KINANIS
LAW FIRM

The Management and Control Test

Taxation of Cyprus and Foreign Companies

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I. THE LAW

For taxation purposes, companies and individuals, are categorised as:

(a) residents or

(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 tax system considers a company to be resident of Cyprus and liable to Cyprus taxation 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 -…"

Meaning of Company

The income tax law No. 118(I) of 2002, as amended, identifies the notion of a company to be any legal body registered either in Cyprus or abroad.

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

II. 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"* which will identify a company to be tax resident of Cyprus.

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

Having in mind this interpretation gap as to the meaning of *"management and control"* in the Cyprus legislation, by operation of article 29 (1) (c) of the Courts' of Justice Law no. 14/60 as amended, the **Common Law**[1] and the **Principles of Equity**[2], are applicable to identify the meaning of "management and control", being one of the sources of the Cyprus legal system, provided they do not come in conflict with local statutes.

So, the Cyprus legal system, based on the Common Law system and the Principles of Equity will refer to these English principles in order to interpret the meaning of *"management and control"* as is abstractly laid down in Section 2 of the income tax law No. 118(I) of 2002, as amended.

1. ***"Common Law"*** *is the body of legal rules, based upon court decisions and not on statutory law made by a parliament, embodied in reports of decided cases, that has been administered by the common-law courts of England since the Middle Ages. Common laws vary depending on the jurisdiction, but in general, the ruling of a judge is often used as a basis for deciding future similar cases.*

2. ***"Principles of Equity"*** *are set of rules which rectify injustice done by the rigid application of court precedents and statutory law. It is the rectification of legal justice.*

III. ENGLISH LAW CONCERNING THE RESIDENCY OF A COMPANY

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) and now all UK registered companies are taxable in UK irrespectively of their place of management. They are automatically treated as tax residents in the UK.

The management and control test, irrespectively 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 etc., companies, might be taxable in the UK if their management and control is exercised in/from the UK.

In view of the provisions of the UK Law as above indicated, 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 and courts.

In this respect, since our legal system is based on Common Law and the Principles of Equity, 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"*. English Law will give the guidance for Cyprus in the interpretation of the management and control test.

IV. INTERPRETING THE MANAGEMENT AND CONTROL TEST

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 company through the management and control test:

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

B. **Who** exercises the management and control?

C. **Factors** identifying the location of the management and control exercise;

D. **How** must the management and control be exercised in order for a company to be considered tax resident of Cyprus? and,

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

V. ANALYSIS

A. 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 of its business 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 company is tax resident of Cyprus only if its management and control is exercised in/from Cyprus.

In conclusion, the tax residency of a company is identified by determining where the management and control is exercised. If the management and control is exercised in/from Cyprus then the company is a tax resident of Cyprus, if it is not, then it is not a tax resident of Cyprus. It is irrelevant the place of incorporation.

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/from** Cyprus*.

B. Who exercises the management and control?

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

1. Management and control of <u>the business</u> of the company Vs. Shareholders' control of <u>the company</u>

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 supports 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 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.*** In this case it was clearly laid down that Corporate residence is related to the central management and control of the business of the company, which is exercised by the directors from the place where they meet (and not to the control of the company itself, which is exercised by its shareholders).

The fact that the shareholders through their voting rights can remove the directors from their office does NOT affect the above principles. The business of 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. Central management and control of the business must be distinguished from (and need not be in the same place as) the place of business, where the actual trading and business operations of the company are conducted. We need to distinguish 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 Cyprus, will be tax resident of Cyprus even if the actual trading business of the company is outside Cyprus.

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 business 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 business 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.

C. Factors identifying the location of the management and control exercise

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/from Cyprus in order for the company 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 company's policy, finance and related matters, subject to various qualifications which will be discussed further below, 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, deciding on company's policy, finance and related matters, 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 tax 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 tax 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 Cyprus tax resident company, the directors or at least the majority of them must be permanent 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/from Cyprus.

Nominee Directors - Directors' remuneration – Decision process

Nominee directors appearing in hundreds of companies should NEVER be used. Directors must consider genuinely the company's affairs and reach a reasonable, commercial decision, justified by the activities of the company and their expertise and knowledge. Directors should be paid market price directorship fees and not nominal fees as nominee directors usually receive. In effect, the directors MUST decide the policy and crucial decisions as to the company and NEVER be directed by external bodies.

Decisions taken should be properly documented and board meetings should be regularly held. Further below a detailed analysis is given as to this item.

Administrative Office

An administrative fully fletched 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 and or local employees properly authorised.

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.

Accounting records

Maintenance of accounting records should be in Cyprus.

General Powers of Attorney

General powers of attorney should NEVER be granted to non – residence or

otherwise. If a general power of attorney is issued, there is real risk the management and control of the business to be considered that is exercised in the country of residence of the attorney. Specific, (and not broad) powers of attorney, may be granted to non-resident-based persons. Details of this item are given further below.

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 environmental factors weakening the Cyprus location of management and control

The requirement to hold the board meetings in Cyprus will be weaken 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 company intended to be Cyprus tax resident company, might be considered as managed and controlled in the foreign 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 UK instead of India and then taxable in UK.

The 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 transferring the management and control abroad.

In effect, the director in such a case is a mere cipher, simply stamping documents and doing what he is told.

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, 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/from Cyprus.

Again, there is possibility for dual residency issues as discussed in chapter E. *Double Tax Treaties – Their impact on the residency issue of Cyprus Companies* of this brochure.

We 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.

In effect, 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 Cyprus tax resident company, the directors must meet, manage and control the affairs of the company in/from Cyprus, proper board meetings with minutes must be taken place in Cyprus, all or at least the majority of the directors to be permanent residents of Cyprus and the positive surrounding factual circumstances explained above to be present in Cyprus.

D. 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 judgements 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 business 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 beneficial 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. Nominee directors with nominee fee, should NEVER be used.

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}.

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

It is very interesting to mention this judgement 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.

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".

Laerstate BV v HMRC [2009] UKFTT 209

In this case, the First Tier Tribunal held that a company's residency cannot be established merely on the basis of the location of board meetings.

Central management and control requires to look beyond the board meetings and board resolutions and requires wider examination of company's 'course of business and trading'. The board of directors would need to really exercise management and control and would need certain minimum amount of information to make decisions.

The court decided that company residency cannot be established on such simplistic terms as Wood v Holden and looked at where the company was conducting its real business, including contract negotiations and obtaining its advice.

As per the court decision a company should be resident in the place that it had been doing all its real business, including contract negotiations and obtaining its advice.

In this case the court found that this was within the UK, which made the company tax resident in the UK.

HMRC v Development Securities plc and others *[2020] EWCA Civ 1705*

In this *case* the Court of Appeal (the "**CA**") has overruled the Upper Tribunal and agreed with the First-tier Tribunal that the relevant Jersey incorporated subsidiaries of a UK parent were resident in the UK for tax purposes by reason of being centrally managed and controlled in the UK.

In *Wood v Holden* in 2006 it was held that mere influencing of the decision of the directors by a third party (e.g.: a parent or third-party adviser) does not necessarily lead to a conclusion that the central management and control is removed from the non-UK company's directors.

In this case, it has now been held that the UK parent could be taken to effectively take the decision for the non-UK company by giving instructions to proceed with the specific transactions notwithstanding that the non-UK's directors considered (or satisfied themselves of) the legality of the relevant transactions but did not give any decision to the merits of the transactions. This led to a conclusion that the central management and control was conducted by the parent and therefore in the UK and not in Jersey where the subsidiary was incorporated.

This shows that there may be a high bar in future to establish that central management and control is exercised outside the UK in case of a UK parent company in place.

The CA's decision also serves as a timely reminder that resident directors cannot provide a purely "administrative" service for the benefit of the parent owner but each director carries all the duties and responsibilities of a director generally and as such must ensure that they have sufficient knowledge and understanding of the business of the company and individually decide on all company matters.

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 judgement. 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, whoever these may be, by simply stamping resolutions sent to them.

E. 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.

According to the Commentary to the OECD Model Tax Convention "the place of effective management is the place where the key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made. To determine the tax residency of a company, tax authorities would be expected to take into account various factors, including among others where the chief executive officer and other senior executives usually carry on their activities and where the senior day-to-day management of the person is carried on."

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, namely with, Singapore, Mauritius, Belgium, Russia, South Africa, Syria, India, Malta, Poland, Austria, Yugoslavia, Kuwait, Sweden, France, Romania, Hungary, Czechoslovakia, Denmark, Italy, Democratic Republic of Germany, Lebanon and UK.

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 too.

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 judgement 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.

In more recent court cases though, it was decided that the effective management was situated in UK and not overseas where the companies were registered and the board of directors was situated. See, **HMRC v Development Securities plc and others *[2020] EWCA Civ 1705 and* Laerstate BV v HMRC [2009] UKFTT 209 and Laerstate BV v HMRC [2009] UKFTT 209,** discussed above.

VI. INLAND REVENUE APPROACH

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 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 taxation. Relevant Tax residency certificate is issued by the Inland Revenue, if requested. In such a case though a relevant questionnaire is completed confirming in effect that the management and control is exercised in / from Cyprus.

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 form Cyprus point of tax view for Cyprus companies. 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.

VII. CONCLUSION – FINAL SUMMARY

Cyprus or foreign companies anywhere registered, 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.

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February 2021

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