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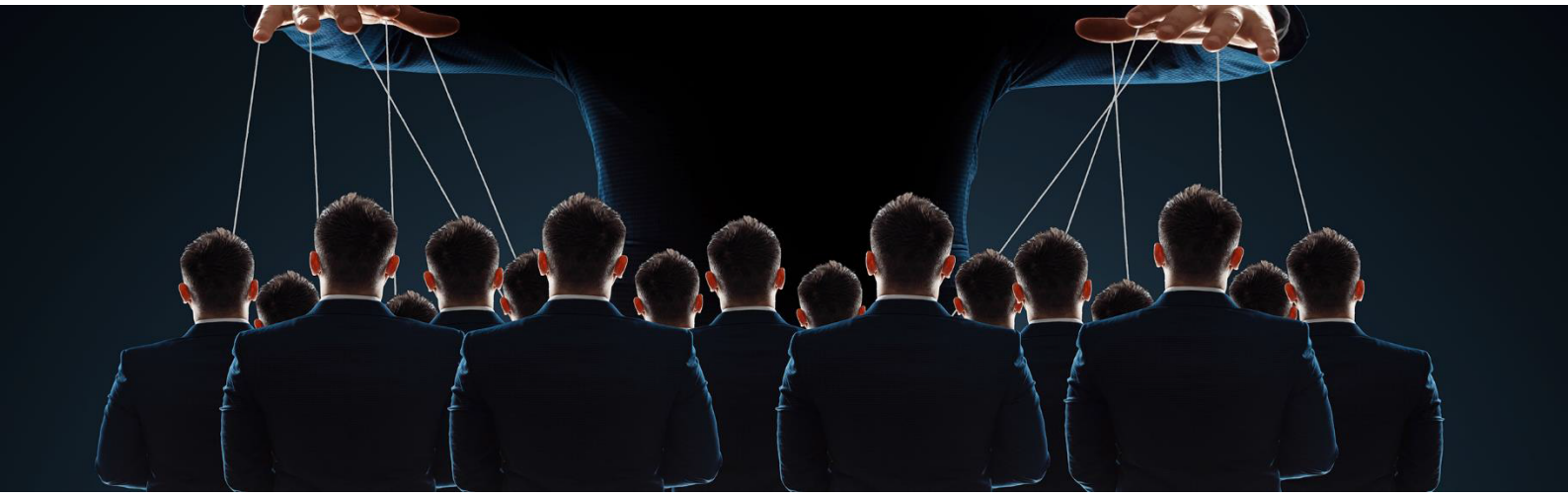

The Management and Control Test

Taxation of Cyprus and Foreign Companies

Updated April 2023

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I. INTRODUCTION

In this publication, we shall examine the notion of "management and control" of companies as this is applicable in Cyprus and how it affects the taxation of Cyprus and Overseas companies.

II. THE LAW

Basis of Taxation

A company or an individual are taxed in Cyprus, if they are residents of Cyprus, subject to specific exceptions[1].

The residency requirement as the basis of taxation, is provided in article 5(1) of the Income Tax Law, No. 118(I) of 2002 as amended, hereinafter referred to as the "Income Tax Law".

Article 5(1) of the Income Tax Law provides the following:

> *"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 Resident in the Republic

The meaning of "Resident in the Republic" is defined in the Income Tax Law article 2 which provides the following:

> *"**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 and non-resident or resident outside the Republic shall be interpreted accordingly".*

[1] *See further below under the heading," Taxation of Companies" at page 5, what is provided as to the taxation of non-resident companies of Cyprus.*

Pursuant to this provision, a company is considered to be resident of Cyprus, and in effect subject to Cyprus taxation, when its ***"management and control"*** is exercised in Cyprus.

In addition to the above meaning of Resident in the Republic as to companies, as from 31.12.2022, a company, which is established or registered pursuant to any law in force in Cyprus, will by default be considered as Resident in the Republic, provided it is not tax resident in any other country.

In article 2 of the Income Tax Law, the proviso of the definition of the meaning of *"Resident in the Republic",* provides the following:

> *"It is provided that, a company which has been established or registered pursuant to any law in force in the Republic, of which its management and control is exercised outside the Republic, it is considered that it is resident in the Republic, unless the said company is tax resident in any other country".*

This provision is applicable as from 31.12.2022, identified as *the incorporation rule* for taxation purposes.

Meaning of Company

The Income Tax Law, in article 2, identifies the notion of company to be "*any legal body registered either in Cyprus or abroad".*

Taxation of Companies

All companies, anywhere registered, being residents of Cyprus are taxed on their worldwide income, accrued or arising from sources in Cyprus and/or abroad.

As per the above provisions of the Income Tax Law, a company:

1. If it is incorporated in Cyprus, it is resident of Cyprus, the incorporation rule applies and it is subject to Cyprus taxation;

2. If it is incorporated in Cyprus with management and control outside Cyprus, as from 3.12.2022, it is resident of Cyprus, unless it is tax resident in any other country[2];

3. If it is incorporated outside Cyprus but its management and control is in Cyprus, then it is resident of Cyprus, subject to Cyprus taxation.

A Cyprus resident Company, is liable to taxation on its worldwide income.

Note: A special case may arise when a company has dual residency. This happens when there is fragmentation of the management and control in various countries. In such a case, if a Double Tax Treaty (DTT) is in force between the relevant countries, the company will be tax resident in the country where its effective management is exercised. In case there is no Double Tax Treaty in force between the relevant countries, the company will be tax resident as per the applicable laws of each country where the management and control is exercised. If the laws of the various countries have conflicting rules as to this issue, then there might be a state dispute as to where the company is tax resident.

Permanent Establishment

A non - Cyprus tax resident company, despite the fact that it is not tax resident of Cyprus, is taxed on income accrued or arising from a business activity which is carried out through a permanent establishment in Cyprus and/or from sources in Cyprus.

Article 5(2) of the Income Tax Law provides the following:

> *(2) Subject to the provisions of this Law, in the case of a person who is not a resident of the Republic, for each tax year a tax is imposed at a rate or rates, as specifically determined in this Law, on the income acquired or arising, in relation to:*
>
> *(a) any profits or other benefits from a permanent establishment situated in the Republic*

As per Art. 2, of the Income Tax law the meaning of permanent establishment is:

> *"Permanent establishment" means-*

[2] *The law provides … of being tax resident in any other country. There is no condition that the taxation laws of that other country impose any taxation on the income earned. So, any country, where the Cyprus company is tax resident, meets the requirement.*

(a) fixed base of business through which the activities of the business are wholly or partly carried on.

(b) The term 'permanent establishment' includes in particular:

(i) seat of administration;

(ii) branch office;

(iii) office;

(iv) factory;

(n) laboratory;

(vi) a mine, oil or gas well, quarry or any other place of extraction of natural gas resources;

(vii) offshore activities regarding the mining, exploration or exploitation of the continental shelf, subsoil or natural resources, as well as the installation and exploitation of pipelines and other facilities on the seabed.

(c) site or construction or installation work or supervisory activities in relation thereto constitute a permanent establishment only if they last more than three months.

*(d) Notwithstanding the provisions of paragraphs (a), (b) and (c) hereof, the term 'permanent establishment' shall be deemed **not** to include:*

(i) the use of facilities only for the purpose of storing, displaying or delivering goods or merchandise belonging to the business;

(ii) keeping stock of goods or merchandise belonging to the business solely for the purpose of storage, display or delivery;

(iii) keeping stock of goods or merchandise belonging to the enterprise only for the purpose of processing them by another enterprise;

(iv) maintaining a fixed base of business solely for the purpose of purchasing goods or merchandise or gathering information about the business;

(v) maintaining a fixed base of business solely for the purpose of carrying out, for the business, any other activity of a preparatory or ancillary nature;

(vi) the maintenance of a fixed base of the enterprise only for the purposes of any combination of the activities referred to in sub-paragraphs (i) to (v), provided that the total activity of the fixed base of the enterprise resulting from this combination is of a preparatory or auxiliary nature ·

*(e) Notwithstanding the provisions of paragraphs (a) and (b), **where a person** - other than an independent agent to whom paragraph (f) applies **- is acting on***

behalf of an undertaking and has, and ordinarily exercises in the Republic, authority to entering into contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in the Republic in relation to any activities that such person undertakes for the enterprise, *unless the activities of that person are limited to those referred to in paragraph (d) which, if they were made through a fixed base of business, they would not make it a permanent establishment under the provisions of this paragraph.*

(f) A business shall not be deemed to have a permanent establishment in the Republic merely because it carries on business in the Republic through a broker, general commission agent or any other independent agent, provided that such persons are acting in the ordinary course of their work.

(g) The fact that a company which is a resident of the Republic controls or is controlled by a company which is not a resident of the Republic, or carries out operations outside the Republic either through a permanent establishment or otherwise, cannot in itself make one of these companies a permanent establishment of the other;

(h) Regardless of the provisions of paragraphs (a) to (g), the investment of a person who is not a resident of the Republic in a mutual fund or cooperative that operates under the provisions of the Open Type Collective Investment Organizations Law or the Alternative Investment Organizations Law, it is not considered to create a permanent establishment of the person in the Republic with regard to his specific investment:

Provided that the management of an Organization for Collective Investment in Transferable Securities (hereinafter "UCITS") and/or an Alternative Investment Organization (hereinafter "UEE") established outside the Republic, by a person who is a resident of the Republic, is not considered to create in said UCITS and /or OEE right of permanent establishment in the Republic.

Controlled Foreign Company (CFCs)

With effect as from 1 January 2019 Controlled Foreign Company (CFCs) rules apply, i.e., non-distributed profits of CFCs directly or indirectly controlled by a Cyprus resident company, may become subject to tax in Cyprus. Certain exceptions apply. In such a case, foreign taxes paid can be credited against the Cyprus corporation tax liability.

The provisions of CFC rules of Cyprus do not apply to individuals, residents of Cyprus, so they do not have any applicability in case the shareholder of the foreign company is an individual resident in Cyprus

III. DEFINITION OF MANAGEMENT AND CONTROL IN CYPRUS – LACK OF STATUTORY OR JUDICIARY INTERPRETATION

There is no definition in the Income Tax Law or in any other enactment as to the meaning of the notion of *"management and control"* which will identify whether a company is resident of Cyprus or not.

There is no definition in the law, stating who exercises management and control and how it should be exercised.

There is also, no definition in the law as to what particular acts substantiate the management and control.

Having in mind this interpretation gap as to the meaning of management and control in the Cyprus legislation, we should request assistance from any court judgements in place interpreting this notion. Unfortunately, though there are no Cyprus court cases interpreting the notion of management and control.

The only one court case which touched the notion not directly but indirectly, without giving any interpretation, is, ***Lanitis Bros Ltd., v. The Central Bank of Cyprus 27/06/1974 – case No. 74/74*** which is a recourse case and adopted the notion of management and control as this was adopted in the most known UK court case on the subject, namely, ***De Beers Consolidated Mines Ltd. v. Howe (1906) A.C., 455.***

In the ***Lanitis*** court case above, J. Loizou, confirmed the following:

> *"…….. a company's residence is where it really keeps house and does its business, ... where the **central management and control is exercised**, as laid down in the **De Beers Consolidated Mines Ltd. v. Howe (1906) A.C., 455".***

Article 29 (1) (c) of the Courts of Justice Law no. 14/60

By operation of article 29 (1) (c) of the Courts of Justice Law no. 14/60 as amended, Common Law[3] and the Principles of Equity[4], are among the sources of the Cyprus legal system, provided they do not come in conflict with local statutes.

In this respect, since among the sources of the Cyprus legal system are the Common Law and the Principles of Equity, we may refer to English court cases, in the absence of Cyprus court cases, in order to interpret the meaning of management and control.

IV. INTERPRETATION OF MANAGEMENT AND CONTROL NOTION BASED ON UK COURT JUDGEMENTS

The management and control test to identify the residency of a company was applicable in the UK until 1988 for UK registered companies. In 1988, it was replaced by relevant statutory provision, (Finance Act 1988), and now all UK registered companies are by default treated as residents of UK, taxable in UK, irrespectively of their place of management, unless they can show that their place of effective management is in a country with which UK has relevant double tax treaty[5].

In such a case, where possible dual residency of companies may be in place, the so called "Tie – breaker" article of the OECD model treaty as to effective management, usually included in all double tax treaties signed among the countries, apply and controls the residency of a company.

The management and control test, which is the Common Law test of corporate residence, irrespectively of the above statutory provision which applies by default to all UK companies, is according to the UK law, applicable to non-UK companies i.e., foreign registered companies.

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[3] **"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.*

[4] ***"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.*

[5] *FA 1994 s.249.*

Under these Common Law provisions, a foreign company i.e., Cyprus, BVI etc., might be taxable in the UK if their management and control is exercised in the UK.

This corporate residency test is a fundamental concept of international corporate taxation and is the tool of income tax authorities to impose taxation on foreign companies for their activities undertaken abroad BUT managed and controlled onshore.

In view of the provisions of the UK law as above indicated, there is a considerable number of court decisions which deal with the interpretation of the management and control test and from which we are getting guidance as to how this test will be applicable in Cyprus, if a case arise and interpretation of this term will be required by the Cyprus authorities and courts.

In this respect, since among the sources of the Cyprus legal system are the Common Law and the Principles of Equity, our courts and the Commissioner of Income Tax, is expected to follow the principles laid down by UK court cases in interpreting the notion of management and control, which court cases, will give the guidance to Cyprus authorities in the interpretation of this notion.

V. TO WHAT THE MANAGEMENT AND CONTROL OF A COMPANY REFERS TO?

The management and control notion refers to the management and control of the strategic decisions related to the business of the company.

Management and control is not:

1. The exercise of powers vested in the shareholders in general meeting (for example, the appointment of directors, the amendment of the Articles, the winding up of the company or the increase or reduction of the share capital);

2. The day-to-day administration of a company's business (since this is the implementation of the policy and decisions of those who ultimately manage and control the company) – this generally has a more administrative flavour; or

In effect, the management and control of the company refers to the management and control of the business of the company, **it is related to the strategic decisions which are issued,** as to the fundamental policies of the company, and its implementation, its vision and mission, the identification of its targets and the procedures to be implemented to achieve its targets.

As an indication, it is manifestation of management and control, to decide if the company will proceed to expansion of its business, in setting up more factories, in reducing the factories, in setting up more shops, in reducing the shops, as to whether particular contracts will be signed or not, whether the company will be financed or nor, whether it will dispose its assets or not, whether it will expand in other lines of business or not, whether it will merge with other businesses or not, and all related key strategic decisions as to the operation of the company to meet its targets.

The above meaning of the management and control notion related to the strategic decisions of the business of the company, is confirmed by a series of court cases along the years, indicatively the following:

1. The management and control notion was first used as the main factor in determining a company's residence in the cases of ***Calcutta Jute Mills Co Ltd v Nicholson*** and ***Cesena Sulphur Co Ltd v Nicholson (1876) LR 1 Exch D 428,*** which were heard and decided together by the Court of Exchequer.

   The Calcutta Jute Mills Co Ltd was incorporated in the UK and its registered office was in London. It conducted its entire business of manufacture and sale of jute in India, where it also kept all its books, papers and documents and where it received its income. The company had no property in the UK. However, its directors and shareholders met in the UK where dividends were declared and paid. **The directors also controlled the main operations of the company from the UK although the majority shareholders resided in India.**

   The Cesena Sulphur Company was also incorporated in the UK. It was registered in Italy where it kept its books and documents, where it conducted the whole of its manufacture and sale of sulphur, where its profits were earned and banked.

   The practical management of the company's properties and affairs was done by its Italian directors. The company also had directors' resident in France and in England

who met at the company's registered office in London and with whom the Italian directors were in constant correspondence. The shareholders of the company met in the UK, where only a minority of them were resident.

Both companies were held to be resident in the UK **on the basis that the direction and control of the business of each company took place in the UK.**

2. The 'control' test was affirmed by the House of Lords in ***De Beers Consolidated Mines Ltd v Howe [1906] AC 455, 5 TC 198.*** There the company was incorporated in South Africa and the whole of its profits were made from mining and disposal of diamonds. The head office of the company was at Kimberley in the Cape of Good Hope, where general meetings were held.

   The directors met both in Kimberley and in London but the majority resided and met in London**. It was found on the facts that the chief control of the company's affairs was in the hands of the London directors who controlled the negotiation of contracts, determined policy in regard to the disposal of diamonds and other assets and the working and development of the mines.**

   The South African company, based on these facts, was held to be resident in UK.

3. The place at which a company's management and control is exercised, and therefore its residence, is to be determined by reference to the facts as they exist, rather than according to any requirement of the law or of the company's regulations.

   It follows that where a subsidiary of a company is under the control of the directors of that company, (parent), it is the place at which that control is exercised and not the location of the meetings of the subsidiary's directors that determines the residence of the subsidiary **(*Unit Construction Co Ltd v Bullock* [1960] AC 351).**

4. Further, the residence of those directors will not necessarily determine the residence of the company; the directors of a company may all be UK resident but if they exercise central management and control of a company outside of the UK, the company will not be UK resident **(*Laerstate BV v R & C Commrs [2009] TC 00162).***

In conclusion, the management and control notion, refers to the management and control *of the strategic decisions as to the business of the company* and not to the management and control of the company itself which is another matter related to the shareholders' powers.

VI. THE CORE ELEMENTS OF THE MANAGEMENT AND CONTROL NOTION

In the following chapters we shall deal with the interpretation of the notion of management and control and we shall try to identify its core elements. In this respect we shall examine:

A. Who exercises the management and control of the business of the company?

B. In which place a company is considered as resident according to the management and control test?

C. Which are the substance requirements that connect the exercise of the management and control with a particular place?

D. How the management and control must be exercised in order for a company to be considered as resident in the place where the management and control is exercised?

VII. ANALYSIS OF THE CORE ELEMENTS OF THE MANAGEMENT AND CONTROL NOTION

A. Who exercises the management and control of the business of the company?

The question in effect is, which company body has been entrusted with the power to decide the fundamental policies and the key strategic decisions as to the business of the company? The board of Directors? The shareholders? Third persons? Who?

The distribution of powers between the general meeting of shareholders and the board of directors as per the Companies' Law Cap 113, is left to the Articles of Association which in practice confer extensive powers on the directors.

The Articles of Association generally follow Table A of the Companies' Law Cap 113 as to the distribution of powers. Table A, in section 80, provides that the business of the company shall be managed by the directors, subject to any special provisions of the Articles of Association of the company or the law.

Section 80 provides the following:

> ***Powers and Duties of Directors***
> *80. The business of the company* ***shall be managed by the directors****, who may pay all expenses incurred in promoting and registering the company, and may exercise all such powers of the company as are not, by the Law or by these regulations, required to be exercised by the company in general meeting, subject, nevertheless, to any of these regulations, to the provisions of the Law and to such regulations, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting but no regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made.*

Following the above, as per the Articles of Association, a plethora of powers is generally granted to the directors who manage and control the business of the company and its day-to-day activities.

In effect, as a general rule, the shareholders control **the company** through their votes at general meetings as per the powers granted to them according to the provisions of the Companies' Law Cap 113, while the directors control **the business** of the company by its management.

In this respect,

Directors → Manage and control the business of the company

Shareholders → Control the company itself

As already discussed, the control that we are discussing in this publication, is that which relates to the highest level of management of the company's business related to its strategic decisions and must not be confused with the control which vests in the company's shareholders.

In this respect, the management and control of the business of the company, by default is exercised by the directors, (section 80 of Table A) and not by the shareholders who control the company itself.

Superiority of decisions taken by the board of directors

The distribution of powers among the board of directors and the shareholders is such that any decision taken by the board of directors in respect of management matters as to the business of the company cannot be overruled by the shareholders in general meeting.

A case illustrating the significance of the Articles of Association as regards the division of powers between the board of directors and the general meeting of shareholders is that of ***Automatic Self – Cleansing Filter Syndicate Company v Cunninghame [1906] 2 Ch. 34,*** where the court of Appeal supported and upheld the directors' refusal to carry out a sale of corporate property in defiance of simple resolution passed in general meeting which purported to authorise the sale. Such power was reserved by the Articles to the directors and the shareholders could not intervene.

In effect, the powers delegated to the board of directors cannot be exercised by the shareholders in General meeting.

Additional relevant authority supporting this separation of powers is ***Breckland Group Holdings v London Suffolk Properties [1989] BCLC 100,*** where the 51% shareholders instructed their lawyers to file a court case on behalf of the company. The court held that such power was left with the board of directors as per the Articles and the majority shareholders were effectively precluded from initiating such an action on behalf of the company. In this respect, the company was not obliged to pay the lawyers' fees.

Also, in the case ***John Shaw & Sons (Salford) Ltd v Shaw [1935] 2 KB 113***, the board of directors decided to institute court proceedings for a debt owed to the company. Subsequently, the shareholders by a relevant resolution purported to discontinue the case. It

was held that the decision of the board of directors it could not be overruled by the shareholders' resolution which was invalid.

In the case ***Stanley v Gramophone and Typewriter Ltd (1908) 5 TC 358*** the general position that the directors are not the servants or agents of the shareholders to obey their orders was emphatically stated.

> ***The facts***
> *The appellant company (resident in England) held all of the shares in a German company. The appellant company was assessed on the monies retained by the German company, and the case depended on whether the unremitted funds considered as the gains of a business 'carried on' by the English company as opposed to a separate entity.*
>
> ***The Issue***
> *Whether the appellant company was liable under the Income Tax Act, 1853?*
>
> ***Held***
> *The Court of Appeal held that the fact that the appellant company owned shares in a German company was not enough to make the business of that German company the business of the appellant company (resident in England). Thus, the appellant company did not bear liability under the Income Tax Act, 1853. The court further held that the directors are not the servants of the shareholders. They shall not obey shareholders' directions. They are not the agents of shareholders.*

In this case it was accepted that the management and control of the business of the company, was exercised by its own directors from the place where they met and decided the matters of the company, and not by the board of directors of its parent company.

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

It is clear from the cases so far that the shareholders cannot interfere with the directors' discretion and cannot instruct the directors how to exercise their discretionary functions.

Pawers of shareholders

The Companies' Law, Cap 113, reserves certain powers to the general meeting of shareholders such as the alteration/amendment of the Memorandum and Articles of Association, an increase or reduction of the share capital, the removal of the directors from their office and the voluntary winding up of the company, actions which are relate to the control of the Company but not related to the decision making process as to the business of the company and do not affect the management and control notion related to the business of the company.

Important note as to articles of association

Despite the above general principle, there are though in some cases, specifically drafted Articles of Associations which deprive the directors of the management and control 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 central management and control of the business from the directors to the shareholders and each case must be carefully examined.

If such serious step is taken, the company might be considered as resident at the place of meetings and decision-making process of the shareholders as the management and control of the business is exercised by them.

Shadow Directors

In addition, once the appointed directors follow blindly the instructions of third persons, such as auditors or lawyers or other consultants, again, it might be considered that the management and control of the business of the company is exercised by these third persons and not by the appointed directors. Again, there might be a serious risk the residency of the company to move to the place of the residence of the instructing person. In such a case the shadow director notion comes into play as this is provided in art. 192(9) of the Companies' law, Cap 113. The instructing persons are considered as shadow directors and are the actual persons who manage and control the business of the company.

In conclusion, *the answer to the question,* ***who exercises the management and control of the business of the company*** *by default, pursuant to section 80 of Table A of Companies, Law Cap 113, this is the board of directors, subject to any specific provisions of the Articles of Association or the presence of any shadow directors.*

B. In which place a company is considered as resident according to the management and control test?

Place of management and control

1. 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, 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 there where the trading operations are taking place, but where the central management and control of its business actually takes place, as said in the judgement, "*there where the central management and control actually abides".*

As per the facts of this case, the company was incorporated in South Africa and the whole of its profits were made from mining and disposal of diamonds. The head office of the company was at Kimberley in the Cape of Good Hope, where general meetings were held. The directors met both in Kimberley, South Africa, and in London but the majority resided and met in London.

It was found as a fact that the chief control of the company's affairs was in the hands of the London directors who controlled the negotiation of contracts, determined policy in regards to the disposal of diamonds and other assets and the working and development of the mines.

The House of Lords, confirming the decision in both courts below, unanimously held that the company was resident in the UK. In the course of his opinion Lord Loreburn observed (at p. 213):

> *"The decision of Chief Baron Kelly and Baron Huddleston, in the Calcutta Jute Mills v Nicholson and the Cesena Sulphur Co. v Nicholson, now thirty years ago, involved the principle that a Company resides, for purposes of Income Tax [now Corporation Tax], where its real business is carried on. Those decisions have been acted upon ever since.* ***I regard that as the true rule; and the real business is carried on where the central management and control actually abides.***
>
> *It remains to be considered whether the present case falls within that rule. This is a pure question of fact, to be determined, not according to the construction of this or that regulation or byelaw, but upon a scrutiny of the course of business and trading."*

De Beers *is a case where the majority of the directors of the overseas company, incorporated in South Africa, were reside and met in London and the company was held to be resident in the UK as the central management and control of the business of the company was conducted by the directors from London.*

The De Beers case has been adopted in the Cyprus case: ***Lanitis Bros Ltd., v. The Central Bank of Cyprus 27/06/1974 – case No. 74/74***

This was a recourse case in relation to exchange control law. As the law stood those days, only with the licence of Central Bank of Cyprus someone could transfer funds to any country in the world. Also, except with the permission of the Central Bank, no person resident in the Republic shall lend any money or securities to anybody corporate resident in the Republic which is by any means controlled (whether directly or indirectly) by persons resident outside the Republic.

The firm Lanitis Bros, had as shareholder a Bahamian company in which Bahamian company 3 out of the 4 directors were non-residents. The shareholders of the Bahamian Company were Cypriots residents in Cyprus. The argument that the Bahamian company was controlled by Cypriot shareholders and in effect the Cyprus Company was controlled by resident Cypriots and no licence was needed, was rejected based on the De Beers. It was accepted that the directors controlled the Bahamian Coamony who by majority were non – residents and in effect Lanitis Bros was controlled by a non-resident company.

J. Loizou, confirmed the following:

> *"…….. a company's residence is where it really keeps house and does its business, ... where the* ***central management and control is exercised****, as laid down in the* ***De Beers Consolidated Mines Ltd. v. Howe (1906) A.C., 455".***

Cyprus hypothetical case based on the facts of *De Beers*

If we transform the facts of **De Beers** to a Cypriot hypothetical case, such as that a Cypriot individual resident of Cyprus registers a BVI company to handle its overseas business and manages and controls the business of this BVI company form Cyprus, such a BVI company will be considered as resident of Cyprus and will be liable to Cyprus taxation for its worldwide income.

2. Important is also the Court of Appeal case in ***Bullock v Unit Construction Co Ltd (1959) 38 TC 712 at 729 – 730 also at, [1960] AC 351.***

The Facts

The case concerned a UK-resident subsidiary of Alfred Booth & Co Ltd, a UK-resident parent company. This UK subsidiary made certain payments to three fellow subsidiaries in Kenya and claimed these as allowable business expenses in arriving at its UK taxable profits. However, these payments would only have been allowed for tax purposes if the three subsidiaries to which they were made were resident in the UK, not Kenya. They were incorporated in Kenya and their Articles of Association expressly stated that management and control rested with the directors and also required directors' meetings to be held outside the UK. Presumably this had been done with the intention of protecting the company from any future accusation of residence outside Kenya.

The Issue

Whether the companies were resident in the UK and thus taxable in UK.

Held

It was found as a fact that due to trading difficulties at the material times the boards of directors of the Kenyan subsidiaries were standing aside in all matters of importance and also many matters of minor importance affecting the central management and control and that real control of them was being exercised by the Board of Alfred Booth & Co Ltd in London. Therefore, all subsidiaries physically located in Kenya were in fact UK tax residents.

Lord Radcliffe said that on the facts ([1960] AC at p. 364):

'… the seat of the 'central management and control' of the subsidiaries changed, and passed from Africa to the United Kingdom. This is a straightforward case of de facto control being actively exercised in the United Kingdom, while the local directors 'stood aside' from their directorial duties and never purported to function as a board of management.'

This case confirmed the view that, where the business of a subsidiary of a company is under the control of the directors of its holding company, it is the place at which that control is exercised and not the residency of the subsidiary's directors that determines the residence of the subsidiary.

Bullock *is a case where the foreign subsidiaries, incorporated in Kenya, were managed and controlled by the board of directors of the holding company situated in UK and the subsidiary companies was held to be resident in the UK and thus taxable in UK.*

Place of management and control Vs. Place of business operations of the company

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.

1. The same principle has been reconfirmed in ***R v Dimsey (1999) STC 846,*** where 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 strategic decisions of fundamental policy are made as opposed to the place where the day-to-day profit earning activities are undertaken.

The central allegation in those cases was that companies incorporated in Jersey and other tax heavens, and of which Mr Dimsey, a solicitor, was a Jersey resident director, were in fact centrally managed and controlled in the UK, such that the companies were liable to UK corporations' tax. The evidence accepted by the jury was that Mr Dimsey's client in the UK (Mr Allen), who was not an actual director, was a shadow director, and was in fact actually managing and controlling the companies in respect of board level decisions. The result for the companies was that they were resident in the UK rather than Jersey.

R v Dimsey *is a case of a shadow director residing in UK who was instructing the company director residing in Jersey how to act*[6]*.*

[6] *The shadow director principle is also provided in Cyprus companies' Law Cap 113, in section 192(9).*

2. In addition, in ***Trevor Smallwood Trust v HMRC [2010] EWCA Civ 778,*** the Court of Appeal confirmed that a Mauritian trust that has been arranged and orchestrated in the UK was ultimately controlled and managed in the UK.

This was a case about the residence of a trust, not about a company and although there are important differences between a Trust and a Company, the concept of management and control is applicable in the same way.

The facts

Mr. Smallwood was the settlor and beneficiary of two trusts established for himself and his family in 1989 and he also had the power to appoint trustees. The trusts were based in Jersey and held shares in companies and the shares grew in value. There would potentially be a capital gain of over £6million on their disposal. The taxpayer appointed trustees in Mauritius. He relied on the double tax convention between the UK and Mauritius which has the effect of transferring the right to tax the gain in Mauritius, where the trustees were based at the time of the disposal of the shares' property of the trust. The trustees sold the shares and considerable profit was made. Shortly afterwards the taxpayer and his wife, who were based in the UK, both became trustees. HMRC raised an assessment on the trust for £2.7million. The taxpayer appealed.

The issue

Whether the gain which arose on the disposal of the shares done by the trustees in Mauritius, was exempt from capital gains tax in the United Kingdom.

The Decision of the commissioners

The commissioners found for HMRC: the place of effective management of the trust had been where Mr Smallwood was located, i.e., in UK. He directed and orchestrated the trust from UK. So, the income was taxable in UK.

Held on Appeal

The Court of Appeal confirmed the commissioner's findings that the trust was managed from UK so the assessment and taxation imposed was correct.

Trevor Smallwood Trust *is a case where the foreign trustee who conducted the trust business abroad, was in effect following the instructions of the settlor and beneficiary resident in UK. It was held that the taxation imposed on the settlor and beneficiary for the overseas activity was correct.*

Cyprus hypothetical case based on the facts of R v Dimsey and **Trevor Smallwood Trust**

If we transform the facts of **R v Dimsey** and **Trevor Smallwood Trust** to a Cypriot case, such as a Cypriot nominee director is appointed in a Cyprus company and it follows the instructions of the foreign shareholder of the company, such a company will be considered as managed and controlled from the place of residency of the instructing shareholder wherever this will be.

It is for this reason that currently, a lot of requests are addressed to Cyprus income tax authorities for Cyprus companies from foreign income tax authorities trying to discover whether the director is simply a nominee following the instructions of the foreign shareholder and in effect the tax residency of the company is moved from Cyprus abroad.

Such a company might be held liable to foreign taxation by operation of foreign laws as it might be considered to be resident in the place of residency of the instructing shareholder.

Future important change

In December 2021, the European Commission proposed that member states adopt the Third Anti-Tax Avoidance Directive known as "ATAD 3". The proposed Directive, as will be discussed further below, aims to prevent the use of shell companies for obtaining tax advantages and in the cases where the minimum pre-requisites of substantial residence in the Member State country are not present, (substance requirements), unfavourable tax consequences for the shell company are provided.

In conclusion, *the residency of a company is identified by determining where the central management and control is exercised. If the central management and control of a company is exercised in Cyprus then such a company, anywhere registered, is a tax resident of Cyprus.*

A Cyprus registered company with management and control outside Cyprus, as from 31.12.2022, is resident of Cyprus, irrespectively of where the management and control is exercised, unless it is a tax resident in another country in which case the company will be considered, for Cyprus law purposes, as resident in that other country.

In answering to the question, *in which place is a company deemed to be resident under the management and control test, the answer is that it is located in the place where the central*

management and control of its business is exercised and that is where the person or persons issuing its strategic decisions are located.

C. Which are the substance requirements that connect the exercise of the central management and control with a particular place?

The question as to which are the substance requirements that connect the exercise of the central management and control with a particular place **is a question of fact.**

We need to identify the facts that connect the exercise of the central management and control with a particular place.

Indicatively these are:

Location of Board meetings

It has been decided and stressed repeatedly in court cases that, **the place where the directors meet** in order to reach their strategic 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.

If the intention is to have a Cyprus resident company, avoiding any possible allegations that the company is resident abroad, then all board meetings should be held in Cyprus.

It is best practice therefore, to avoid a moving / transit board, since that makes it harder to demonstrate clear residence in any one location and might create issues of multiple residencies.

In effect, the place where the directors meet for their board meetings, deciding on strategic company's issues such as its policy, finance and related fundamental 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 resident at that location.

Art. 191A of the Companies Law Cap 113

As to this issue, it is worth noting the provisions of Art. 191A of the Companies Law Cap 113, which provides the following:

> ***"Participation in the directors meeting by electronic means***
> ***191A.*** *Unless expressly provided for in the company's articles of association, a meeting of the directors may be held by telephone or by any other means by which persons participating in it can simultaneously listen and be heard by all the other persons participating in it and the persons participating by in this way, for the purposes of establishing a quorum and for any other purpose, and the people participating in this way are counted as present at the board meeting:*
>
> *Provided that,* ***in the above case, the meeting of the directors is considered to have taken place where the person who kept the minutes of the relevant meeting of the directors is located".***

In effect, in case the board meetings are held through electronic means such as the Zoom platform, once the directors are located in various jurisdictions, the place of the meeting is considered to be the place of the person who kept the minutes of the relevant meeting of the directors.

In such a case the decision is considered as taken in the place where the minutes are kept.

Directors' permanent residence

The residence of the directors is closely connected to the place where the 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 are taking place in Cyprus and the management and control is exercised in Cyprus.

Appointment of directors residing outside Cyprus

If a Cyprus company resident is desired, the appointment of directors residing outside Cyprus, although possible, must be avoided. In case 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 to avoid adverse possible tax effects.

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

The fact that as from 31.12.2022 such a Cyprus company, from Cyprus law perspective, will be considered resident of Cyprus unless it is tax resident in another country, does not save the situation. The foreign country might claim that the company is resident in its jurisdiction and impose taxation, despite the implication of the Cyprus law.

In such a case we may have **dual residency issues** which will be explained further below under chapter, *"IX. 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.

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 foreign country where the income of the Cyprus 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 Romania and the income is generated in or from Romania, it seems not proper to appoint as directors of the Cyprus resident company, persons residing, living and working in Romania.

In case of such appointments, one leaves room for arguments, that the company or its real beneficial shareholder are taxable in Romania, as the effective management of the company is situated in Romania.

Also, an argument which can be put forward is that the company is not resident of Cyprus as its management and control might be alleged not to be exercised in Cyprus.

Again, in such cases, there is possibility for dual residency issues as discussed in chapter "*IX. 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 resident of Cyprus, will be a suitable director.

Appointment of directors residing in Cyprus, as directors in foreign / overseas companies

The same factors that will strengthen the position of a Cyprus company to be considered as managed and controlled in Cyprus, will be also considered to examine whether a foreign / overseas registered company is managed and controlled from Cyprus.

In this respect, it is not advisable to appoint directors residing in Cyprus as directors in companies registered in tax haven countries like BVI, Panama, Bahamas, Nevis, Cayman Islands, etc. In such a case, there might be a real risk that these companies may be considered to be managed and controlled in Cyprus, and consequently taxable in Cyprus, as a consequence of the applicability of the management and control test.

If such a claim is put forward by the Inland Revenue, BVI, Panama, Bahamas, Nevis, Cayman Islands, etc., companies, in order to avoid taxation in Cyprus, will need to prove that the Cypriot director acts only on instructions of the real owners or other advisors situated abroad transferring the management and control abroad, there where the shareholders or other advisors, reside.

In effect, the director who follows blindly the instructions of the shareholders, or other advisors, is a mere cipher, simply stamping documents and doing what he is told, not managing and controlling the company. Relevant evidence and confidential information will need to be disclosed to the Inland Revenue to prove the director's symbolic status.

Risk of permanent settlement in Cyprus

What must be noted in this case is that the director appointed to the foreign company, being resident of Cyprus, does not have authorization to enter into contracts in the name of the company, because this company can be considered to have a permanent

establishment in Cyprus in relation to any activities that this person undertakes for the business with the result that these activities are also taxable in Cyprus.

There is no need though 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 principle.

Frequency of Board meetings

Board meetings should be sufficiently frequent to enable the directors to exercise control over the strategic affairs of the company. Depending on the level of activity in the company, a minimum of six board meetings in each year with each board meeting taking no more than two months after the last one.

Administrative Office

A 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 the properly recorded board minutes must be kept. The company secretary should be resident of Cyprus and accounting records, corporate records and other significant original documents should be maintained.

Employees

Employees must be employed and paid reasonable salaries according to 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 also in Cyprus and managed by the local directors or employees.

Accounting records

Maintenance of accounting records should be in Cyprus.

In conclusion, as to the factors which will support the argument that the management and control is exercised in Cyprus in order to have a resident company in a particular place, the directors must meet, manage and control the affairs of the company in 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 to be present in Cyprus and avoid the negative surrounding factual circumstances as explained above. The provisions of Art. 191A discussed above must be born in mind.

Any appointments in a Cyprus company of directors not residents of Cyprus, raise serious risks as the company might be considered as resident in another jurisdiction with adverse tax consequences.

The provision of the law that such company without being officially tax resident in another jurisdiction, as from 31.12.2022 will be considered as tax resident of Cyprus, does not save the situation. The foreign jurisdiction where the directors reside and decide, might claim the residency for such company and claim to impose taxation for its activities.

The appointment of Cypriot resident directors in foreign companies, should be avoided because the company may be considered to be managed and controlled from Cyprus and in effect resident in Cyprus with adverse tax consequences.

D. How the management and control must be exercised in order for a company to be considered as resident in the place where the management and control is exercised?

This is the most crucial and most important criterion in order for a company to be considered as resident in the place where the management and control is exercised.

1. Real exercise of management and control by the board of directors - Decision process – effective consideration and knowledge of the facts

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 strategic 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, independently, without any external influence, think and decide on all policy matters, strategies, financing, declaring of dividends, marketing and all other relevant strategic key 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 or the board of directors. **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.

The directors MUST decide the policy and crucial decisions as to the company and NEVER be directed by external bodies. They must think and decide on the "*key strategic mattes*" of the company based on sufficient knowledge they must have in order to decide accordingly.

In simple words, the directors must take the strategic decisions of the company.

Key Strategic company matters - decisions

What are regarded as "key strategic matters" of the company depends on the nature of the company in question but might include, inter alia, decisions relating to:

- The acquisition or disposal of assets;
- Capital expenditure;
- Budgets approval;
- Operational decisions;

- Financial decisions such as granting or receiving loans;
- Decisions on the engagement or dismissal of directors and other senior personnel;
- Concluding and execution of contracts;
- Mergers and acquisitions;
- Expanding or changing the line of business;
- Appointment of consultants; and,
- Nominating accountants and auditors.

If the directors 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 applying their thinking 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/her 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 might be.

Professional Directors

A board must consist of directors with sufficient knowledge, experience, and expertise to manage the strategic affairs of the company. Directors must be able to consider genuinely the company's affairs and reach a reasonable, commercial decision, justified by the activities of the company and their expertise and knowledge. The directors should be appropriately qualified and experienced in the relevant sector to enable them to consider (rather than merely follow) proposals and reach a reasonable conclusion. They must be paid reasonable fee applicable to the market for such positions. Nominee directors should not be used.

Records and administrative matters

Full and accurate minutes of each board meeting should be taken, mentioning the below:

- The time and place of the meeting and who was present;
- What was resolved and the reasons for such resolution should be recorded in as much detail as possible. Discussions in board meetings should be recorded in detail. Any views or debates or agreements or disagreements are important to be recorded in detail as these are important evidence that the directors applied their minds to the relevant questions. Establishing a pattern of decision making is also important. The key point is that these minutes are likely to be more comprehensive than is perhaps the norm.

  Copies of notices, agendas and other documentation circulated to directors should be kept at the company's office. Minutes should be prepared as soon as possible, be approved and signed.

  Decisions of the board should not be made by unanimous written resolutions circulated among the board members as these can suggest "rubber stamping" procedures.

- The provisions of Art. 191A discussed above must be born always in mind.

Directors' remuneration

Directors should be paid market price directorship fees and not nominal fees as nominee directors usually receive.

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.

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.

Appointment of Nominee directors

Nominee directors, non-professionals, appearing in hundreds of companies should NEVER be used. If such type of directors is used it is a clear indication that such directors do not think and decide the affairs of the company but simply "rubber stamp" the decisions directed to them by the shareholders or other advisors.
In such a case the location of the management and control is moved to the place of residency of the shareholder or the advisors.

Delegation of powers

No key, strategic decisions should be made other than by a formal meeting of the directors.

Where discretionary powers have been delegated to any person (including a director), that power should only relate to day-to-day affairs and should not include the power to make key strategic decisions.

Parent Company directing the decisions of its subsidiary

There is a risk that a parent company, may exert significant influence over a subsidiary. The exercise of powers available to a shareholder in general meetings (appointments to the board, changes to financial structure etc.) do not on their own affect the residence of the subsidiary. It is, however, important to avoid the parent/holding being deemed to have usurped the functions of the subsidiary board, and thereby to exercise central management and control over the subsidiary's business.

The degree of autonomy of the subsidiary board is important in conducting the business of the company, including the extent to which the directors take decisions on their own

authority as to investments, production, marketing and procurement, without reference to the parent/holding. It is the management and control of the subsidiary's business, rather than the location of shareholder control, that determines residence.

Relevant is the case discussed already ***Bullock v Unit Construction Co Ltd (1959) 38 TC 712*** and the cases to be discussed further below, ***Laerstate BV v HMRC [2009] UKFTT 209,*** and **HMRC v Development Securities plc and others *[2020] EWCA Civ 1705.***

Cyprus companies with holding companies registered in UK

A lot of Cyprus resident companies have as their holding companies, companies registered in UK. Usually for prestige reasons. In such a case, extra attention must be paid as if the holding company with its board of directors residing in UK, controls and directs the business of the Cyprus subsidiary, then the Cyprus subsidiary might be considered from UK law perspective, as resident of UK and relevant taxation to be imposed on its income.

Advisers / consultants

Similar questions of influence can arise in relation to advisers/consultants, or other officers of the company giving instructions to directors residing overseas.

In the 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 resident of UK instead of India and then taxable in UK.

The case, ***Wood v Holden, 2005 BTC 253 - High Court 18.4.2005***, the facts of which are analysed further below, clearly directs to the avoidance of such appointments.

Similar considerations apply to the presence of observers or other non-directors at board meetings. Inviting a particular person to be present at the board meetings on a particular subject on an ad hoc basis does not present concerns. However, where an individual is a regular attendee of meetings covering a range of subjects, Income Tax may argue that he/she is in fact taking part in the central management and control of

the company and, if that person is based in any foreign country, this may point to the decisions being taken outside Cyprus with possible risks.

Rubber-stamping Decisions

In all cases where proposals, suggestions or other advice is being submitted to the company's board by a person or entity who is resident or otherwise present abroad, the directors should examine them critically and adhere to a proper decision-making process. It is important that the board meeting at which such proposals etc. are considered cannot be seen as a sham or as merely "rubber stamping" decisions which have been taken not in Cyprus. The independence and expertise of the board, together with the manner of communication between the parties, is crucial here.

Issuing of general powers of attorney

General powers of attorney should never be granted to non – residents 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.

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, such as 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 authorities 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.

Consultants' involvement in the affairs of the Company

The various advisors and shareholders who would like a particular company to be resident of Cyprus, must be very careful in the way they draft their opinions / 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[7].

The recent court cases that direct the way the management and control should be exercised

We shall examine in more depth three court cases as they play an important role in the development of the principle of central management and control and represent its current version.

1. Wood v Holden, 2005 BTC 253 - High Court 18.4.2005

This is a case where consultants (PWC) resident in UK were advising directors of a Dutch company resident in holland.

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.

[7] *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; New Zealand Forest Products NV v Commissioner of Inland Revenue [1995] 17 NZTC 12,073}; Wood v Holden, 2005 BTC 253 - High Court 18.4.2005; Laerstate BV v HMRC [2009] UKFTT 209; and,* HMRC v Development Securities plc and others *[2020] EWCA Civ 1705.*

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 reaffirmed the above principles as to the management and control.

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".*

The above court case on 26/01/2006 has been upheld by the court of Appeal **[Wood v Holden (HM Inspector of Taxes) 2006 BTC 208].**

*What **Wood v Holden** established is that once the board of directors applied their mind on the relevant issue that was sufficient not to disturb the place of central management and control. They followed a formalistic approach.*

2. Laerstate BV v HMRC [2009] UKFTT 209

This is a case where a UK parent company was instructing the board of directors of its subsidiary.

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 as decided in *Wood v Holden*.

In this case the First-tier Tax Tribunal found that a company incorporated in the Netherlands was centrally managed and controlled by its sole shareholder and director, in the UK. The existence of a dominant shareholder does not of itself determine the residency status of a company; it is still necessary to establish who exercises central management and control of the company and from where.

Central management and control require 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 said that:

> *"… there is no assumption that central management and control must be found where the directors meet.* ***It is entirely a question of fact where it is found.*** *Where a company is managed by its directors in board meetings it will normally be where the board meetings are held. If the management is carried out outside board meetings one needs to ask who is managing the company by making high level decisions and where, even where this is contrary to the company's constitution."*
>
> *"We do not consider that the mere physical acts of signing resolutions or documents suffice for actual management … What is needed is an effective decision as to whether or not the resolution should be passed and the documents signed or executed and such decisions require some minimum level of information.* ***The decisions must at least be informed decisions.*** *Merely going through the motions of passing or making resolutions and signing documents does not suffice."*

The court also went on to state that:

> *"There is nothing to prevent a majority shareholder indicating how the directors of the company should act. If they consider the wishes and act on them, it is still their decision."*

The question is whether the directors have the absolute minimum amount of information that a person would need in order to be able to make a decision at all on whether to agree to the shareholder's wishes or to decide not to sign the documentation.

In this case, that would have included information or advice on whether the price was sensible. There was no such information or advice given to the director.

As a consequence of the key decisions having been taken in the UK, ***Laerstate*** was held to be UK resident under domestic law.

It is not enough just to have the formal acts of a company documented as occurring outside the UK in order to maintain that it is not UK resident. It is essential that the directors are kept informed so that they can properly make their decisions (whether they accede to the shareholder's wishes or not).

Sufficient knowledge of the affairs of the company plays an important role in reaching an independent decision.

Laerstate BV v HMRC *abandoned the formalistic approach followed in* ***Wood v Holden*** *and followed a substantial approach as to how the board of directors must act in reaching the decisions in issue.*

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

This is a case where the UK parent company was directing the acts of the board of directors of the subsidiary in Jersey.

This case considered whether certain wholly-owned Jersey-incorporated subsidiaries of a UK property development and investment group were resident in the UK for corporation tax purposes. The Court of Appeal (CA) has overturned the decision of the Upper Tribunal (UT) and restored the decision of the First-tier Tribunal (FTT) that the Jersey-incorporated companies were centrally managed and controlled (and therefore tax resident) in the UK at the material times. They were acting under instructions from the UK, and were thus UK resident.

In ***Wood v Holden*** 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, {***HMRC v Development Securities plc and others}***, 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 director 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 the conclusion that the central management and control was conducted by the parent and therefore in the UK and not in Jersey where the subsidiaries were 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 Court of Appeal'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.*

This case has shown that,

1. Decisions by subsidiaries should be taken at proper board meetings and that,
2. Such board meetings properly consider the merits of any decisions to be taken as well as the legality of those steps. Particular care should be taken that, in implementing proposals given by a parent company, directors do not treat such proposals as instructions and that they consider carefully the commercial context for the decision.

In ***Wood v Holden*** a formalistic approach was adopted as to what was constituting a proper decision taken by the board of directors of the subsidiary. It was enough that the directors applied their mind and decided whether the decision was within the interest of the company and lawful.

In ***HMRC v Development Securities plc*** a clear substantial approach was adopted, following in effect the approach of ***Laerstate BV v HMRC.*** The board of directors must substantially be

involved in the taking of the decision, knowing the facts and the surrounding environment to reach such decision. **The question is simple: Did they take the decision or this was directed to them?**

In conclusion, in order to have a resident company in the place where the board of directors meets and decides, the directors must always genuinely meet in that place, apply their mind, think and decide on all fundamental strategic issues and policy decisions of the company with regard to its best interest using their own experience, knowledge and judgement. They must be well 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. Following other root, might move the tax residency of the company in the place where the instructing person is situated, outside the place of residence of the directors, with possible adverse tax consequences.

VIII. TAX RESIDENCY OF CYPRUS COMPANIES AND SUBSTANCE REQUIREMENTS UNDER THE PROPOSED THIRD ANTI-TAX AVOIDANCE DIRECTIVE, KNOWN AS "ATAD 3"

The European Commission on the 22nd of December 2021 published a legislative proposal for a Directive to be issued, named, the Third Anti-Tax Avoidance Directive, known as "ATAD 3", which sets forth rules to prevent the misuse of shell companies for tax purposes.

The Proposed Directive should have been adopted early 2022 by the European Union Council and be implemented by the Member States by the 30th of June 2023 at the latest. The provisions should subsequently be effective in all Member States as from the 1st of January 2024.

The Directive lays down a uniform test that will help Member States to identify undertakings that are engaged in an economic activity, but which do not have minimal substance and are misused for the purpose of obtaining tax advantages.

Once these minimum substance requirements are not met, the undertaking will be classified as "shell entity" and will sustain certain adverse tax consequences.

In order to examine if an entity meets the minimum substance requirements, so that not to be characterised as "shell entity", the following information must be provided:

(a) Whether the entity has an office space, (owned or rented), through which it exercises its activities;
(b) Whether the entity has an active EU bank account; and
(c) Whether at least one of its directors is an in-house director properly qualified to handle the business of the undertaking or the majority of its full - time employees reside in the same country as the undertaking.

ATAD 3 with its requirement as to particular substance conditions in order to avoid the characterization of the company as a shell company, officially gives a way out to the substance issue which should have been present in identifying the place of management and control of a company.

In effect, once the substance requirements of ATAD 3 are met, in the case where the in-house qualified director has been appointed, and who is indeed managing the affairs of the company from Cyprus, the management and control test identifying the tax residency of a company is strengthen and supports the allegation that such a company is managed and controlled from the place where the director is resident and decides the affairs of the company.

The substance requirement as per ATAD 3 is also met if the majority of the full-time employees are resident for tax purposes in the Member State of the undertaking.

This condition of substance though, cannot be connected with the management and control of the company which is a notion related to the directors' powers or related to the powers a person managing the company. If the substance requirements as per ATAD 3 are met only by the majority of the employees stationed in Cyprus, in the absence of the directors' involvement and the capacity residing and deciding from Cyprus, then such a company might not be managed and controlled from Cyprus and in this respect, if it will be considered as resident in another jurisdiction, where it has been also considered as tax resident of that jurisdiction then the Directive will not be applicable to it.

So, in the case where the company has the majority of its employees stationed in Cyprus, but the management and control is outside Cyprus, the directors or third persons meet and decide abroad, such a Cyprus company despite the application of incorporation rule, if is a tax resident of the jurisdiction where the management and control is exercised, the proposed Directive, ATAD 3, does not apply, despite the fact that the company meets the substance requirements.

ATAD 3 applies only tax resident companies of Member States.

If the company is a Cyprus registered company, as from 31/12/2022, irrespectively of the fact that the management and control will be exercised abroad, and provided that such company does not have a tax residency in any country abroad, it will be considered, by reason of its registration in Cyprus, as tax resident of Cyprus as well.

Reservations put forward

After the initial draft of the Proposed Directive which has been published by the European Commission on the 22nd of December 2021, doubts arose as to whether the Proposed Directive would succeed through the EU legislative process – requiring the unanimous approval of all EU Member States for adoption. Serious concerns were expressed by various bodies and authorities related to the legality of the measure, its effectiveness and its necessity.

Also, the current presidency of the European Council, Sweden, has circulated a compromise text on the Proposed Directive, suggesting various extensive changes to be effected and asked the opinion of all delegations on this draft. Various proposals have been put forward. It remains to be seen the final outcome and what recommendations will be put forward amending the current version of the initial draft.

European union parliament recommended changes

The EU Parliament on the 17th of January 2023, approved a revised version of the Proposed Directive and suggested several amendments to be made on the initial draft.

The EU Parliament in its recommendations acknowledges the possible legitimate setting up of undertakings with minimal substance and according to its recommendations, this possibility must be observed, but on the other hand it urges to adopt stronger minimum substance requirements to be effective in combating tax fraud, evasion and aggressive tax planning through the use of shell entities.

It should be noted that these recommendations are not binding on the European Commission/Council but they will be taken into consideration. Some of the recommendations put forward make the Proposed Directive stricter and some of them adopt a more relaxed approach.

Distinction between management and control principle and substance conditions as per ATAD 3

In view of the above analysis, we have to distinguish the following:

- the principle of management and control which will identify whether a company is resident of Cyprus, being a principle related to the directors' and third persons powers to decide the policy issues and business of the company, and

- the substance requirements as per ATAD 3 which substance requirements will identify whether the company is a shell one or not.

The management and control principle is related to the residency of companies while the ATAD 3 Directive and the substance requirements, identify whether a company is a shell company or not.

ATAD 3 applies only once we have a tax resident company in a Member State. In effect, in order for its provisions to apply, the management and control test which will identify if a company is tax resident of Cyprus, must have already been examined and concluded that the company is managed and controlled in Cyprus so that, this inference will generate the provisions of ATAD 3.

Detailed analysis of ATAD 3 is given in our article, *"The Third Anti-Tax Avoidance Directive (ATAD 3) The EU Parliament Recommendations The End of Shell Companies"* published March 2023, and can be found here

IX. 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 of the two contracting states. In our case, the Cyprus company, must be 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 Organisation for Economic Co-operation and Development - OECD, model treaty which provides the following:

> ***"RESIDENT***
> *For the purposes 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 a similar nature, and also includes that State and 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 therein".*

Further, 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 OECD 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.

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 laws of contracting States, Cyprus law in our case, 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 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 only one country.

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 considered in many court cases[8].

The authorities clarify and confirm that there where there is a fragmentation of the 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

[8] *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.*

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 resident Cyprus company, for matters of management, domicile or other similar issues, is **also** resident of Russia or UK or in that other country and not only in Cyprus. Because of this conclusion, they seek to impose taxation on the Cyprus resident company for a particular operation.

In case of such a dual residency problem, (Cyprus also alleges that the company is a 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 might 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 ***Wood v Holden*** mentioned above, handles also the issue as to the effective management test, due to the fact that a 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.

X. THE CYPRUS INLAND REVENUE APPROACH IN IMPLEMENTING THE NOTION OF MANAGEMENT AND CONTROL

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

1. Cyprus companies under investigation by Cyprus Inland Revenue

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 after 31/12/2022, due to the incorporation rule in place, 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 practice, still despite the incorporation rule in place, 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 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 that the management and control is exercised in / from Cyprus.

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

As from 31.12.2022 all Cyprus companies, except in the case they are tax residents in another country, are considered as residents of Cyprus by virtue of their registration and the Inland Revenue approach must be amended accordingly.

With the application of ATAD 3, obviously the above unilateral declaration will not be enough as the companies will have to declare whether they meet the minimum conditions of substance and if they do not, then the tax authority will either not issue the tax residence certification or if it issues it, it will make relevant note that the company is a shell company.

2. Foreign registered Companies under investigation by Cyprus Inland Revenue

The Cyprus Inland Revenue, if a case arise, might claim that a foreign registered company is resident of Cyprus if its management and control is exercised in Cyprus.

The burden of establishing that a foreign company is Cyprus resident, and liable to tax by virtue of its Cyprus residency, lies with the Cyprus Inland Revenue authority.

In order for the Cyprus Inland Revenue to claim that a company is within the Cyprus tax net, they will need to argue that:

a. The directors of that foreign company exercise management and control in Cyprus; or
b. Someone other than the appointed directors, such as consultants, shareholders, or third parties, acting in effect as shadow directors, exercise management and control from within Cyprus over the business of the foreign company; or
c. It has a permanent establishment in Cyprus.

In these cases, the Cyprus Inland Revenue, is expected to follow the above steps in order to identify the place of central management and control of such companies, and if found to be in Cyprus, local taxation laws will apply as the foreign coamony will be considered as resident of Cyprus.

Important note

A lot of Cyprus based service providers, for various foreign companies they manage, i.e., BVI, Bahamas, Belize, Seychelles, Cayman Island, etc., for their convenience, appoint as directors Cyprus resident persons. This is very risky as the Inland Revenue may institute an investigation whether the particular foreign company is tax resident of Cyprus based on the management and control principle having in its board local resident Cypriot directors managing its affairs from Cyprus.

3. Cyprus companies under investigation by foreign Inland Revenue departments

Tax residency problems though, might arise for Cyprus tax resident companies in foreign jurisdictions.

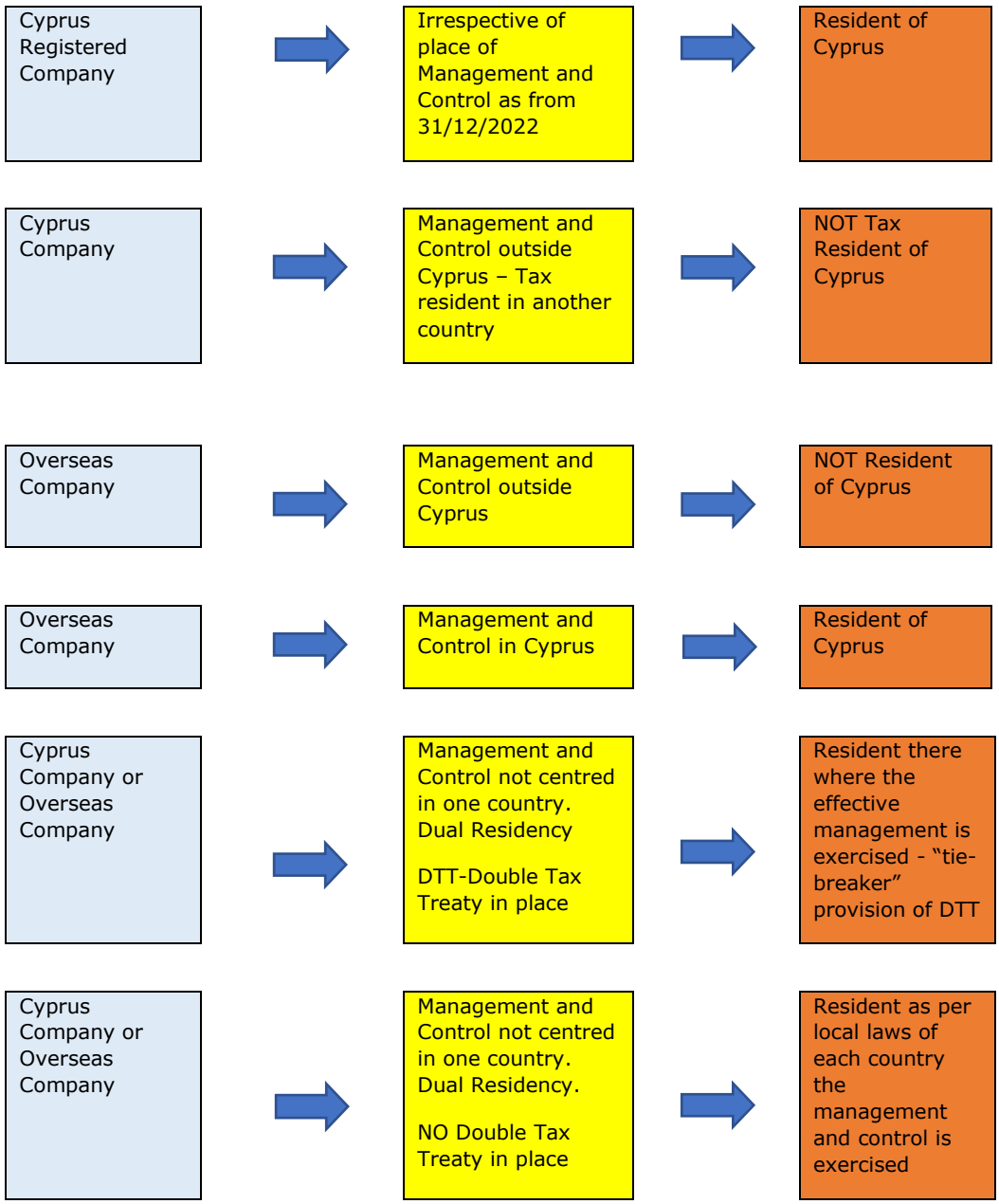
A foreign country, if a Cyprus company is managed and controlled from its territory, might allege that it is resident in its jurisdiction, and may claim to impose taxation to it.

In such a case, in order to avoid and be able to defend such allegation, the above factors strengthening the tax residency of a Cyprus company as being in Cyprus must be met.
In case a Double Tax Treaty between Cyprus and the claiming of residency country is in place, the effective management rule, "tie-breaker" provision, pointing to Cyprus must be invoked to defend such allegation.

If there is no Double Tax Treaty in place, then the local laws of each country will be invoked to solve the issue. A conflict of laws might appear if the two countries do not coincide on the result.

XI. THE MANAGEMENT AND CONTROL TEST IN ONE PAGE

What has been discussed in this publication is summarized below in the following diagram:



XII. FINAL CONCLUSIONS

As per above analysis, a company:

- If it is incorporated in Cyprus, it is resident of Cyprus, the incorporation rule applies, and it is subject to Cyprus taxation;

- If it is incorporated in Cyprus with management and control outside Cyprus, it is still resident of Cyprus unless it is tax resident in any other country;

- If it is incorporated outside Cyprus but its management and control is in Cyprus, then it is resident of Cyprus, subject to Cyprus taxation.

- 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 and negative factors explained above;

- The directors, at the board meetings held in Cyprus, give genuine consideration as to the affairs and business of the company and decide its policy, structural and main issues 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; Knowledge of the business of the company and the business factual situation is of paramount importance.

- 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.

XIII. 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.

Updated April 2023

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