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# GLOBAL TAX WEEKLY

## a closer look

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**SUBJECTS** TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

**SECTORS** MANUFACTURING RETAIL/WHOLESALE INSURANCE BANKS/FINANCIAL INSTITUTIONS RESTAURANTS/FOOD SERVICE CONSTRUCTION AEROSPACE ENERGY AUTOMOTIVE MINING AND MINERALS ENTERTAINMENT AND MEDIA OIL AND GAS

**COUNTRIES AND REGIONS** EUROPE AUSTRIA BELGIUM BULGARIA CYPRUS CZECH REPUBLIC DENMARK ESTONIA FINLAND FRANCE GERMANY GREECE HUNGARY IRELAND ITALY LATVIA LITHUANIA LUXEMBOURG MALTA NETHERLANDS POLAND PORTUGAL ROMANIA SLOVAKIA SLOVENIA SPAIN SWEDEN SWITZERLAND UNITED KINGDOM EMERGING MARKETS ARGENTINA BRAZIL CHILE CHINA INDIA ISRAEL MEXICO RUSSIA SOUTH AFRICA SOUTH KOREA TAIWAN VIETNAM CENTRAL AND EASTERN EUROPE ARMENIA AZERBAIJAN BOSNIA CROATIA FAROE ISLANDS GEORGIA KAZAKHSTAN MONTENEGRO NORWAY SERBIA TURKEY UKRAINE UZBEKISTAN ASIA-PAC AUSTRALIA BANGLADESH BRUNEI HONG KONG INDONESIA JAPAN MALAYSIA NEW ZEALAND PAKISTAN PHILIPPINES SINGAPORE THAILAND AMERICAS BOLIVIA CANADA COLOMBIA COSTA RICA ECUADOR EL SALVADOR GUATEMALA PANAMA PERU PUERTO RICO URUGUAY UNITED STATES VENEZUELA MIDDLE EAST ALGERIA BAHRAIN BOTSWANA DUBAI EGYPT ETHIOPIA EQUATORIAL GUINEA IRAQ KUWAIT MOROCCO NIGERIA OMAN QATAR SAUDI ARABIA TUNISIA LOW-TAX JURISDICTIONS ANDORRA ARUBA BAHAMAS BARBADOS BELIZE BERMUDA BRITISH VIRGIN ISLANDS CAYMAN ISLANDS COOK ISLANDS CURACAO GIBRALTAR GUERNSEY ISLE OF MAN JERSEY LABUAN LIECHTENSTEIN MAURITIUS MONACO TURKS AND CAICOS ISLANDS VANUATU



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## GLOBAL TAX WEEKLY a closer look

### Global Tax Weekly – A Closer Look

Using the unrivalled worldwide multi-lingual research capabilities of leading law and tax publisher Wolters Kluwer and its new acquisition BSI (The Lowtax Network), CCH publishes Global Tax Weekly — A Closer Look (GTW) as an indispensable up-to-the-minute guide to today's shifting tax landscape for all tax practitioners and international finance executives.

Topicality, thoroughness and relevance are our watchwords: BSI's network of expert local researchers covers 130 countries and provides input to a US/UK team of editors outputting 100 tax news stories a week. GTW highlights 20 of these stories each week under a series of useful headings, including industry sectors (e.g. manufacturing), subjects (e.g. transfer pricing) and regions (e.g. asia-pacific).

Alongside the news analyses are a wealth of feature articles each week covering key current topics in depth, written by a team of senior international tax and legal experts and supplemented by commentative topical news analyses. Supporting features include a round-up of tax treaty developments, a report on important new judgments, a calendar of upcoming tax conferences, and "The Jester's Column," a light-hearted but merciless commentary on the week's tax events.

Read Global Tax Weekly — A Closer Look in printable PDF form, on your iPad or online through Intelliconnect, and you'll be a step ahead of your world on Monday morning!



**CONTENTS**

**FEATURED ARTICLES**

**International Tax Planning Using Cyprus Companies – The Increasing Importance Of Substance**

by Philippos Aristotelous and Stavros Supashis,  
Andreas Neocleous & Co LLC

**Financial Accounting Foundation Completes Review Of Accounting For Income Taxes**

by PricewaterhouseCoopers

**An International Indirect Tax Briefing From KPMG: Part I**

from KPMG's international offices

**Topical News Briefing: The EU Savings Tax Impasse**

by the Global Tax Weekly Editorial Team

**J P Morgan: Can Taxpayers Use The Judicial Review Process To Challenge Tax Assessments That Are Contrary To The CRA's Administrative Policies**

by Brent F. Murray and Ian Bradley,  
Wilson & Partners LLP

**Topical News Briefing: FATCA: Another Delay On The Way?**

by the Global Tax-Weekly Editorial Team

5

**The Trans-Pacific Partnership: A Progress Report**

by Stuart Gray, Senior Editor, Global Tax Weekly

9

**PFIC Determination: Domestic Stock Rule Takes Precedence Over Subsidiary Look-Through Rule**

by J. Michael Cornett and Douglas Holland

12

**EU Savings Tax Directive Update**

by Stuart Gray, Senior Editor, Global Tax Weekly

18

19

27

29

39

52

## International Tax Planning Using Cyprus Companies – The Increasing Importance Of Substance

by Philippos Aristotelous and Stavros Supashis,  
Andreas Neocleous & Co LLC

### Introduction

Over the years, and especially since the emergence of the global financial crisis, the challenges for the lawyer or accountant dealing with international tax planning have increased substantially. Faced with declining tax revenues and increased attention from the public, non-governmental organizations and the media on where the burden of austerity measures falls, governments in the major economic powers are showing increased hostility towards legitimate tax avoidance, and the international organizations they dominate have taken over initiatives for global cooperation on worldwide action against what they see as excessively aggressive tax planning. Furthermore, over recent years the tax authorities in Russia and other former members of the USSR have become more familiar with, and confident in challenging, complex tax concepts and elaborate tax schemes.

These two factors make it essential that no detail is overlooked and nothing is left to chance when designing and implementing an international tax mitigation structure, so as to minimize the risk of a successful challenge. This article looks at the issues to be considered in order to limit the exposure of existing or new Cyprus structures to domestic and foreign anti-avoidance rules.



### Cyprus Stance Over Substance

Cyprus follows the "substance over form" and "business purpose test" doctrines, and this allows the tax authorities to disregard any artificial transactions and structures that they considered to be in place solely for the reason of obtaining a tax benefit. The Assessment and Collection of Taxes Law, which was amended to transpose the Mutual Assistance Directive (77/799/EEC) into domestic legislation, contains general anti-abuse rules, under which the tax authorities may disregard artificial or fictitious transactions and assess the taxpayer on the proper object of tax. The provisions apply for both local and international transactions, for residents and non-residents.

A company is able to enjoy the benefits of the business friendly tax framework of Cyprus and its extensive treaty network if it is "managed and controlled" in Cyprus. The determination of the locus of management and control of a company is crucial for the company's tax residency as it will be a determining factor on both the issue of Cyprus tax residence and residence in relation to the tie-breaker rules included in the double tax agreements entered into by Cyprus.

As no domestic precedent on the matter exists, Cyprus courts follow English case law in relation to the concept of management and control. UK courts have concluded that the "management and control" test is met if key strategic decisions are taken in the location concerned. There is no requirement that the day-to-day management of the company should be undertaken from there. The UK courts have made clear that the test is not satisfied if no "intellectual activity" is performed in the board meetings where the decisions are taken – that is, if the board merely gives formal approval to decisions that have already been made elsewhere. In the same case it was also decided that at least some information which is capable of giving guidance to the board in making a decision must be proven to have been at the disposal of the board, even if it is less comprehensive than what would be normally expected by a board of directors to reach a decision.

Even if Cyprus tax residence is established, foreign anti-avoidance rules, the interpretation of the notion of "management and control" and the facts of each case as perceived by foreign tax authorities make it prudent to ensure that there is real substance in each tax structure.

## **Substance Requirements – International Perspective**

### ***International***

The Organization for Economic Cooperation and Development ("OECD") has recently announced its Base Erosion and Profit Shifting initiative

("BEPS"), which is in many ways a continuation of the Harmful Tax Practices initiative of the 1990s. The OECD has published an action plan and has set ambitious deadlines to achieve its goals. One of the key components of the action plan is the strengthening of Controlled Foreign Corporation rules, with a target date of September 2015 set for recommendations for this subject to be developed and the prevention of treaty abuse (for example by means of measures such as denial of treaty benefits in cases of double non-taxation). The publication of the action plan has been followed by the release from Working Party 6 of the OECD of the discussion draft on the Transfer Pricing Aspects of intangibles.

### ***European Union***

In 2012 the European Commission began a similar initiative, adopting an Action Plan which included more than 30 measures to combat tax fraud and tax evasion. These included a proposal to close loopholes in the Parent-Subsidiary Directive (2011/96/EU) (the "Directive"). According to the European Commission these loopholes had been used by some companies to escape taxation, particularly by exploiting differences in the way intra-group payments are taxed.

In November 2013, the European Commission adopted a proposal to amend the Directive, introducing a uniform general anti-avoidance rule which will deny the benefits of the Directive to tax structures that are deemed to be "wholly artificial" and a provision to ensure that a specific form of

tax planning arrangement, namely hybrid loan arrangements, cannot benefit from tax exemptions.

### ***Russia***

Russia has been increasingly active in implementing rules to eliminate what the authorities consider to be aggressive tax planning. The Russian Tax Code has recently been amended to oblige Russian companies to disclose the ultimate beneficial owners of securities registered by means of depository accounts of nominee shareholders. Additionally taxpayers are obliged to report to the Russian tax authorities transactions carried out during previous years which meet the definition of "controlled transactions" under the Tax Code (for example transactions with tax residents of a jurisdiction which is included in the list of offshore jurisdictions issued by the Russian Ministry of Finance where the parties are related or where the transactions amount to more than 60 million rubles.

### ***USA***

The importance of substance and valid business reasons behind each structure was reiterated by the office of Associate Chief Counsel of the US Internal Revenue Service ("IRS") in its Memorandum issued in relation to the granting of treaty benefits to Cyprus companies owned by US and non US residents.

In order for the Cyprus-US treaty to apply, the recipient of the income must be a resident of one of the two contracting states, and no other provision in the treaty providing for the denial of such benefits must be applicable. In the case in respect of

which the Memorandum was issued, the IRS concluded that the Limitation of Benefits clause of the treaty did not apply, and benefits were not to be denied, since the structure was put in place for reasons other than merely to obtain a tax advantage through the application of the treaty.

It therefore follows that the US authorities will be inclined to deny such benefits to structures which they consider to be artificial (for example, structures with no business rationale or insufficient substance).

### ***Other Countries***

More and more countries are introducing anti-avoidance rules and CFC rules where no such rules previously existed. In addition to the examples given above, over the past year Greece has put in place CFC rules, Belgium has introduced anti-avoidance rules (including a new thin capitalisation rule), the United Kingdom has introduced a General Anti Avoidance rule and Germany has introduced a rule denying hybrid instruments in German outbound structures the benefit of the German participation exemption.

### **Meeting The Substance Requirements In Practice**

The importance of substance and valid business reasons behind each corporate structure is cardinal for its efficacy and compatibility with the new emerging era of tax planning. Substance is now an absolute necessity. While the existence of adequate substance required to achieve tax residency and not fall foul of anti-avoidance rules is a question of fact, there are

some best practice standards that can be followed to increase the chances of success, such as exercising management and control of the company in Cyprus, with the board of directors meeting in Cyprus as frequently as required in order to adequately direct the company's activities, and establishing a real physical presence in Cyprus by setting up a fully resourced and independent office in Cyprus.

Economic substance can be further enhanced by employing suitably qualified people to administer

management activities and carry out the day-to-day management of the company in Cyprus and complying with the relevant legal and regulatory requirements, including tax and social insurance obligations, by opening local bank accounts to settle expenses incurred by the company, including employment costs, by maintaining accounting records in Cyprus and ensuring that the company discharges all its statutory corporate and fiscal obligations on time, and by using the Cyprus office as the principal address for notices, letters and other correspondence.