Examiners' report

P6 Advanced Taxation (CYP)
June 2008

The examination consisted of TWO compulsory questions (Question 1 for 35 marks and Question 2 for 35 marks) and THREE elective questions (Questions 3 – 5) of 15 marks each, of which TWO should have been attempted.

Candidates produced good answers to Questions 1, 2, 3 and 5. Question 4, although straight forward was fairly answered. There was evidence however that question 4 was answered in most cases as the candidates' last question, which leads one to the conclusion that insufficient time was allocated to it.
On balance, this examination sitting was well attempted in terms of both quality of responses by candidates and in terms (especially) of exam technique.

Question 1
This question examined many aspects of the tax consequences of using a Cyprus holding company and a Cyprus financing company in an international tax structure. More specifically this question examined the tax treatment of dividends and interest receivable, tax planning in structuring an inter-group loan relationship, withholding taxes on dividends and interest payable, capital gains consequences of disposing of overseas company shares and the stamp duty on specified contracts.

Answers were on the whole satisfactory. Candidates produced on the whole solid answers to parts (a) to (c). The most common error for part (c) was that candidates discussed capital gains tax instead of how 'investment' interest (passive income) would be taxed. 'Investment' interest is interest taxed as interest would normally be taxed (i.e. SDC 10% and corporation tax at 10% with a 50% exemption, thus the effective rate of taxation is 15%) whereas interest income taxed as trading would tax the income only under corporation tax at 10%.

Answers to part (d) re: arrangements to be made to ensure tax deductibility of the loan interest were fair. The impression was that candidates did not fully understand what was required. The majority of the answers were on the right lines but were incomplete. Most candidates discussed the requirement for an arm's length interest rate and some touched on the issue that the loan should have been given for 'trading purposes'.

Another common error was to ignore who were the beneficiaries of Kentavros Trust. Almost all candidates assumed that Kentavros Trust beneficiaries were non resident. Many in fact did not mention beneficiaries but stated that 'Kentavros Trust' was non resident. This demonstrated lack of knowledge as to how trust income is taxed, which was the purpose of the question part.

Candidates showed poor preparation for stamp duty part (g). This part was not answered satisfactorily.

Question 2
This question examined the tax position of physical persons in partnership, where one of the partners was a non-Cyprus resident, the tax treatment of partners' salaries, interest, rental and commissions, tax planning as to the best method of financing a new business and choosing between a partnership and a limited liability company. The question also examined the tax aspects of a disposal of trading goodwill, as well as the VAT treatment of a transfer of business as a going concern.

Candidates produced good answers to this question. Most candidates were comfortable with how a partner in a partnership is taxed as compared to how a shareholder in a company is taxed.

In part (d) a large number of candidates failed to support their advice with relevant computations as required by the question. Many candidates also failed to come to a conclusion and point out Jack's US tax position and the need for advice from the USA (professional mark).

Part (e) re: tax treatment of alternative transactions relating to trading goodwill, although straight forward was fairly answered.

Question 3
This question examined the special mode of taxation of life assurance and insurance companies, their tax administration and their VAT position.

This was the least popular question of choice. Candidates who attempted this question produced strong answers and obtained high marks. If candidates had studied the single chapter in the manual on general insurance and life assurance, then they would be able to score highly on this question, and many did.

Common areas of error were not knowing that insurance and assurance services are exempt supplies for VAT purposes, as well as failure to calculate correctly the taxable income of the company's Cyprus branches.

Question 4
The scenario of this question was the case of a non-resident individual being the beneficial owner of a Cyprus resident company receiving film rental and film production income. It examined the withholding tax position on film rentals, the planning of which method the shareholder should withdraw income from the company, as well as the tax implications at the shareholder's level of using company property free of charge.

This was a popular question, although answers on the whole were unsatisfactorily produced.

Very few candidates took notice of the exemption for withholding tax in the EU for associated companies and as such lost valuable marks for part (a).

Part (b) was well answered with most concluding that a mixture of salary (up to the tax free amount) and dividends was preferable. Very few candidates however made the extra step to state that it is only preferable if the monies are not remitted to the UK.

Part (c) caused problems. Firstly answers were not complete as they should have covered the taxation issues for both the company and Martine. Most candidates answers covered either the company or Martine only but not both. In addition most candidates failed to notice that if the house is provided to Martine rent free, this may result in a taxable benefit in kind on Martine and that the company could not deduct expenses for the house for tax purposes.

A serious mistake made by a number of candidates was their response to part (c)(ii), pointing out that the sale of the house in the UK is taxable under Cyprus capital gains tax, ignoring the Cyprus capital gains tax law provisions, under which only gains realised from sale of property located in Cyprus is assessable

Question 5
The scenario of this question was an International Business Company with offices in Cyprus and overseas, employing persons from Cyprus and overseas. It examined the tax deductibility of staff costs and benefits at the company level, taxability of salaries and benefits received by the company's employees, and the social insurance and social cohesion fund implications for each of the company's employees.

This was a most popular question of choice with satisfactory responses

Most answers picked up on the difference between Nicos and Elli with regards to the 90 day rule which showed good understanding of this particular exemption of the income tax law.

Candidates demonstrated poor preparation on social insurance issues, as they were not able to satisfactorily respond to the social insurance treatment for the employees of the company; notably that Mr Exxon and Boris were not liable to SIC and as such neither was the employer.