C**

**You are required to answer TWO questions from this Part.**

4. The OECD, the EU and other countries have in recent years engaged on what is known as the BEPS project”.

**You are required to briefly explain what is meant by ‘BEPS’. Explain the statutory measures that Cyprus has taken in response to the BEPS project, and identify the areas of the BEPS Action Plan in which Cyprus is significantly behind other countries.** (15)

5. In 2015, Cyprus introduced the concept of domicile in its tax legislation.

**You are required to explain how ‘domicile’ is determined in the context of Cypriot tax legislation, and the tax implications on a non-domiciled individual who is a tax resident of Cyprus.** (15)

6. You have been presented with the following transactions:

- a) Advocacy services undertaken by a Cypriot taxable person to a person residing outside the EU.
- b) Consultancy services performed by a Cypriot taxable person to a consultancy firm established outside of Cyprus.
- c) Entrance to an exhibition, for which a fee was charged by a Cyprus taxable person to a non-taxable person. The exhibition took place in another EU member state.
- d) Carriage of passengers from Cyprus to a non-EU destination by a Cyprus taxable airline, on a contract signed by a non-EU person.
- e) Services provided by a Cypriot civil engineer to a taxable EU person, relating to a building site located in another EU country.
- f) Services provided by a Cypriot civil engineer to a taxable EU person, relating to a building site located outside of the EU.
- g) Valuation services performed by a Cyprus taxable person on an artwork situated in an auction house in Italy, which belongs to a non-taxable Greek resident person.
- h) IT services undertaken by a Cyprus taxable person, to the non-EU branch of another Cyprus taxable person.

**You are required to determine the place of supply of the service in each of the above transactions for VAT purposes, and to state the corresponding VAT compliance obligations of the Cyprus taxable party.** (15)

7. DGH Holdings Ltd (DGH) is a company registered and tax resident in Cyprus. During 2016, DGH had the following income:

	<u>Note</u>	€
Dividends from A Ltd	1	12,000
Dividends from B Ltd (net)	2	30,000
Interest from C Ltd (net)	3	15,000
Branch 1 dividends (net)	4	20,000
Branch 2 dividends (net)	5	8,000
Branch 3	6	0
Tourist apartments in Italy (EU)	7	16,000

Notes

- 1) A Ltd is a tax resident of another EU member state. DGH holds 20% of equity shares in A Ltd. No tax was withheld at source.
- 2) B Ltd is a tax resident of a non-EU state. DGH holds 25% of convertible shares in B Ltd. B Ltd has elected for the dividends payable to holders of convertible shares to be treated as a finance cost in its country of tax residence. Tax withheld at source was at a rate of 5%.
- 3) C Ltd is a 100% subsidiary of DGH and a tax resident of a non-EU state. Tax withheld at source was at a rate of 25%.
- 4) Branch 1 is a registered branch of DGH in another EU member state. The company withdraws all post-tax profits generated by Branch 1. Branch 1 paid income tax on its profits of €3,000.
- 5) Branch 2 is a registered branch of DGH in a non-EU state. During 2016, Branch 2 made a net profit of €50,000 but only remitted €10,000 to DGH after a deduction of branch remittance tax at source, at a rate of 20%.
- 6) Branch 3 is a registered branch of DGH in a non-EU state. Branch 3 incurred losses of €80,000.
- 7) The tourist apartments in Italy are duly licensed tourist apartments in Italy. During 2016 DGH made a pre-tax profit of €20,000 and paid taxes of €4,000 in Italy.

**You are required to calculate DGH's Corporate Income Tax and Special Defence Contribution liabilities for 2016, stating any assumptions you made. (15)**