



THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

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**ADVANCED INTERNATIONAL TAXATION
(JURISDICTION)**

Suggested Solutions

Question 1

Part 1

Both Giovanni and Lena will be taxed on worldwide income basis if they take up residence in Cyprus. Situation of bank accounts irrelevant.

Giovanni

State and private pension taxed in Cyprus in full. Taxation in Italy will stop per DTA (Art.15 of DTA Cyprus-Italy).

Election for special taxation mode at 0% and 5% possible. Given the level of pension income, Giovanni will elect this special mode.

Interest from Italian and German bonds specifically exempt from Cyprus income tax but will subject to SDC @ 30%.

Withholding tax rates will change according to Art.11 of DTA between Cyprus and Italy and Cyprus and Germany. Overseas withholding tax credited against Cyprus SDC.

Dividends from Russia bonds specifically exempt from Cyprus income tax but will subject to SDC @ 17%.

Withholding tax rates will change according to Art.10 of DTA between Cyprus and Russia. Overseas withholding tax credited against Cyprus SDC.

Rental income in Sicily (less 20%) will be subject to Cyprus tax at normal tax rates. Any tax paid in Italy credited against Cyprus income tax, but if Giovanni makes pension election (above), Cyprus tax will be zero re: first 19.500 Euros taxed at 0%.

Rental income (less 25%) in Sicily will be subject to SDC @ 3%. Any Italian income tax paid will be credited against Cyprus SDC.

Immovable in Sicily not subject to immovable property tax in Cyprus.

Lena

State pension taxed in Cyprus in full. Taxation in Italy will stop per DTA (Art.15 of DTA Cyprus-Italy).

Election for special taxation mode at 0% and 5% possible. Given the level of total income, Lena will elect this special mode.

Rental income in Cyprus (less 20%) will be subject to Cyprus tax at normal tax rates, as was the case when she was Italian resident, but if Lena makes pension election (above), Cyprus tax will be zero re: first 19.500 Euros taxed at 0%.

Rental income (less 25%) in Cyprus will be subject to SDC @ 3%. Lena was not subject to SDC when she was Italian resident, as non-residents are outside SDC scope.

Cyprus flats will be subject to immovable property tax in Cyprus, as it was also the case when Lena was Italian resident.

Part 2

Sale of traded bonds and shares specifically exempt from Cyprus income tax. Also outside the scope of Cyprus capital gains tax which only applies to direct or indirect disposal of Cyprus situated immovable property.

Income from trading in financial instruments, potentially exempt from Cyprus income tax if these are included in the prescribed list issued by the Cyprus Tax Office.

Disposal of immovable property in Sicily not subject to Cyprus income tax re:disposal of a capital asset.

Disposal of immovable property in Sicily not subject to Cyprus capital gains tax as this will be outside its scope.

Disposal of Cyprus flats by Lena will be subject to Cyprus capital gains tax at 20%, irrespective of when Lena sells i.e. before or after she becomes Cyprus tax resident.

Lena's taxable gain will be based on the difference between disposal proceeds and the indexed cost of the January 1980 value less any lifetime exemption that Lena may be entitled to avail herself of.

Question 2

Part 1

Transfer of business activity from A Ltd to E Ltd

This is a disposal of trading goodwill by A Ltd.

Disposal proceeds of 10m Euro plus par value of shares in E Ltd determines the sales value. Sales value less any amount paid by A Ltd for acquisition of its trading goodwill is a trading profit, which will be taxed at the corporate income tax rate of 12.5%.

Put options, although of value not taxable until exercised. Not included in consideration value.

Dividends from E Ltd

These are specifically exempt from income tax.

These will also be exempt from SDC, on the basis that A Ltd holds more than 1% of the shares of E Ltd.

Loan advances from E Ltd

Interest expense. This is not a taxable event. No tax consequences.

Interest charged by E Ltd to A Ltd will not be a tax deductible expense in the books of A Ltd, unless A Ltd uses the loan to finance business activities.

No withholding tax on payment of the interest from A Ltd to E Ltd, as Cyprus does not impose withholding taxes on interest payments.

Also, interest received by E Ltd from A Ltd is outside SDC scope, as E Ltd is not a tax resident of Cyprus.

Exercise of put options/sale of shares

Disposal of shares in E Ltd is a capital transaction and outside the scope of corporate income tax. This will also be outside the scope of capital gains tax, as there is no indication that E Ltd will hold immovable property situated in Cyprus.

Loan write off

If this is treated as part of the consideration for the sale of shares, the tax treatment will be as above, i.e. outside the scope of both corporate income tax and capital gains tax.

However, there is a risk that the amount written off is treated as a trading receipt and subject to corporate income tax at 12.5%.

Furthermore, the Tax department may well argue that the monies received from the sale of the shares in E Ltd, as well as the dividend distributions are part of the consideration for the disposal of trading goodwill and treat all the cash received i.e. from the sale of the shares of E Ltd as a trading receipt and tax it at the corporate income tax rate of 12.5%.

Part 2

On the basis of Art. 10 of the Cyprus-Belgium DTA, dividends paid from Belgium to Cyprus will be taxed in Cyprus, but may also be taxed in Belgium through a withholding tax at a rate of 5% or 15%. (OECD MC provisions).

However, as both Cyprus and Belgium are EU Member States, the provisions of the EC Parent-Subsidiary Directive come in force.

Assuming Belgium applies the PS Directive without any restrictions, no withholding taxes will apply, as A Ltd will hold more than 10% of the equity shares of E Ltd.

If Belgium places restrictions on the application of the PS Directive, the worst case scenario will be the application of the Cyprus-Belgium DTA provisions.

Part 3

If B Ltd were to acquire the shares in E Ltd, the risk of the consideration of the share disposal, the dividend distribution and the loan write off , to be treated as a trading receipt by A Ltd would be significantly reduced.

This would be the case in light of the fact that B Ltd is purely a holding company.

The tax treatment of the inward dividend stream (Cyprus and Belgium), disposal proceeds from the sale of shares and the loan write off are the same as the analysis for A Ltd above.

Question 3

Part 1

Registering the patent in Den Ltd and then transferring it to CypCo Ltd or registering the patent directly in CypCo Ltd name, will not make a difference in terms of allocation of costs between Den Ltd and CypCo Ltd.

The issue that arises in this transaction, is the determination of the value of the asset to be transferred between the two companies, which are 'connected parties'.

'Connected parties' definition

Transactions between connected parties must be made at 'arm's length value'.

The value of the transfer value will therefore come under the scrutiny of the Danish Tax Office and if it is lower than 'arm's length', this will be deemed as taking place at 'arm's length value'.

Part 2

Den Ltd running the production facility.

This is a straightforward arrangement in that CypCo Ltd will purchase from Den Ltd and then sell making a profit.

The only issue in this case, is the sales price charged by Den Ltd, which will have to be at 'arm's length' re: connected parties.

CypCo Ltd to have production facilities in Denmark

Production facilities in Denmark will most probably be deemed as a permanent establishment (PE) of CypCo Ltd in Denmark per Art 5 (2).

In this case, profits attributable to this will be taxed in Denmark.

Profits attributed to the Danish PE and taxed in Denmark, will be exempt from taxation in Cyprus (Art.36 Law 118/2002).

Any trading losses of the Danish PE may be aggregated with other profits of CypCo Ltd, but will be recaptured in future years if and when the Danish PE makes trading profits.

Production assigned to independent Danish producer

This is a straightforward arrangement in that CypCo Ltd will purchase from Den Ltd and then sell making a profit.

There will be no transfer pricing considerations in this case re: independent party transactions.

Part 3

Using wholesale distributors in Europe does not prima facie create any tax considerations in the distributors' respective countries, provided they cannot be treated as Dependent Agents.

If these distributors are treated as dependent agents, then an agency permanent establishment (PE) is created per Art 5(5) of the OECD MC.

There are certain tests to be applied to decide if Art 5(5) applies, the main one being the capacity of these distributors to contractually bind the company.

In the case(s) of an Agency PE, CypCo Ltd profits attributable to each dependent agent will be taxable in their home countries but exempt from Cyprus corporate income tax.

Treatment of losses attributable to Agency PE, will be the same as the production facility analysis in Part 2 above.

If this is not the case, and the company's distributors are treated as independent agents (Art 5 (6) OECD MC), there is no Agency PE and all profits will be taxed in Cyprus.

Part 4

The capital expenditure to acquire the patent will be capitalised and amortised equally over 5 years.

Income less direct expenses taxable in Cyprus from either trading or licencing fees is further reduced by 80% deemed expenditure and the residue taxed at the corporate income tax of 12.5%.

No further deduction for indirect expenses is tax allowable.

Question 4

Part 1

Cyprus taxes employment income, irrespective of the residence of the employee, if employment duties exercised in Cyprus.

Residents exercising employment duties outside Cyprus, taxed in Cyprus, but:

- 90 day rule exemption;
- analysis of the 90 day rule exemption; and
- any tax paid overseas for such duties, credited against Cyprus income tax liability.

Non-residents exercising employment duties in Cyprus are taxed in Cyprus, but for duties exercised outside Cyprus, they are not taxed in Cyprus.

Art.15 OECD MC provides that employment income is taxed in the State where employment is physically exercised.

Art.15 (2) however allocates taxing rights to the residence State if the three requisites are all satisfied, i.e. employer not resident, nor has a PE in the state where employment is exercised, nor does the employee spends more than 183 days in the state of his/her employment.

The 90 day rule exemption requires a PE in the overseas State, so not in line with Art 15(2), but assuming the overseas State applies Art 15., that income which is exempt in Cyprus, is taxed in that other State i.e. Cyprus 'waives' its taxing rights through this exemption.

Cyprus offers incentives to persons returning or taking up residence for the first time in Cyprus as follows:

- 20% of gross income exemption for 3 years following tax year of return (capped at 8.550 Euros per annum); and
- For high-earners i.e. earning an annual salary and benefits of over 100.000 Euros, 50% of the income is exempt from income tax for five years.

Above incentives not stipulated anywhere in the OECD MC, but each State is free to give incentives to encourage people to take up residence in their State.

Some other EU States also offer similar incentive

Part 2

Exempt termination payments are as follows:

- Retirement gratuity (if not provided by the terms of the employment)
Lump sum payment by way of commutation of pension.
- Death gratuity
Compensation for death or causation of bodily harm/injury.
- Payments from an approved pension or provident fund.
- Compensation for abrogation of a contract of employment or loss of office.
- Compensation by reason of redundancy.
- Payments in lieu of notice where this is not stated in the initial employment contract.
- Recovery of legal costs from the employer following a successful action for illegal dismissal.

Question 5

Part 1

Cyprus tax law specifically provides for tax paid overseas to be credited against Cyprus tax of the same income i.e. source by source basis. (s.35(2)&s.35(3) of Law 118/2002).

Above relief is provided for in all of Cyprus's DTAs but if no DTA in place, this relief is granted unilaterally.

Foreign tax credit cannot exceed Cyprus tax as computed in accordance with Cyprus tax law provisions (ordinary credit).

Foreign income taken in the calculation grossed up with the Foreign tax credit.

Foreign tax credit cannot be deducted as an expense (s.35(5) Law 118/2002).

In cases where Cyprus companies (or a Cyprus PE of a foreign company), receives a dividend from a company from another EU State (or from a DT State with relevant provision) and this dividend is subject to corporate income tax or SDC in Cyprus, credit is also given on tax paid on the underlying profits of the foreign company (s.35(5)(c) Law 118/2002).

This underlying relief not available to individuals.

Tax sparing credits also available provided there is a relevant provision in a DTA (s.35(5)(c) Law 118/2002).

Taxpayer has an option for non-credit of foreign tax (s.35(8) Law 118/2002).

Notwithstanding any other provisions in Cyprus tax law, profits from a PE abroad are exempt from taxation in Cyprus (s.36(3) Law 118/2002).

If any relief from losses which were attributed to a foreign PE, was granted under s.13 Law 118/2002, these losses will be taxed under s.36(3) in future years (loss recapture).

S.36(3) exemption does not apply if foreign PE engages more than 50% of its activities in investment/passive income AND the tax burden in that foreign Jurisdiction is substantially lower than Cyprus tax burden, i.e <6.25% (s.36(4) Law 118/2002).

Therefore Art. 23A OECD MC provisions are fully satisfied.

Part 2

Income from self-employment – Nicosia	€ 30,000
• Athens –s.36(3) exemption	0
• Romania –s.36(3) recapture	11,000
Rental income UK (24,000 less 20%)	19,200
Consultancy income – SA	10,000
Dividend income – exempt	0
Total taxable income	70,200

Income tax liability

19,500@0%	0
8,500@20%	1,700
8,300@25%	2,075
23,700@30%	7,110
10,200@35%	3,570

Less:

• DTR UK income $19,200 \times 14,455 / 70,200 = 3,953$ capped	14,445
• DTR SA income $10,000 \times 14,455 / 70,200 = 2,059$ capped to 2,000	-3,953
Net tax payable	-2,000
SDC Liability	8,502
Dividends 120,000 @ 17%	20,400
Tax paid overseas	0
SDC payable	20,400
Rental income UK (24,000 less 25% @ 3%)	540
Less: DTR ($6,400 - 3,953 = 2,447$ capped at 540)	-540
SDC payable	0

Question 6

Part 1

The majority of the board of directors of the Cyprus NewCo must be Cyprus residents, as this is one of the requirements of the 'management and control test' (the other two are board meetings taking place in Cyprus and the company's strategic decisions taken in Cyprus).

The reason for this, is to mitigate any possible risk from the Dutch tax authorities treating the company as Dutch tax resident on the basis that the board of directors are Dutch residents.

If the company is treated as Dutch tax resident, its profits will be taxed in the Netherlands at the applicable Dutch corporate income tax rates, this due to the 'place of effective management test' pointing towards a Dutch taxpayer company re: Dual residence decided per Art.4 OECD MC tie-breaker rule.

Part 2

Transactions between the Dutch company, the other subsidiaries of Cy Co1 and CyCo2 will have to be at arm's length as these companies are connected persons.

Definition of 'connected persons'

No transfer pricing problem will ever arise unless the Director of Taxation identifies an effort to 'transfer profits' to a low/no tax jurisdiction.

Part 3

Patent Royalties paid from Cyprus to overseas States are taxed in Cyprus under the special mode of taxation at a rate of 10% deducted at source by the payer, irrespective of the fact that the foreign party is not tax-resident in Cyprus, if exploitation takes place in Cyprus. Lower rates may apply under relevant DTAs.

However, in this case no tax will be withheld in Cyprus as the payment is made to a connected person within the E.U.re: Interest & Royalties EC Directive. Definition of 'connected party' per the Directive.

Part 4

The VAT treatment of CyCo1 transactions is shown below in tabular format.

<u>Transaction</u>	<u>VAT Treatment</u>
Sale of goods:	
• to EU (not Cyprus)	B2B. Zero-rated
• to non-EU	Export. Zero-rated
Cyprus (CyCo2)	Standard rated
Purchase of goods from France	Intra-community acquisition. Zero-rated
Payment of patent royalties	Zero-rated, reverse charge provision
Dividends paid to Netherlands	Outside the scope of VAT

Part 5

CyCo1 has no obligation in respect of its Dutch directors, as they are not resident in Cyprus and they do not provide salaried services in Cyprus.

CyCo1 will have an obligation to contribute to the Cypriot social security and other funds administered by the social security office, in respect of all its employees in Cyprus as they are all EU citizens providing salaried services in Cyprus.

Question 7

Part 1

If AD Properties Limited is dissolved, the company will be deemed as disposing of its assets at market value. As such, the following tax implications will arise:

- The land and buildings in Nicosia will be deemed as capital assets, as they have been generating income and any gain on their disposal will be taxable as a capital gain and subject to capital gains tax (CGT) at 20%.
- With reference to the land in Nicosia, it is not clear as to how the gain will be taxed. It all depends on what the intention of the company was, during the period of ownership. Assuming that it was never the intention to hold it as an investment (e.g. building permission obtained with intention to sell shops/offices), the gain will be treated as a trading profit and subject to corporation tax at 12.5%.

Consequently as a result of the dissolution, the company's deemed distribution may be summarised as follows:

	€' 000
Gain on sale of capital assets	A
Gain on sale of current assets	B
Less: corporation tax (12.5% x B)&CGT (20%xA)	(C)
PROFIT ON TRANSFER OF ASSETS	D
Profit and loss account reserves (all after 2010)	E
PROFITS DEEMED AS DISTRIBUTED	F

Amount F will be subject to special defence contribution (SDC) at 17%, except from that part which relates to Nikos's holding, as Ninos is not a resident of Cyprus. However, Nikos will have to remain not resident of Cyprus until at least up to the end of 2017 (assuming the dissolution is completed within 2015), as if he becomes resident during 2015, the distribution accruing to his shareholding will also be subject to SDC.

No transaction will be subject to value added tax (VAT), as the Nicosia building was built before 1 May 2004, i.e before VAT was introduced on buildings.

Land transfer fees on the transfer of the Cyprus immovables will be payable based on their 1907 values as the company will be transferring its assets to its shareholders who are all relatives up to 3rd degree.

Part 2

The split may be accomplished under a scheme of re-organisation (transfer of assets) partly, as the company has two assets of which one is used for one purpose (generate rental income) and the other asset is held for development. The reason for this is that one of the pre-requisites of a transfer of assets under a scheme of re-organisation is that the company to be divided must have at least two autonomous branches of activity.

Another pre-requisite of a transfer of assets under a scheme of re-organisation is that one or more new companies are formed to which assets are transferred from the initial company. The new companies must have the same shareholders as the existing company and also at the same ratio of shareholding.

Consequently, assuming one new company is formed, Anastasia must decide at which stage she will transfer her shares to her children (either before or after the split). It must also be noted that in order for the required result to be finally achieved, a free transfer of shares between the current shareholders (with no tax consequences as they are relatives up to third degree) will have to take place.

Assuming that Anastasia transfers her shares after the split, a new company with the same shareholding as AD Properties Ltd is formed, and the land in Nicosia to be developed by Nikos is transferred to the new company, as an autonomous branch of the company (re: land development).

Anastasia and Nikos will afterwards donate their shares to Alexia in AD Properties Ltd and simultaneously Alexia, Stelios and Anastasia will donate their shares to Nikos in the new company.

In this way, no capital gains tax, corporation tax, land transfer fees and mortgage fees will be due on the transfer of the Cyprus situated properties.