

# unique

The newsletter of aQUIVER

## editorial



Doing a master's degree in finance has taught me a thing or two. Two actually: The first one is that there is always a set of double doors that separates the front office from the back office of an investment bank; courtesy of the infinite wisdom of Professor David Barr. The second one (courtesy of the same gentleman) is that an inverted yield curve signifies the onset of a recession.

The times we live in have been utterly kind to us. We have been fortunate enough to have acquired an unsurpassed knowledge of virology, pathology and immunology; two years of covid-19 have done the trick. Words like antigen, epidemiology, polymerase chain reaction (or, PCR) have now become our bread and butter. Only recently we have also been acquainted with the essentials of geopolitics, diplomacy and the art of war; that can be attributed to the situation in Ukraine. In between, the rising prices in energy, food, commodities have made every Tom, Dick and Harry an expert in the fundamentals of economics. Stagflation is one of them.

What actually is stagflation? The term, a combination of the words “**stagnation**” and “**inflation**”, is used to describe a period of (a) recession (b) rising inflation and (c) increased unemployment.

Let's have a look at recession first. Is one looming? The answer is “yes”, if one is to take the words of Professor Barr at face value, given that the U.S. Treasury yield curve inverted on 26 March 2022 for the first time since 2019. This was the result of investor reaction to the aggressive increase in the interest rates by the Federal Reserve, the latter attempting to reduce inflation from the record levels it has reached for over 40 years. In all but one instances, the inversion of the US yield curve has signalled the onset of recession in the next 6 to 24 months. I guess that this aberration was the exception that defines the rule.

What about rising inflation? No question that we are facing one. In February, the annual inflation in the US was just a notch short of 8% and in the Eurozone it exceeded 6%. Not that one needs statistics to verify the obvious; that the cost of living is rising sharply and the only way to curb it is to lift the interest rates, making it more costly for consumers to spend. However, this is a monetary policy that ultimately exacerbates recession, leading to a vicious circle which is akin to trying to treat a patient who suffers from both high fever and hypothermia.

I have left unemployment for last, purely because I am ambivalent to whether we are facing one or not. We live in times when lorry drivers in the UK were in short supply (in the tens of thousands of them) and they were offered exorbitant salaries and sign-on bonuses. We live in times when the prices of Swiss watches rose exponentially simply because the leading haute horology companies could not recruit or retain a sufficient number of watchmakers. And of course, the very latest, we live in times where the trend for “flexible working” and “four-day week” is gaining momentum like never before. In my simplistic mind, these are not hallmarks of rising unemployment; the very contrary.

All in all, from a technical perspective, the current economic climate may not qualify for stagflation. What we are most certainly facing however is an extremely dire situation, whereby the economy is found between a rock and a hard place and the governments will have to decide which one to tackle first; recession or rising inflation. As Professor David Miles (that's another professor, lecturing at the same finance course) taught us in September 2001: “These are difficult times. But then again, economists always say these are difficult times”. I guess I learnt three things after all.

Have a pleasant reading

Pericles

ISSUE 11 MAR 2022

## what's on this edition?

### PAGE 2

New double tax treaties for Cyprus

### PAGE 3

European Union's latest Directive targets 'shell' companies

### PAGE 4

Les Misérables

# New double tax treaties for Cyprus

## Cyprus - Germany double tax treaty

On 2 February 2022, the Tax Department of Cyprus issued Circular 2/2022, confirming that the legal procedures for the entry into force of the Cyprus – Germany Double Tax Treaty Protocol have been completed in both jurisdictions.

The protocol was signed on 19 February 2021, entered into force on 8 December 2021 and has an effective date of 1 January 2022.

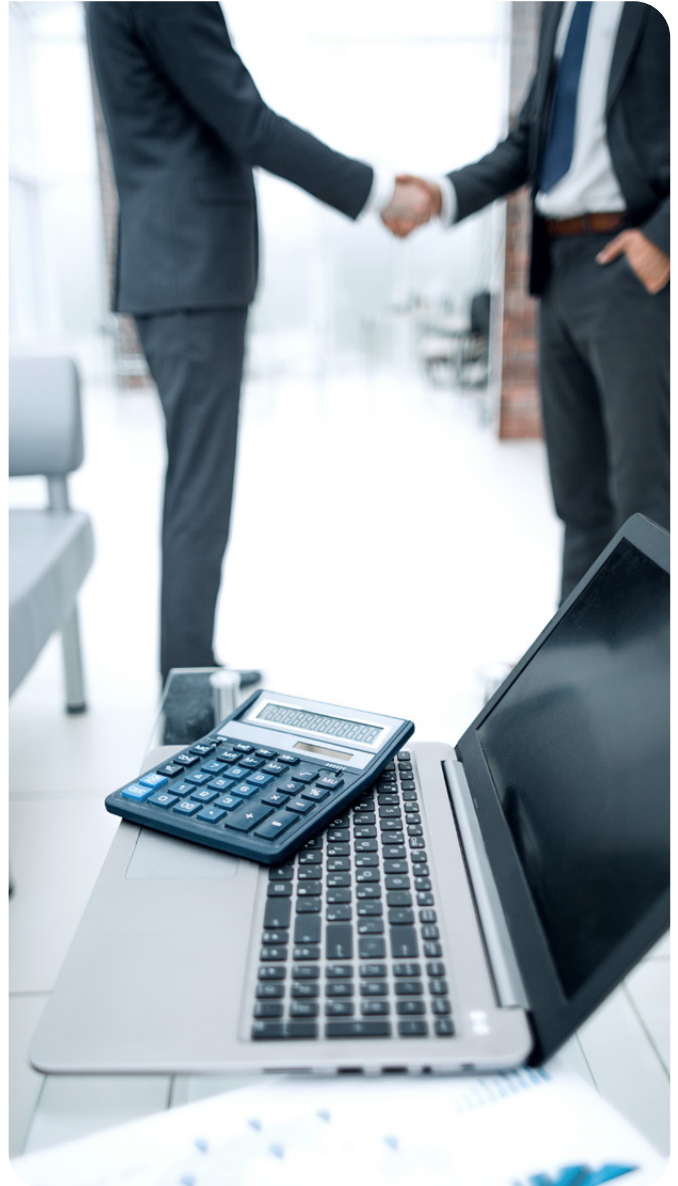
The main changes to the double tax treaty between the two countries which are introduced by the protocol is the introduction of the Base Erosion and Profit Shifting (“BEPS”) minimum standards and amendments to Article 7 “Business Profits” in line with the OECD Model Tax Convention (2017).

## Cyprus - Switzerland double tax treaty

On 3 February 2022, the Tax Department of Cyprus issued Circular 3/2022, confirming that the legal procedures for the entry into force of the Cyprus – Switzerland Double Tax Treaty Protocol have been completed in both jurisdictions.

The protocol was signed on 20 July 2020, entered into force on 3 November 2021 (with certain provisions having effect on the same day) and the remaining having an effective date of 1 January 2022.

Similar to the instance with Germany, the main amendments to **the** double tax treaty between Cyprus and Switzerland which are introduced by the protocol is the introduction of the BEPS minimum standards with an effective date of 1 January 2022 and amendments to Article 7 (“Business Profits”) and Article 9 (“Associated Enterprises”) with an effective date of 3 November 2021.



# European Union's latest Directive targets 'shell' companies

The European Commission published its draft Directive outlining the rules to prevent the abuse of the so-called 'shell' entities' and amending Directive 2011/16/EU. This proposal was originally announced in May 2021 and was subsequently put out to consultation amongst professional bodies. It is now taking its final shape and form.

## Shell companies

Traditional bureaucratic wisdom dictates that certain businesses direct their income to entities registered in jurisdictions that have no or very low taxes; such entities have normally been called 'shell companies'. The introduction of this Directive is to target these companies and to dissuade them from doing so.

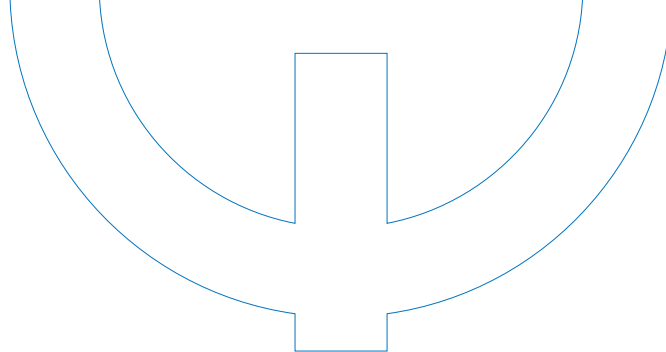
## Gateways and substance indicators

The draft Directive sets out a set of indicators that would be used to establish whether an entity is a shell one or not. The first one ("activities gateway") would be met if more than 75% of a company's total revenue does not come from trading activity or if more than 75% of its assets are real estate property or other private property of particularly high value. The second one ("cross-border gateway") would be met if a company receives most of its income through transactions linked to another jurisdiction or passes this income on to other companies situated abroad. The third one ("outsourcing gateway") would be reached if the company outsources day-to-day administration and decision-making on significant functions.

A company which crosses all three "gateways" will have to report information ("substance indicators") in its tax return pertinent to its physical premises, its bank accounts, the tax residency of its directors/employees and so on. If a company fails at one of these indicators, it will be presumed to be a 'shell'.

## Loss of benefits

A shell company will be denied a number of benefits such as access to bilateral tax treaties, eligibility for tax residence certificates, eligibility for tax benefits provided by



the Parent-Subsidiary Directive or the Interest and Royalties Directive and so on.

## Assistance between member states

The authorities of the EU member states will automatically exchange information on all entities in scope of the Directive. An EU member state will also have the prerogative to request another EU member state to conduct a tax audit of any entity that reports there and to communicate the outcome back to the requesting member state.

## Exemptions

A number of companies would be exempted, including companies from the investment management industry, companies that employ more than five full-time members of staff to carry out income-generating activities and (naturally) companies that can demonstrate a genuine commercial or non-tax advantage from the use of a shell entity. One can easily deduce that the latter will be convoluted, unintuitive and subject to abuse.

## Timeline

The EC hopes the proposal will come into force on 1 January 2024, assuming it will be adopted by all EU member states first.

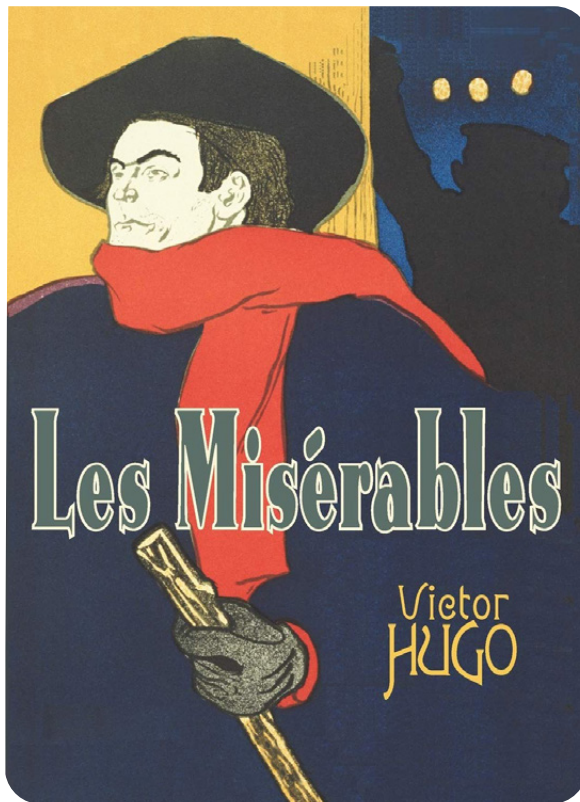
# Les Misérables

*I have to preface this article by stating that, had it not originated from a 100% trustworthy source, I would not have believed it myself.*

"Les Misérables" is an 1862 novel by Victor Hugo that famously narrates the story of Jean Valjean, a pauper who ended up spending 20 years in prison for stealing one loaf of bread. One could write this off as a pure work of fiction, owing to the sheer disproportionality between the initial crime and the eventual and accumulated penalty. One could dismiss it as being characteristic of the nineteenth century, a time where lawfulness and common sense were at odds with other. One could indeed.

A friend of mine was serving on the board of directors of a private company. A fraudster hijacked the bank credentials of one of the company's directors, forged his signature and communicated to the bank instructions via email, instructing it to make a payment of €850,000 to an EU bank; in the European Union that is. The EU bank gladly received the funds and then, presumably upon the same fraudster's instructions, paid them out to an account held in an obscure part of the world, making tracing or recall of the funds virtually impossible. Yes, that is eight hundred and fifty thousand Euros. Nearly one million US dollars. Vanished into thin air and all through the EU banking system. The EU bank that hosted the receiving account, an account that benefited from the criminal proceeds (forgery and theft to name only a couple of crimes) not only allowed the money to be both received and paid out but never ever compensated the injured party. Does this EU bank actually have a compliance department? Does this EU bank still have a banking licence? Does this country have a Central Bank for that matter?

Another friend of mine (and yes, I am fortunate to have enough of such friends, not many of whom are fortunate enough and they seem to run into trouble all the time) was summoned to a police station to testify on a case of a far higher importance. A bank account (to which she had no access) for a company (to which she was neither a director nor an owner nor a shareholder) has received the



grand sum of €10,000 from a foreign account that was being investigated for money laundering. The police approached for testimony the company secretary, the company director, the beneficial owner, the company administrator, even the messenger who made the filings with the Registry. Assuming that each of the above attended the police station and testified, one can easily work out that the cost of the police investigation would have escalated to be a multiple of the perceived/alleged offence. I wonder whether these resources could have been put to better use. Stating what is obvious, there was no money laundering in this instance. Thankfully, the authorities have eventually reached the same conclusion.

Victor Hugo famously stated in Les Misérables that "there is always more misery among the lower classes than there is humanity in the higher." I can't say whether this is right or wrong; could be either. What I am fairly certain is that there is far more sensitivity for perceived "money laundering" than there is for outright theft.