



CYPRUS TAX RESIDENT COMPANIES  
MANAGEMENT AND CONTROL TEST

2012

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## A. THE LAW

The Republic of Cyprus, in view of its European Union accession, and in order to harmonise its domestic legislation with European Union directives and guidelines, in July 2002 enacted new taxation laws. These new taxation laws came into force as from 1<sup>st</sup> January 2003 and have effected important structural changes to the whole tax system. For taxation purposes, companies and individuals, are distinguished now as:-

- (a) residents and
- (b) non – residents.

A company or an individual are taxed in Cyprus only if they are residents of Cyprus according to the meaning of “resident” as defined in the taxation laws.

The new tax system considers a company to be a tax resident of Cyprus when its **“management and control”** is exercised in Cyprus.

Section 2 of the income tax law No. 118(I) of 2002, as amended, provides the following definition as to residency:-

**“Resident in the Republic”**, when applied to an individual, means an individual who stays in the Republic for a period or periods exceeding in aggregate 183 days in the year of assessment and *when applied to a company, means a company whose management and control is exercised in the Republic and “non-resident or resident outside the Republic” shall be construed accordingly.*

Further, according to clause 5(1):-

*“Subject to the provisions of this law, in the case of a person who is resident in the Republic, tax shall be charged at the rate or rates specified hereinafter for each year of an assessment upon the income accruing or arising from sources both within and outside the Republic, in respect of -... ”*

***According to the above provisions, a company is a tax resident of Cyprus only if its management and control is exercised in the Republic of Cyprus.***

## **B. MANAGEMENT AND CONTROL – DEFINITION**

There is no definition in the income tax law or in any other enactment as to the meaning of the term "*management and control*".

There is no definition in the law, stating who exercises management and control and how it is exercised. There is also no definition as to what particular acts constitute management and control in Cyprus.

The Cyprus legal system is based on the common law system and thus English law will be referred to in order to interpret this term.

## **C. ENGLISH LAW CONCERNING THE RESIDENCY OF A COMPANY – GUIDANCE FOR CYPRUS LAW IN THE INTERPRETATION OF MANAGEMENT AND CONTROL TEST.**

The management and control test was applicable in the UK until 1988 for UK registered companies. It was replaced by a relevant statutory provision (Finance Act 1988, s.66) and now all UK registered companies are taxable in UK irrespective of their place of management. They are automatically treated as resident in the UK.

- I. An exception to this rule applies for those companies which fall within the provisions of the Finance Act 1994 s.249 by which a UK company is regarded, for the purposes of any double taxation arrangement, as resident in a territory outside the UK (with which UK has a Double Taxation Treaty) and not resident in the UK. We shall not expand on this topic as it is not of relevance to this brochure.
- II. The management and control test, irrespective of the above statutory provision which applies automatically to UK companies, is according to the UK law applicable to non UK companies – foreign registered companies. The common law of corporate residence is applicable for non UK companies. Under these

common law provisions, a foreign company i.e. Cyprus, BVI, companies, might be taxable in the UK if their management and control is exercised in the UK.

- III. For a detailed analysis of the UK law on this subject, see the recent High Court judgement issued on 8/4/2005, in *R v Holden*.
- IV. In view of the provisions of the UK law above, there is a considerable number of court decisions which deal with the management and control test and from which we are getting guidance as to how this test will be applied in Cyprus if a case arise and interpretation of this term will be required by the Cyprus authorities.
- V. In this respect, since our legal system is based on common law, our courts and the Commissioner of Income Tax – Inland Revenue, will follow the principles laid down by UK authorities in interpreting the term “management and control”.

#### D. AGENDA

In considering the subject matter of this brochure we shall deal with the following issues which in effect identify the meaning of tax residency of a Cyprus company through the management and control test:-

- I. **Where** is a company tax resident according to the management and control test and **When** is a company tax resident of Cyprus;
- II. **Who** exercises the management and control;
- III. **Where is** management and control exercised. Factors identifying the location of management and control;
- IV. **How** must the management and control be exercised in order for a company to be considered as a tax resident of Cyprus.
- V. **Double Tax Treaties** – Their impact on the residency issue of Cyprus companies.

I. Where is a company tax resident according to the management and control test and When is a company tax resident of Cyprus

The leading case on company residency is *De Beers Consolidated Mines Ltd v Howe* [1906] AC 455, 5 TC 198. In this case it was established that a company resides, for tax purposes, there where its real business is carried out. In the same case it was decided that the real business of a company is carried out, not where the trading operations are taking place, but **where** the central management and control actually takes place.

Our income tax law No. 118(I)/2002 in section 2 identifies the meaning of a tax resident company, and in effect, implements the above old court decision i.e. that a Cyprus company is tax resident of Cyprus only if its management and control is exercised in Cyprus.

**Summary**

**In conclusion**, the tax residency of a Cyprus company is identified by determining where the management and control is exercised. If the management and control is exercised in Cyprus then the company is a tax resident of Cyprus, if it is not, then it is not a tax resident of Cyprus.

In answering the question, **where** is a company tax resident according to Cyprus Law, the answer is, at the place where its management and control is exercised. In answering the question, **when is a company** tax resident of Cyprus, the answer is, when the management and control is exercised **in** Cyprus.

II. Who exercises the management and control

In order to give an answer to the above question the following distinctions need to be made.

## **1. Management and control of the business of the company Vs. Shareholders' control of the company.**

In our legal system it is a well - established principle, that shareholders control **the company** through their votes at general meetings, while the board of directors exercises control **of the business** of the company by its management. A long line of authorities support this.

The board of directors exercises the central management and control of the business, while the shareholders exercise the control of the company.

The above principle is also specifically adopted in our Companies' Law Cap 113, Table A, section 80, subject to any special provisions of the law or the articles of the company. According to section 80 the directors exercise the day – to – day activities of the company and its administration.

In view of the above, it is clear that corporate residence is related to the central management and Control of **the business** of the company, which is exercised by the directors and **NOT** to the control **of the Company** itself, which is exercised by its shareholders.

In effect, the control that we are discussing in this brochure, is that which relates to the highest level of management of the company's business and must not be confused with the control which vests in the company's shareholders. The distinction was laid down emphatically in the old case *Stanley v Gramophone and Typewriter Ltd (1908) 5 TC 358*.

It follows, therefore, that a company whose business is in fact managed and controlled by a board of directors situated in Nicosia, Cyprus, will be tax resident in Cyprus even if the shareholders of the company are residing in any other country outside Cyprus. This proposition was also

specifically approved by the Court of Appeal in *Bullock v Unit Construction Co Ltd (1959) 38 TC 712 at 729 – 730*.

The fact that shareholders through their voting rights can remove the directors from their office does NOT affect the above principles. The company will still be managed and controlled by its board of directors.

**2. Management and control of the business of the company Vs. Place of business, i.e. there where the actual trading and business operations of the company are conducted.**

The central management and control of the business must be distinguished from where the company's business is actually taking place. The management and control of the business need not be in the same place where the actual trading activities and operations of the company are conducted.

In *R v Dimsey (1999) STC 846* the court emphasised that the central management and control test is a composite test designed to identify where the decisions of fundamental policy are made as opposed to the place where the day - to - day profit earning activities are undertaken.

A company whose business is in fact managed and controlled by a board of directors situated in Nicosia, will be tax resident in Cyprus even if the actual trading business of the company are outside Cyprus.

**Summary**

***In conclusion, the answer to the question, who exercises the management and control of the company's business, is the board of directors being the highest management body of the Company.***



***Important note:-***

***Despite the above general principle, there are though, in some cases, specifically drafted articles of association of companies, which deprive the directors of the management and administration of the company or give them limited authorities subject to the approval of the shareholders. This is a serious qualification moving the management and control from the directors to the shareholders and each case must be carefully examined.***

III. Where is management and control exercised – Factors identifying the location of management and control.

The question as to the location of the management and control is a matter of fact.

According to the above principles, the management and control is exercised by the board of directors, and must be exercised in Cyprus in order to be considered a Cyprus tax resident company. We need to identify the facts which the board must undertake or which must be in place, in order to connect the location of the management and control, with Cyprus.

It has been decided and stressed repeatedly in court cases that, **the place where the directors meet** in order to reach their decisions on policy, finance and related matters, will be the place of central management and control of the company's business.

**In effect, the place where the directors meet for their board meetings, is the location of the central management and control of the company's business and consequently once the other factors are in place, the company is resident at that location.**

Authorities supporting the above principle:- *Calcutta Jute Mills Co v Nicholson [1876] 1 TC 83, Cesena Sulphur Co Ltd v. Nicholson 1876 1 TC 88,*

*De Beers Consolidated Mines Ltd v Howe [1906] Ac 455, 5 TC 198, Bullock v. Unit Construction Co Ltd [1959] 38 TC 712.*

The recurrent emphasis on the place of directors' meetings must not, however, lead one to suppose that the location of directors' meetings is the only factor used to determine the company's residency.

The place of directors' meetings is a significant factor to be taken into consideration but it can be of such importance only if those meetings constitute the medium through which the central management and control is **in fact and in reality** exercised, as we shall discuss further below.

Positive surrounding factual environment strengthening the Cyprus location of management and control.

The above requirement, i.e. to hold the board meetings in Cyprus, will be strengthened further with additional **positive** surrounding facts which support the real presence of the management and control of a company's business in Cyprus in the following circumstances:-

**- Directors' permanent residence to be in Cyprus**

The residence of the directors is closely connected to the place where board meetings are held. If the intention is to have a tax resident Cyprus company, the directors or at least the majority of them must be residents of Cyprus. In this way it is easily proved that the board meetings have been taking place in Cyprus and the management and control is exercised in Cyprus.

**- Administrative Office**

An administrative fully fledged office must be established in Cyprus where the actual management and control of the company's business will be exercised.

In this office the fundamental policy and management decisions must take place, and properly recorded board minutes must be kept.

**- Signing of Contracts**

Signing of contracts, issuing of invoices, and any other relevant company documents relating to the management, control and administration of the company must be executed in Cyprus by its directors.

**- Employees**

Employees must be employed and paid reasonable salaries according to the market levels.

**- Stationery**

Stationery must be printed with the letterheads of the company and its office address and other contact details such as telephone, fax numbers, email address and website.

**- Bank accounts**

Bank accounts must be opened in Cyprus and managed by the local directors.

**- Other factual considerations**

Any other similar outward indications of local presence and activity must be clearly undertaken by the board of directors residing and meeting in Cyprus.

Negative surrounding factual environment weakening the Cyprus location of management and control.

The requirement to hold the board meetings in Cyprus will be weakened in the following circumstances:-

**- Appointment of directors residing outside Cyprus**

The appointment of directors residing outside Cyprus, although possible, must be avoided if a tax resident Cyprus company is desired. In the instance that it is impossible to avoid such appointment, then the law of the country of residence of the foreign director to be appointed, must be very carefully examined.

There are countries which apply the management and control test in a similar manner that Cyprus does, and in implementing this test might consider that, if a foreign company is managed by a director who resides in their jurisdiction, becomes their tax resident and impose or claim taxation from the company concerned.

In such a case we may have serious **dual residency issues** which will be explained further below under chapter, E. *Double Tax Treaties – Their impact on the residency issue of Cyprus Companies.*

Appointing directors residing in countries in which the management and control test for foreign companies is applicable, such as the UK, as explained above, must be avoided. There are considerable risks which need not be taken.

In effect, it is not advisable to appoint as directors in Cyprus tax resident companies, persons residing in countries that will be in a position to claim the tax residency of the company, such as UK, since there is a risk to be considered that a Cyprus company is managed and controlled in their jurisdiction with serious adverse tax and legal consequences.

In the tax case *Calcutta Jute Mills v Nicholson (1876) 1 TC 83*, the director of the company, although residing in Calcutta, India, was receiving instructions from the company's office in London.

This fact was sufficient for the court to consider that the company was a tax resident of the UK instead of India and then taxable in UK.

The recent case, *R v Holdon*, High Court 18.4.2005, the facts of which are analysed further below, clearly directs the avoidance of such appointments.

Based on the same argument, it is not advisable to appoint directors residing in Cyprus or UK, as directors in companies registered in tax haven countries like BVI, Nevis, etc. In such a case there may be a real risk that these companies may be considered to be managed and controlled in Cyprus or UK, and consequently taxable in Cyprus or UK too, as a consequence of the applicability of the management and control test.

If such a claim is put forward by the Inland Revenue, BVI, Nevis companies etc, in order to avoid taxation, will need to prove that the director acts only on instructions of the real owners situated abroad. In effect the director is a mere cipher simply stamping documents and doing what he is told. In such a case relevant evidence and confidential information will need to be disclosed to the Inland Revenue to prove the director's symbolic status. There is no need to be engaged in such complications since the possibility can easily be avoided with the appointment of directors not residing in a country which applies the management and control test.

**- Appointment of directors residing in the place where the income of the company is generated.**

It is also advisable to avoid appointing directors who reside in the country where the income of the Cyprus tax resident company is expected to arise or in which country tax issues might be raised as to the taxation of the Cyprus company or as to the taxation of its beneficial shareholder.

If for example, the activities of the company are in Russia and the income is generated in or from Russia, we do not consider it proper to appoint as directors of the Cyprus tax resident company, persons residing, living and working in Russia. In case of such appointments one leaves room for arguments, namely, that the company or its real beneficial shareholder are taxable in Russia as its effective management is situated in Russia. Also an argument can be put forward that the company is not tax resident of Cyprus

as its management and control might be alleged not to be exercised in Cyprus.

Again there is possibility for dual residency issues as discussed in chapter E. of this brochure.

I would like to clarify though, that the crucial issue is not the nationality of the director but his/her residency. Where he/she permanently resides. A foreign national permanently residing in Cyprus, being a tax resident of Cyprus, will be a suitable director.

**- Issuing of general powers of attorney.**

The issuing of general powers of attorney to persons who are not directors and granting them full authority and power to decide on fundamental matters and operations of the company, to sign contracts, to have unlimited investment powers and to generally deal in blank with all the affairs of the company, may be considered as abdication of authority and a serious reason to consider that the management and control of the company is entrusted and passed to the attorneys.

In such a case there is a high risk of the company being considered to be resident at the place of the residency of the attorney and not in Cyprus.

General powers of attorney giving unlimited and wide authority to the attorneys, as a rule, must be avoided. The company can perfectly do its business by issuing special resolutions or special powers of attorney for the execution of particular acts. Such a step does not affect the management and control test. On the contrary it strengthens it.

For more details on the matter especially from the Russian point of view and its consequences kindly refer to our brochure :- *General Powers of Attorney Tax and Legal implications - The Russian and Cyprus consequence.*

### **Summary**

The above facts will identify the location of the management and control test – where the management and control is really exercised - and combined with the other requirements will identify the company as being a tax resident of Cyprus or not.

**In conclusion, as to the question of the location of management and control, in order to have a tax resident Cyprus company, the directors must meet, manage and control the affairs of the company from / in Cyprus, proper board meetings with minutes must take place in Cyprus, all or at least the majority of the directors to be residents of Cyprus and the positive surrounding factual circumstances explained above to be present in Cyprus.**

IV. How the management and control must be exercised in order for a company to be considered as a tax resident of Cyprus.

This is the most crucial and most important criterion in order for a company to be considered a tax resident of Cyprus.

**- Real exercise of management and control by the board of directors**

A long line of court cases has established that the board of directors, who meet in execution of their duties and powers, **must in fact** exercise management and control over the company's affairs.

The directors must apply their mind and decide at their own discretion, on all the company's issues and express their free opinion on the parameters which govern the activities and operations of the company.

In effect, the management decisions must be taken by the board of directors who must think and decide on all policy matters, strategies, financing, declaring of dividends, marketing and all other relevant matters and execute all their functions as members of the board, acting in the best interests of the company.

This policy making is the primary expression of management and control.

The directors must reach their decision NOT by simply following the instructions of the shareholders or of any third person such as the consultants, lawyers, accountants or other advisors of the shareholders.

They must think and decide at their own discretion for each case that arrives or put forward for consideration and implement the company's policy in an autonomous way.

If they simply act on instructions received from third persons or the shareholders or lawyers or accountants or other consultants acting on behalf of the shareholders, they are mere ciphers simply stamping documents and doing as they are told. This is not management and control but secretarial execution of orders.

The board of directors will of course consider the **suggestions** put forward by the advisors or the shareholders, but in each case they must only consider these suggestions and proceed to decide only having in mind the interests of the company. They must be ready to refuse adopting decisions not to the benefit to the company's interest and be ready even to resign if their decision is not followed.



**- Autonomous status of the board**

In effect the board must act autonomously and be in the position to reject requests which it considers not to be in the interests of the company or contrary to local law.

**- Knowledge of the business of the company**

The directors must know the business of the company and genuinely determine its affairs, acting from Cyprus. If they simply obey the instructions of the beneficial owner or his advisors who reside in another jurisdiction, the central management and control, and therefore the residency of the company for the purpose of its tax liabilities will be the location/residence of the ultimate owner or the advisor or as the case may be.

**- Directors' remuneration**

The directors must be properly paid for the work and meetings they have in such manner that demonstrates that this fee is sufficient to allow them to spend time to get to know the business of the company.

**- Consultants' involvement in the affairs of the Company**

The various advisors and shareholders who would like a particular company to be a tax resident of Cyprus, must be very careful in the way they draft their requests to the directors. They must avoid phrases as "I instruct you to do this ....." or "I order you to do that .." or similar phrases.

The proper wording would be that they request the board to consider the particular matter and if accepted by the board to be within the interest of the company, then to implement it.

Not only the old court decisions mentioned above but also very recent ones support the above principles:- { *Re Little Olympian Each Ways Ltd* [ 1994]

*4 All ER 561, Untelrab Ltd v McGregor [1996] STC (SCD) 1, R v Crown Court at Kingston [2001] STC 1615, Esquire Nominees Ltd v Commissioner of Taxation [1971] 129 CLR 177 and New Zealand Forest Products NV v Commissioner of Inland Revenue [1995] 17 NZTC 12,073}.*

**- Recent UK High Court case (R v Holden) implementing the above principles**

What is very interesting to mention is the recent judgment of the UK High Court in the appeal case *R v Holden*, given on 18/4/2005.

In this case, the Special Commissioners in the UK found that a Dutch resident company, paying taxes in Holland and acting through its board of directors in Holland, was also resident and taxable in the UK.

They considered that the advisors, PricewaterhouseCoopers, (PWC) and the shareholders UK tax payers, both resident in the UK, were in effect pre-ordained the board decisions.

Park J rejected the above approach on the facts of the case but not on the principles put forward by the Special Commissioners, something which is highly important to have in mind. The Court in this case re - affirmed the above principles.

On the facts, the judge accepted that PWC, acting from UK, never directed the directors to do anything and were not in position to do so. PWC gave them only advice and asked that the directors consider the offer, subject matter of the case, and further decide whether they will accept it or not.

The court accepted that the directors applied their mind and decided whether the offer was within the interest of the company and so were not merely going through the motions and simply stamping and signing documents.

It was clear that, if the directors just mindlessly followed the advice of PWC, the taxation imposed in the UK on the Dutch company would have been upheld due to the PWC and shareholders' intervention, both residing in the UK.

As Park J mentioned in this case, "if directors of an overseas subsidiary sign documents mindlessly, without even thinking what the documents are" it would be difficult to argue that the subsidiary was tax resident where the directors met. "But if they apply their minds to whether or not to sign the documents, the authorities... indicate that is a very different matter".

### **Summary**

**In conclusion, the directors must always genuinely meet in Cyprus, apply their mind, think and decide on all fundamental issues and policy decisions of the company with regard to its best interest using their own experience, knowledge and judgment.**

**They must be informed of the business of the company and this information must be recorded and in discharging their duties must make informed decisions and keep proper minutes showing that the corporate formalities are met.**

**They must never act on instructions of third persons, who ever these may be, by simply stamping resolutions sent to them.**

V. Double Tax Treaties – Their impact on the residency issue of Cyprus companies.

Cyprus has signed a considerable number of Double Tax Treaties which regulate taxation on various matters between the contracting states.

In order for a company to take advantage of the provisions of the Double Tax Treaties, it must be **resident** of one in the two contracting states. In our case, the Cyprus company, must be a resident of Cyprus for tax purposes.

A definition of what a “**resident of a Contracting State**” means, is given in article 4.1 of the O.E.C.D. model treaty which provides the following :-

**RESIDENT**

*For the purpose of this convention, the term “Resident of a Contracting State” means any person **who under the laws of that State**, is liable to tax therein by reason of his domicile, residence, **place of management** or any other criterion of similar nature and also includes that state any political subdivision or local authority thereof.*

*This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated there in.*

The first part of this article is used among others, in the treaties that Cyprus has signed with, Canada, the Czech Republic, Denmark, France, German Democratic Republic, Hungary, Italy, Kuwait, Romania, ex. USSR as it was then, Yugoslavia as it was then, Russia, Singapore, Bulgaria, Mauritius, Thailand, Belgium, Belarus, South Africa, Syria, India, Malta, Poland, Austria, Sweden and Slovenia.

In some of the treaties such as with Denmark, France, German Democratic Republic, Hungary, Russia, Bulgaria, Mauritius, Thailand, Belgium, Belarus, South Africa, Egypt, Syria, India, Malta, Poland, China, Austria, Sweden, Lebanon, the second part of article 4.1 is included as well.

Some differences in wording as to the residency issue appears for example, in the treaties with Greece, Ireland, USA, Canada, Norway, Bulgaria, Belarus, China, Russia, Poland, which introduce some additional terms as, effective

management, head office, registered office, place of registration, headquarters, place of incorporation.

**- Place of effective management as per relevant article in Double Tax Treaties. Tie – breaker article**

Article 4.3 of the O.E.C.D. model treaty, provides the following:-

*Where by reason of the provisions of paragraph 4.1, cited above, a person other than an individual is a resident of both Contracting States then it shall be deemed to be a resident only of the State in which **its place of effective management** is situated.*

The above crucial provision, known as the “ tie – breaker” article, which provides the solution to a possible problem of dual residency, is included nearly in all treaties that Cyprus has signed.

In some cases however, such as in the treaty with Bulgaria and Thailand, the place of incorporation solution has been introduced. In other cases, provisions have been included such as in the treaties with Egypt, China, USA, Canada and ex. USSR, to include the criteria of a national of a country, head office and effective management.

**- Definitions of the terms in the Double Tax Treaties**

There is no definition of the terms, place of management, effective management, head office, registered office, place of registration, headquarters, place of incorporation, or other similar criteria which are used in the Double Tax Treaties.

### **- Applicability of local laws as to residency**

The lack of any definition of the above terms used in respect of all legal bodies in the Double Tax Treaties, leads to the consideration of the Cyprus law in order to establish the residency of a Cyprus company, under such law, for tax purposes and consequently for treaty purposes as well.

In effect, the treaties point to the local laws of the contracting states, in order to identify, under which conditions a company registered in their jurisdiction, or not registered there, will be considered as their tax resident. Local tax law provisions will need to be examined in order for a company to be considered as tax resident under the provisions of the Double Tax Treaties.

In considering whether a Cyprus company is a tax resident of Cyprus, and consequently being benefited from the provisions of the Double Tax Treaties, the analysis provided in the previous chapters of this brochure as to the management and control test, applies.

### **- Dual residency**

There might be a situation where a company is a resident of more than one country. This might be the case when **the management and control** of the affairs of the company is not centred in one country but is divided or distributed among one, two or more countries.

Such situations might appear when the directors of the company, which form the highest level of management of the company, are resident in various countries and execute their management duties from their place of residence and not from Cyprus.

Also such situations might appear when the advisors or the shareholders of the company reside in different countries than where the board meets and from their place of residence direct the decisions of the board.

If such factual situations exist, then the allegation and possibility of dual residency of a company can be raised by Inland Revenues with drastic tax effects. It is for this reason that we are of the opinion that if a Cyprus tax resident company is needed, the appointment of directors with effective management, residing outside Cyprus must be avoided, as dual residency issues may arise.

The above possibilities as to the dual residency of a company have been discussed and approved in many court cases and in particular, the, *Swedish Central Rly Co Ltd v. Thomson* [1925] 9 TC 342, *Union Corp Ltd v IRC* [1952] 34 TC 207, *Koitaki Para Rubber Estates Ltd v Federal Comr of Taxation* [1940] 64 CLR 15, *R v Holdon*, High Court 18.4.2005.

The above authorities clarify and confirm that there where there is a fragmentation of the central management and control of the business of the company, exercised in effect from two or more countries, there can be dual residency for the company with further tax issues to be considered.

**- Allegation of dual residency by a treaty country.**

If dual residency exists or if such allegation is raised by any one of the treaty states, e.g. that a Cyprus company is also resident in that other state which claims taxation, then the solution is provided by the “tie – breaker” article of the Double Tax Treaties, article 4.3 discussed above.

According to article 4.3, if dual residency exists, the company is deemed to be resident **where its effective management is exercised.**

The answer to the question, where the effective management is exercised, identifies the tax residency of the company and in effect the country of its taxation.

As to the effective management test and its conditions, the analysis provided in the previous chapters of this brochure relating to the management and control test, apply accordingly.

In the court case, *Wensleydale's Settlement Trustees v IRC [1996] STC (SCD) 241*, a Special Commissioner considered that the place of effective management is there where the shots are called, implying realistic positive management. In effect, the analysis of the management and control test provided above applies for this issue as well.

## E. CASE STUDY

Suppose that, the Russian or the UK tax authorities or the Inland Revenue of any other treaty country, allege that a tax resident Cyprus company, for matters of management, domicile or other similar issues, is **also** tax resident of Russia or of the UK or in that other country and not only in Cyprus.

Because of this conclusion they had arrived, they impose or they seek to impose taxation on the Cyprus tax resident company for a particular operation.

In case of such a dual residency problem, (Cyprus also alleges that the company is a tax resident of Cyprus liable to taxation in Cyprus) article 4.3 of the Double Taxation Treaty signed between Cyprus and Russia, and the relevant article of the UK treaty or as the case may be with the other treaty countries, applies and gives the solution. This tie – breaker article, as being a provision of an international treaty, supersedes any local laws and directs that the residency of the company is deemed to be there where **the effective management** of the company is exercised. If the effective management is exercised in Cyprus, taxation cannot be imposed in Russia or in the UK or in the other contracting State, by operation of the Double Taxation Treaty.

In view of this provision which provides a solution, special attention must be paid to what has been said above in order to establish and to secure that the management and control of the company's affairs is exercised in Cyprus.



Similar arguments can be put forward in all other cases where Double Tax Treaties have been signed with the above provision in place.

The recent judgment in *R v Holden* mentioned above, handles also the issue as to the effective management test, due to the fact that relevant provision is in the Double Taxation Treaty between UK and Holland and the case was decided on this principle. It was decided that the effective management was situated in Holland and not in the UK.

## **F. CYPRUS INLAND REVENUE PRACTICE**

**The Cyprus Inland Revenue has not yet issued any practice guidelines as to how it will deal with the management and control test and its interpretation.**

It is clear that the Cyprus Inland Revenue will not disturb on its own initiative a Cyprus company which has decided to get registered as a tax resident of Cyprus. Such a company is taxable in Cyprus on its worldwide income and the Inland Revenue will not object to such a request for obvious reasons.

As a matter of recent practice, the Cyprus Inland Revenue in order to accept a company as a tax resident of Cyprus requests the directors to declare that they exercise the management and control of the company in Cyprus. Once this declaration is signed and submitted to the Inland Revenue, then the company is accepted and registered as a tax resident of Cyprus liable to the Cyprus tax. Relevant Tax residency certificate is issued by the Inland Revenue, if requested.

No other conditions at this early stage of registration of the company are examined or demanded by the Cyprus Inland Revenue in order to accept a Cyprus company as a tax resident of Cyprus.

### - Possible investigation by foreign Inland Revenue

Tax residency problems though, will not arise from Cyprus point of tax view. The Cyprus Inland Revenue will not dispute on its own initiative the status of a Cyprus tax resident company.

A foreign country though, for internal law reasons, might allege that a Cyprus tax resident company is a tax resident also in its jurisdiction, and may claim to impose taxation to it or to its beneficial shareholder.

In such a case, in order to avoid and be able to defend such allegation, the above conditions as to the management and control and the positive factual environment establishing the central role of Cyprus explained in detail, must be met.

In case a Double Tax Treaty between Cyprus and another State is in place, the effective management rule, "tie-breaker" provision, pointing to Cyprus must be invoked to defend such allegation.

### - Investigation of residency by Cyprus Inland Revenue

It is also believed that if the Cyprus Commissioner of Income Tax – Inland Revenue, will need to check the residency of a company will follow the guidance applied by the UK Inland Revenue where the following steps are considered:-

- a. They will first attempt to ascertain whether the directors of the company **in fact exercise** central management and control. Do they think and decide the policy and fundamental issues of the company? Do they act on their own initiative and discretion or they simply follow third parties' instructions?
- b. If they in fact exercise management and control, they will seek to determine **where** the directors exercise this central management and control. Is it in Cyprus or not? If in Cyprus, then the Company is a tax resident of Cyprus.

- c. In cases where the directors do not exercise central management and control of the company in Cyprus the Revenue will then look to establish where and by whom it is exercised.

Such incidents, where the Cyprus Inland Revenue will start to examine the tax residency of companies, will be mainly related to non Cyprus tax resident companies such as BVI, Nevis, etc where they will have information that they are managed and controlled from Cyprus in order to impose taxation on them as the UK Revenue does for non UK companies.

In these cases, the Cyprus Inland Revenue or any other foreign Inland Revenue, is expected to follow the above steps in order to identify the place of the effective management and control of such companies, and if found to be within their territory, their local taxation laws will apply.

## **G. CONCLUSION**

### **Cyprus companies will be considered tax residents of Cyprus if:-**

- Their management and control is exercised **in Cyprus**;
- The management and control is exercised in Cyprus, if the board of directors resides or at least the majority resides in Cyprus and genuinely holds board meetings in Cyprus having in mind all the positive surrounding factual circumstances explained above;
- The directors, at the board meetings give genuine consideration as to the affairs and business of the company and decide on policy, structural and main issues of the business of the company without simply following the instructions of the owners or their advisors. The directors must apply their mind, think and decide autonomously on all issues of the company and in its best interests;

- Any instructions and decisions relating to the business, management matters of the company, must be generated and given solely by the board of directors.
- Dual residency issues might be raised in case of fragmentation of power, namely, the management and control of the company's business is exercised by the directors / shareholders / advisors, in various countries. In such a case, if there is a Double Tax Treaty in place, the effective management rule "tie-breaker" article applies and identifies the residency of the company. If there is not any Double Tax Treaty in place, local laws will apply and give the solution.

#### **H. DISCLAIMER**

This publication has been prepared as a general guide and for information purposes only. It is not a substitution for professional advice. One must not rely on it without receiving independent advice based on the particular facts of his/her own case. No responsibility can be accepted by the authors or the publishers for any loss occasioned by acting or refraining from acting on the basis of this publication.

January 2012



## CYPRUS TAX RESIDENT COMPANIES MANAGEMENT AND CONTROL TEST

### Our Firm

**Kinanis LLC**, a law and consulting firm, is one of the leading and largest business law firms in Cyprus and advises for over 30 years the international investor and private clients on all aspects of law, tax and accounting.

Kinanis LLC absorbed the business of its shareholders which are in the legal and consulting profession since 1983, with local and international dimensions.

Experience and practice over the years brought forward the need for transformation from a traditional law firm to a more innovative multidisciplinary firm providing a full range of services combining law and accounting with the extensive expertise in corporate and tax advice to ensure that our clients will obtain the best possible spherical advice adopting the principle as to the services offered "All in one place", so that the client will find a quick, correct and efficient solution to its daily legal, accounting and tax issues in a trustworthy environment.

This combination of legal, accounting and tax services through our well qualified personnel and our involvement and participation in international transactions over the years, have established our firm as one of the key players in the field. Our involvement in international financial transactions has also provided us with the extensive expertise in representing groups, corporations, funds as well as the private client.

The firm is staffed with around 80 young, energetic and ambitious professionals, including lawyers, accountants and administrators who provide prompt, efficient and high quality services and who are capable of meeting the current demanding challenges of the local and international business environment.

We always look to give solutions in a simple and as possible quick way focusing on the needs of each client trying to anticipate the issues before becoming a problem.

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