

Akrotiri and the horrible, terrible, no good, very bad tax loophole

Those who consider themselves seasoned travellers with substantial tax regulation expertise, prepare for an enlightening and surprising fiscal revelation.

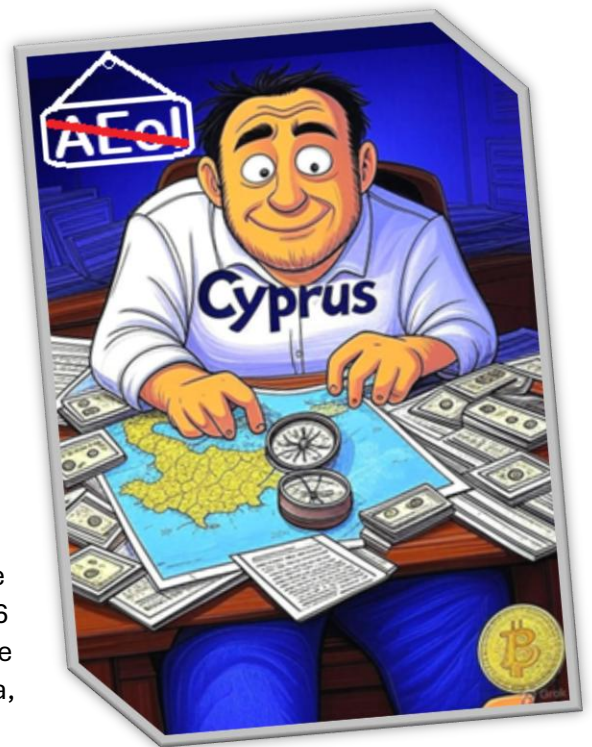
There is a place in the EU where confidentiality, wealth management and asset protection structures well-suited to be featured in the 60's *Twilight Zone*. Cue theme music...

The establishment of the least known British Overseas Territory: The Sovereign Air Bases

The US coerced the UK and France to abandon their presence in Egypt after Russia's nuclear sabre rattling during the 1956 the Suez crisis. The UK wanted to extend a military presence in the middle east to keep a pulse on Egypt, Jordan, Syria, Israel, Iran, Algeria etc.

Cyprus as a nearby UK colony was ideal to relocate to. After the Crimea war, the Ottoman Sultan in 1878 leased Cyprus to Brittain as a protectorate in return for an alliance against Russia. Things change, and the UK militarily occupied Cyprus when Turkey entered the Great War in 1914. Cyprus became a UK colony in the 1925. However, the Cypriots sought *enosis*¹ and engaged in a determined uprising, resulting in the deaths of hundreds of British soldiers. Britain eventually relented and granted independence to Cyprus in 1960.

However, a prime condition of the treaty establishing Cyprus was the UK retaining sovereignty over the military areas in Cyprus. These would be British Overseas Territories (BOTs), known as Sovereign Base Areas (SBA). The SBAs differ to the other 12 BOTs and the 3 Crown Dependencies which all have the right to self-determination i.e., can request independence. The SBAs on the other hand are permanent facilities, without possibility to ever turn them over to Cyprus. Also, the other BOTs are administered by a UK Governor and are overlooked by the UK Foreign Commonwealth Department Office (FCDO), a UK Parliamentary body whilst the SBA is instead governed by the most senior UK military officer, overlooked by the Ministry of Defence.



¹ The political union of Cyprus and Greece, as an aim or ideal of certain Greeks and Cypriots.

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The British Overseas Territory of Akrotiri and Dhekelia

The UK military regions are known as Sovereign Base Areas (SBAs) comprise 3% of Cyprus territory. They are run as military bases.

Akrotiri, adjacent Limassol, contains the security fenced Royal Air Force airport, and Dhekelia garrisons mostly Nepal Gurkhas to electronically monitor the region.

There are about 7,000 UK military personnel between the two bases. The SBAs are UK British Overseas Territory, and not Cyprus territory. The borders between Greek Cyprus and the SBAs are unmarked, except for minimal signage. Navigation maps demarcate the border line as UK and Cyprus. Travelling over the SBA borders, navigation maps switch to imperial distances and oddly, the UK time zone. Road signs the SBAs are clearly English e.g. Queen Elizabeth Road, Abbey Lane, humped Zebra crossing ahead, etc.

Living in the SBAs

Only UK military personnel can live within the securely fenced military facilities. Civilians and military live in the SBAs outside the fenced areas, with residences, fish and chip shops, pubs taverns, military surplus stores, gyms, supermarkets and businesses servicing the SBA military and civilians. 12,000 civilians are allowed to continue residing on the SBAs, but property development is prohibited except for minor refurbishment. Anyone from the EU can reside on the SBA civilian areas.



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Tax Enigma

- i. The SBAs are not considered UK or Cyprus territory.
 - ii. The SBAs have their own tax regime², which differ from both the UK and Cyprus.
 - iii. The SBAs collect tax customs and sales tax, but do not tax income.
 - iv. The civilians living on the SBAs who are Cypriot nationals, are considered Cyprus tax residents, despite not living in Cyprus.
 - v. Cyprus does not tax individuals who are not Cypriot nationals living on the SBAs³
 - vi. The UK military personnel, referred to as Crown Servants, despite not paying income tax⁴, remain UK tax residents⁵.
 - vii. **The tax residence exception of spouses of crown servants posted abroad**⁶
 - Partners of Crown servants posted overseas⁷: Partners of Crown servants posted overseas: There is no requirement for the partner of a Crown servant to be ordinarily resident in the United Kingdom.
 - This recognises that some posted Crown servants may form relationships while they are abroad with partners who do not have close or enduring ties to the United Kingdom.
- a) **Tax resident nowhere:** If a UK national spouse of a Crown Servant is not a Cyprus tax resident and not a UK tax resident, then the spouse is tax resident nowhere.
 - b) **Tax resident in the UK:** UK nationality spouses are UK tax resident if they pass the UK Statutory Residence Test⁸, e.g., spend a minimum number of days, or own property in the UK
 - c) **Tax resident in Cyprus:** The UK national spouse of a Crown Servant can be tax resident in Cyprus if they earn income in Cyprus, e.g., employed or establish a Cyprus company, or spend more than a certain number of days in Cyprus.

² Income Tax Ordinance 2003

https://www.sbaadministration.org/home/legislation/01_02_09_04_INCON/I/20180122_IncomeTax-Ordinance-2003.pdf

³ The Cyprus Ordinance 235 of 2017 clarifies that UK nationals resident in the Sovereign Base Areas (SBAs) of Cyprus are not subject to Cypriot income tax. The SBAs (Akrotiri and Dhekelia) are British Overseas Territories and not part of the Republic of Cyprus for tax purposes. UK nationals living in the SBAs are generally subject to UK tax laws, not Cypriot tax laws. This ordinance explicitly states that individuals resident in the SBAs (including UK nationals) are not considered tax residents of Cyprus. It prevents double taxation by confirming that such individuals are taxed only by the UK if they are UK resident, not Cyprus.

⁴ The following shall be exempt from tax - the emoluments payable from United Kingdom Government funds to members of Her Majesty's Forces and to persons occupying posts as public officials, as so classified by the Commissioner, in the service of the United Kingdom Government or the Administration in the Areas in respect of their offices under the United Kingdom Government or the Administration

⁵ HMRC: Tax for crown servants <https://www.gov.uk/guidance/tax-and-national-insurance-for-crown-servants-eu-employees-and-volunteer-development-workers-abroad>

⁶ TCTM02050 - Entitlement: Tax Residency and Income Tax Treatment of the spouse of a crown servant on posting abroad <https://community.hmrc.gov.uk/customerforums/pt/7b6b26f7-dd19-f011-9d48-002248008e2a>

⁷ <https://www.gov.uk/hmrc-internal-manuals/tax-credits-technical-manual/tctm02050>

⁸ SRT - The Residence and FIG regime manual RFIG20000, The SRT takes into account: the amount of time you spend and, where relevant, work in the UK, the connections you have with the UK, automatic overseas, automatic UK tests, sufficient ties test <https://www.gov.uk/hmrc-internal-manuals/residence-and-fig-regime-manual/rfig20000>

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Wealth planning structures

The SBA is one of the four British Overseas Territories that are not members of the global automatic exchange of information initiatives, viz Common Reporting Standard (CRS), Foreign Account Tax Compliance Act (FATCA) and Crypto Asset Reporting Framework (CARF).

Untaxed Financial Institution trusts, no matter the governing law or where established, are located where the trustees are resident.

If the trustee is not tax resident anywhere the trust is located where the trust is administered.

If the trust is an Investment Entity located in non-participating jurisdiction, then it is treated as a Passive NFEs. It is then transparent for reporting on its Controlling Persons.

A trust can be a Custodial Institution

A Custodial Institution is an entity that holds assets for someone else and earns a significant portion of its income from custody-like fees.

HMRC confirms a trust can be a Custodial Institution⁹, which is a Financial Institution for AEOI purposes.

A Custodial Institution trust with trustee in a SBA, not resident anywhere, is located in the SBA.

⁹ HMRC IEIM400700 - Custodial Institution: Trusts A trust can be either a financial institution or a Non-Financial Entity. Where a trust meets one of the definitions for being a Financial Institution it is most likely to be an Investment Entity but it may, alternatively, meet the requirements for being a Custodial Institution [see IEIM400640].
<https://www.gov.uk/hmrc-internal-manuals/international-exchange-of-information/ieim400700>

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A. CRS treatment of Non-Participating Financial Institutions

Under the OECD Common Reporting Standard (CRS) the CRS makes a crucial distinction between different types of Financial Institutions (FIs) that are not resident in a Participating Jurisdiction.

1. Investment Entities in a Non-Participating Jurisdiction:

These are treated as Passive NFEs for CRS purposes.

Reporting Financial Institutions (e.g., banks) holding accounts for them must:

- Look through to Controlling Persons, and
- Report those persons if they are tax resident in a Reportable Jurisdiction.

2. If a Custodial Institution is located in a non-CRS jurisdiction, like Akrotiri, and opens an account with a CRS Reporting FI:

- The FI does not report on the entity.
- There is no look-through, and no reporting on Controlling Persons.
- The entity is treated as a Non-Participating FI, but not a reportable one.
- Only Investment Entities in non-Participating Jurisdictions are deemed Passive NFEs and subject to look-through.
- Other FIs in non-Participating Jurisdictions — Custodial Institutions, Depository Institutions, Specified Insurance Companies — are not reportable under CRS and do not trigger reporting by Reporting FIs.

B. Foreign Account Tax Compliance Act (FATCA:

- i. The SBAs did not sign up with the USA for FATCA¹⁰.
- ii. The Custodial Institution remains a non-participating FFI and has no IGA¹¹ reporting obligations.
- iii. The issue of an Expanded Affiliate Group¹² (EAG) for FATCA is covered in a separate article.
- iv. No payments are routed via the Custodial Institution, so there is no 30% withholding penalty by the underlying paying agent.
- v. Nor is there a recalcitrant report.

¹⁰ Foreign Account Tax Compliance Act (FATCA) generally requires that foreign financial Institutions and certain other non-financial foreign entities report on the foreign assets held by their U.S. account holders or be subject to withholding on withholdable payments.

¹¹ Model Intergovernmental Agreements <https://home.treasury.gov/policy-issues/tax-policy/foreign-account-tax-compliance-act>.

¹² Expanded Affiliated Groups 26 CFR § 1.199A-12 - <https://www.law.cornell.edu/cfr/text/26/1.199A-12>

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C. Crypto Asset Reporting Framework (CARF):

- For CARF, there is no look-through to Controlling Persons by the underlying Reporting Crypto Asset Service Provider.

D. Other jurisdictions which can be used:

- St Helena
- Falkland Islands
- Ascension Island
- Svalbard, Norway
- Dhekelia

E. Blocker of settlor

- The Custodial Institution trust resettles the trust to any trust/trustee in the world
 - The settlor of the new trust is the old Custodial Institution trust
 - Must still hold some assets for the beneficiaries, such as a dormant company
 - The new trust does not report on the settlor, which is a non-reportable Custodial Institution
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