



Examiners' report

P6 Advanced Taxation (CYP)

December 2008

The examination consisted of two compulsory questions (Questions 1 and 2 for 35 marks each) and three optional questions (Questions 3-5) of 15 marks each, out of which candidates were required to answer any two. All questions were narrative and candidates were required to apply knowledge to practical cases.

Candidates produced satisfactory responses to questions 1-3, fair responses to question 4 and poor responses to question 5. A detailed analysis for each question follows.

Question 1

This question was based on a scenario of a foreign software developer, who wished to expand its operations to Cyprus and other countries (both EU and third countries), either through a Cyprus subsidiary or through a Cyprus branch. Sources of income comprised an initial licensing fee and an annual support fee. Part (a) of the question required responses on income tax issues including withholding taxes relating to the legal form to be used in Cyprus including a brief analysis of the legal aspects of setting up a subsidiary as compared to setting up of a branch and the method of financing the new activities, as well as capital gains issues relating to the subsequent disposal of the operations. Part (b) required responses on VAT issues relating to registration obligations under the different suggested mode of operation.

Candidates produced solid answers overall to parts (a) (i-iii).

The most common error for part (a) (iv) was candidates' omission to discuss withholding tax which was specifically required. Some candidates discussed VAT aspects at length, instead of withholding taxes. Candidates must ensure that they review the requirements adequately before giving their response, or should at least not produce irrelevant responses for which no marks will be allocated. This is a waste of candidates' valuable exam time.

In part (a) (v) large number of candidates discussed the provisions of how interest receivable is taxable in Cyprus, despite the question scenario discussing the use of a Cyprus company to receive a loan, i.e. interest was payable from Cyprus, not receivable in Cyprus. This indicates that candidates did not adequately read the question.

Responses to part (b) were satisfactory. Candidates' demonstrated satisfactory knowledge of the VAT issues involved i.e. intra-community trade, although there appears to be some confusion over the difference between trading with a VAT registered partner in another EU country and trading with a partner situated outside the EU. There was a strong tendency to discuss general aspects of VAT and not use the specific question scenario. This was most probably a result of candidates being unsure of the correct answer attempting to score marks through displaying all their knowledge of VAT.

Question 2

This question was based on the scenario of a family land developer company with activities in Cyprus and overseas, having four shareholders, two silent shareholders of which one resident overseas whilst the other two shareholders working for the company and wishing to split their interests from the interests of the other parties. Candidates were required to give responses as to the income tax special defence contribution and capital gains issues relating to a transfer of shares from a parent to her children, a possible dissolution of the company or a transfer of part of the company's assets within a scheme of re-organisation, the possible tax benefits of using a holding company or a trust and the tax implications of the legal vehicle that could be used to realise a land development project overseas.

Answers were satisfactory overall. Part (a) was correctly answered by a large majority of candidates. Part (b) was also well answered, although some candidates ignored the fact that one of the shareholders was non-resident, when discussing SDC on liquidation of the company. Not a single candidate was aware of the 1907 rule for land

transfer fees, although this was only worth 1 mark. Many candidates produced lengthy calculations despite the fact it was specifically mentioned in the question that these were not required. This created a waste of valuable exam time.

Many candidates displayed a theoretical understanding of a re-organisation scheme of a transfer of assets. However; very few candidates' applied their knowledge to this scenario specific question.

Parts (d) and (e) were overall well answered. Part (e) produced a few errors that were common amongst answers where candidates recommended the use of a foreign registered company given that the corporate tax rates, imposed by the foreign country and Cyprus were similar, ignored the fact that a non-Irish resident owner is not liable to Irish CGT on disposal of Irish assets. A large number of candidates also failed to highlight that the country of incorporation is irrelevant in determining tax residency and ignored the 'management and control' test.

Question 3

This question was based on the scenario of a foreign company having the patent rights for the production of alcohol products. Production takes place in another foreign country and is distributed to another country through a distributor who wishes to expand distribution to other countries through a Cyprus group structure which is planned to pay patents and dividends to the first mentioned foreign country. The intention was to have foreign directors, resident in the first mentioned country appointed on the board of the Cyprus companies. The question required candidates to produce a response on the corporation tax issues relating the 'management and control' test, the transfer pricing issues of transactions between connected parties, the VAT treatment of the Cyprus trading company and the social security obligations of the Cyprus trading company in respect of foreign individuals employed overseas, Cypriot and other EU citizens employed in Cyprus.

This was a popular question among candidates, who produced good responses. Parts (a) and (b) were answered well with most candidates scoring high marks.

Some candidates failed to refer to the withholding tax exemption on payment of royalties to associated companies within the E.U. (part (c))

In part (d), some candidates failed to discuss whether the transactions described in the question were subject to VAT in Cyprus. Instead, the general VAT rules were discussed regarding the place of supply of goods and services which did not gain many marks. In addition very few candidates discussed the VAT treatment of patent royalties.

Part (e) related to social security issues, a small number of candidates produced irrelevant responses.

Question 4

This question was based on the scenario of a group of companies, with the ultimate holding company being tax resident overseas, but holding shares in Cyprus subsidiaries and the company's owners desire to 'move' the tax residency of the ultimate holding company outside the first mentioned overseas jurisdiction, through setting up of a Cyprus holding company and subsequent share transfers. The question required candidates to produce a response of the direct tax implications of the contemplated share transfers with reference to the stated share price, the tax implications of the eventual liquidation of an existing Cyprus subsidiary, the VAT implications of the contemplated disposal of assets and operations of a Cyprus company and the tax treatment of future dividend payments by the new Cyprus holding company.

Some candidates produced satisfactory responses but the majority of candidates produced fair responses.

Many candidates seemed confused as they treated the proposed restructuring as an approved scheme of re-organisation and as such responded to parts (a) and (b) accordingly, stating that there was no tax payable, losing 9 of the 15 available marks. Although there are some aspects of a reorganisation that candidates may have

recognised, such as the unchanged shareholding structure before and after, the facts of the question scenario did not justify an approved reorganisation scheme.

Answers to parts (c) and (d) were on the whole satisfactory although many candidates failed to recognise that the transfer of assets and operations was on a going concern basis and as such not subject to VAT.

Question 5

This was a straight forward theoretical question examining the 'character' of 'tax warehouses' and 'fiscal warehousing' for VAT purposes.

This was the least popular question, as it tested a very specific area of VAT, which candidates demonstrated they did not study. The large majority of candidates who responded to this question demonstrated a lack of knowledge of the topic examined as their responses revealed general information which was irrelevant to the question VAT knowledge.