



# Examiner's report

## P6 Advanced Taxation (CYP)

### December 2009

#### **General Comments**

The paper consisted of two sections. Section A was comprised of two compulsory questions, the first worth 40 marks and the second 30. Section B was comprised of three questions, each worth 15 marks and candidates were requested to choose two from three.

Exam technique has historically been an area of weakness for candidates sitting the Cyprus Advanced Taxation paper. I was therefore especially pleased to take note of significant progress in this area. Almost all candidates answered four questions, and for the majority, a good attempt was made at all parts of the question answered. On the whole answers seemed to follow in length the mark allocation of the requirements. However, there is still room for improvement. A key strategy is to read and understand the requirements before beginning the answer to any part of the question. It is always a good idea to read all the requirements of the question first and try and assess what is being asked for in each part. No two requirements will ever test the same thing. As such, as in the example of question 1, where repetitive answers for different parts of the same question were noted, some time invested in reading through the requirements and understanding them would be time well spent. In addition, there was clear evidence that time management was an issue for many candidates, especially with regards to question 1.

A small suggestion arising from this sitting is for candidates not to cross out answers. I came across, sadly too often, entire pages of answers that had been crossed out. Crossing out means the text will be ignored. On closer inspection, I found that candidates would have been awarded marks for parts of their crossed out text, and such marks could potentially be the difference between a pass or fail.

#### **Specific Comments**

##### **Question One**

Question 1 was concerned with tax residence and use of the Cyprus holding company. Candidates were asked to cope with personal and corporation taxes of different countries affecting various distributions of income. A good answer would compare how the income would be taxed in the different jurisdictions and how this would be affected by the use of a company or a branch or by changes in the residency of the beneficial owner of the income.

This was the least well answered question of the sitting. The main problem that was immediately apparent through the answers was how candidates communicated their answers. It appeared that candidates launched into their answers before perhaps fully appreciating what the requirements were asking for. The result was repetition of the same arguments in more than one part of the answers, and an often incoherent flow of advice. This problem of rushing to answer before fully understanding the requirements was even more apparent in scripts where candidates left Question 1 until last.

Part (a) proved to be the most challenging for candidates. Although ultimately being a comparison between a branch and a company, answers ventured into topics which were not examinable, such as how Emily could extract profits from the companies (salary vs dividends). This may have been perhaps the result of the information in paragraph 3 of the question which discussed Emily's need to have a certain amount of disposable income. The requirements however were specific and no discussion of salary was warranted. Another common error was the discussion of tax on dividends emanating from branches, which is of course not applicable-branches do not issue dividends.

Part (b) was well answered and almost all candidates obtained full marks for discussing how management and control arises.

For part (c) most candidates successfully spotted that by using a holding company, dividend payout under the deemed distribution rules would be postponed for two years. However the discussion on using a non-Cyprus resident holding company in a zero tax jurisdiction produced surprising answers. I was surprised by the large number of candidates that were happy to advise that any ultimate holding company in a nil-tax jurisdiction would result in the Cyprus tax authorities ignoring their non-residence status and imposing SDC on dividend payments from the Cyprus subsidiary. This was because, they argued, the Cyprus Income Tax Office would view the structure as a scheme to avoid tax and thus ignore it. I have not been able to locate where this argument appears in the official literature. The above argument is wholly incorrect. In practice it is very common in fact to find zero-tax jurisdictions in the tax structures in which Cyprus companies belong. I would urge candidates to be professionally skeptical of the conclusions which they state. A concise answer which stated 'any dividends from Cyprus to a non-tax resident, including a company in a zero-tax jurisdiction, will not be subject to SDC' and a short explanation of how this would be beneficial to the structure, would have received all the available marks. Instead there were typically two or three paragraphs developing the above former argument which ultimately resulted in little or no marks.

For part (d), although most candidates were able to advise on one method of disposal of the business, usually of Emily selling her shares, only stronger candidates were able to advise on two or three methods and thus score high marks. I would urge candidates, when developing their arguments to take them through to the end. In part (d) for example, most candidates correctly stated the SDC consequences in Cyprus with regards to Emily being a non-Cyprus resident person receiving Cyprus dividends. However, the next step would be to discuss how that income would be taxed in the country where Emily was resident i.e. France. This was a step that only stronger candidates included in their answers.

Part (e) was well answered with most candidates gaining almost full marks. Stronger candidates spotted that even though Emily would be subject to SDC if she became Cyprus resident, the Cyprus tax was still less than the tax she would have paid had she remained a resident in France.

I was happy to note that almost all candidates were awarded the two marks available for style and presentation. I would strongly urge the candidates to seek out these 'easy' marks and not produce a memo when the requirement is for a letter.

### **Question Two**

Question 2 was a 30 mark question examining mainly the area of company reorganisations. Reorganisation in company structures has been a growing area for the tax consultant in Cyprus. As such it is an important area of tax planning and one to which candidates should give particular attention.

Overall answers given were satisfactory. Stronger candidates produced well balanced, accurate and complete answers and scored high marks.

Parts (a)(i) and (ii) examine the detail of the reorganisation. Overall answers to part (i) were good and covered the basic elements of reorganisation. Candidates produced on the whole clear and concise

replies to this part of the question. Part (ii) resulted in some errors that could have easily been avoided had more attention been given to the requirements. The requirement specifically states that no new company will be formed and asks for the advice. This automatically closes the door to any schemes of reorganisation that require the use of a new company. The wording was purposely used to guide candidates to the answer requested by the examiner. However a surprising number of candidates discussed schemes involving new companies and effectively lost out on any potential marks for this part. I urge candidates to read and re-read the requirements before starting their answer.

Another point to make is with regards to the specific taxes on which part (a) requests discussion. These are detailed in the requirement before part (i). Surprisingly a significant number of scripts did not mention one of the given taxes thus not attempting to gain marks that are available. Many answers left out for example stamp duty or SDC when discussing the benefits of the scheme, thus missing out on available marks.

Part (a) (iii) was answered well and most answers picked up on the fact that costing the value of the deemed distribution benefit was incorrect, primarily because less tax means more net profit subject to deemed rules.

Part (a) (iv) also produced reasonable answers with most discussing correctly the use of a branch initially and then to consider a subsidiary.

Finally, part (b) was reasonably straightforward and most candidates correctly discussed the VAT implications of the merger.

### **Question Three**

This question examined capital gains tax and particularly the exchange of property. Candidates were given three scenarios and asked to evaluate the tax position of each, advising of the best option. Answers produced were on the whole satisfactory, although there was evidence that certain aspects of capital gains tax were not fully understood.

Part (a) required the analytical tax evaluation of the three options. Answers were mostly good. Certain fundamental principles of Cyprus capital gains tax were ignored by a significant number of students, notably that the house in London would not be a chargeable disposal due to its geographical location being outside of Cyprus. The fact that it was being exchanged with a Cyprus property is possibly what threw candidates off.

Another common error noted was with regards to life-time exemptions. Many candidates assumed that because the pieces of land in option 3 were agricultural, Kyri would be allowed to claim the agricultural life-time exemption. This did not apply however. The reason is that the exemption only applies to persons whose main occupation is agriculture. There is nothing in the question to suggest this. The fact that Kyri arrived from the UK recently makes it even more unlikely that such exemption would apply. Candidates should understand that the exemptions 'follow' the persons and not the immovable property.

The requirements of part (a) state 'to advise' and 'support answers with appropriate computations'. This translates to marks for computations and marks for descriptive advice. Yet many answers only

had one of the two. A relatively small number of candidates produced both descriptive analysis and calculations. This forms part of the exam technique chapter which candidates should consider very important.

A small number of candidates incorrectly rolled over the capital gains tax itself instead of the gain.

Part (b) follows on from the calculations of part (a). Answers were good and candidates displayed awareness of how the base value is calculated.

Part (c) produced, overall, excellent answers.

#### **Question Four**

Question 4 was a 15 mark question on one of the special VAT schemes in the law, the tour operators margin scheme (TOMS). Candidates who were familiar with the scheme and who attempted this question produced some excellent answers.

Parts (a) and (b) examined the matter of registration and use of the scheme. Practically all candidates correctly answered part (a). With regards to part (b) many candidates incorrectly stated that Jenni had a choice whether to use the scheme or not.

Parts (c) and (d) tested the elements of TOMS and candidates who were aware of the scheme were able to score high marks. Some candidate answers displayed clear guess work which resulted in poor marks. I would advise candidates to avoid specific topic questions such as this when they have not revised the topic.

Finally, for part (e), although the majority of candidates correctly calculated the 'difficult' calculation of the VAT within the margin, they then failed to calculate the much 'simpler' one relating to the value of supplies (excluding the VAT).

#### **Question Five**

Question 5 proved a popular question. Those who attempted it did very well. The concept of a trust is becoming increasingly important for Cyprus as more and more people turn to a Cyprus Trust for regulating certain matters, especially that of managing wealth succession. As such I was happy to see that candidates have attached sufficient importance to this topic during their studies. The knowledge they have received will be invaluable in their role as professional Cyprus tax advisors.

Parts (a) and (b) were on the whole well answered, and examined candidates' understanding of the characteristics of a trust, and specifically those of the Cyprus International Trust.

Parts (c) and (d) examined how the income that the trust received is taxable. Once again candidates produced solid, concise and complete answers when addressing this. Given that the income of the trust is taxable on the beneficiaries and not on the trust itself, answers to part (c) that stated this and in essence produced one answer for parts (c) and (d), were not penalised, provided such answers were correct.

I would urge candidates to follow the requirements as closely as possible. In parts (c) and (d) the requirement specifically states that answers should make reference to each source of trust income. Yet in many instances, certain sources of income were omitted from the answer. Whether this was down to time pressure or just forgetfulness does not matter. What matters is that marks were lost unnecessarily.

Finally two common errors appeared in part (d). The first was to treat royalty income as being subject to the 10% special mode of taxation. This only applies to royalty income derived from sources within Cyprus and payable to a non-Cyprus resident (except in the case of an associated company). This was not the case in this question. The royalty income here is considered as any other business income and taxed accordingly. The second error was for candidates to interpret the question data as stating that the overseas immovable property was held within the overseas companies whose shares were held by the trust. In fact these are two different assets of the trust- the shares and then the immovable property. Marks were thus lost for discussing only the tax consequences relating to the shares and not the immovable property.