Examiner's report
P6 Advanced Taxation (CYP)
December 2014

General Comments
The examination consisted of two sections. Section A contained two compulsory questions, question 1 for 35 marks and question 2 for 25 marks. Section B comprised three further questions of 20 marks each, from which candidates had to choose two.

The vast majority of candidates attempted four full questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure.

Candidates performed particularly well on questions 1(b)(i), 1(b)(iii), 1(b)(vii), 2(a), 3(a), 4(c) and 5(a) and 5(b)(ii). The questions candidates found most challenging were questions 1(b)(iv), 2(c) and 3(c). Especially with regards to 2(c), this appeared to be mainly due to candidates rushing to answer the question without properly thinking the answer through. Generally it appears that exam technique is becoming an issue once again. Candidates should pay special attention to this area.

A number of common issues arose in candidates' answers:

- Failing to read the question requirement clearly and therefore providing irrelevant answers
- Failing to tailor their answers to the facts contained within the scenario, resulting in generic answers that may not have been appropriate to the question
- Poor time management between questions, some candidates wrote far too much for some questions and this put them under time pressure to finish the remaining questions.
- Not learning lessons from earlier examiner's reports and hence making the same mistakes
- Providing more than the required number of points.
- Illegible handwriting and poor layout of answers.

Specific Comments

Question One
This 35-mark question was based on a grain wholesaler, Lambros Grain Trading Ltd (LGT), and tested candidates' knowledge of making an investment through equity vs debt, personal employment taxes (including the 90-day rule), and expanding using a branch vs a subsidiary as well as VAT issues.

Part (a) for five marks required candidates to explain the VAT treatment of grain purchased from within the EU (France) and from outside of the EU (Russia). For the French purchases candidates were expected to use the term 'intra-community acquisition' and explain that the taxable amount would include transportation costs, on which LGT would undertake the reverse charge. This was answered sufficiently well overall. As per previous exam paper comments, candidates must use the correct terminology for VAT questions. For example a number of answers incorrectly referred to the transaction from France as not an import. For the Russian purchases, candidates were expected to discuss importation. The most common omission was to discuss the taxable amount, and state that this should include the transportation costs. A small number of answers discussed triangulation which was not applicable in this case.

Many candidates scored well on the marks for the format of the memorandum and presentation. In some cases answers were poorly laid out which made marking difficult. Efforts should be made by all candidates to obtain these marks as they represent four valuable marks on a paper where only 50 marks are required to pass.
Part (b)(i) for six marks examined candidates understanding of the 50% emoluments exemption for new Cyprus tax residents when these exceed €100.000 in a year. The requirements specifically asked for a comparison of

the recommendation that candidates would make with the tax Evgenia and Demetris would pay if they received the same salary. Many answers did not produce two computations even though it should have been clear that this was required. Some candidates incorrectly set one of the salaries at €100k, even though the legislation specifically requires the gross salary to *exceed* this threshold in order for the 50% exemption to apply.

Part (b)(ii) for two marks required candidates to correctly explain why Evgenia was not entitled to the 90-day rule exemption. Overall answers were satisfactory showing a clear understanding of the requirement to have a permanent establishment of a Cyprus employer or to work for a foreign employer in order to be eligible for the 90-day rule exemption.

Part (b)(iii) was worth three marks and tested candidates understanding of the choice that Demetris has with regards to taxing his overseas pension. This was also well answered by the majority of candidates. Most answers correctly stated the special mode of taxation and the choice. Satisfactory answers also concluded that it was beneficial for Demetris to apply the special mode of taxation as he was paying tax at a higher rate than 5%.

Part (b)(iv) for two marks looked at the use and enjoyment (U&E) provisions that apply to VAT for domestic transportation. Candidates who were aware of the U&E provision correctly identified that under the normal rules, the place of supply would have been outside Cyprus (in Israel) and therefore the U&E provisions apply and the place of supply becomes Cyprus. Cyprus VAT should thus be charged on the invoice. The majority of candidates did not perform well, and this was down to a lack of understanding of the use and enjoyment rules. Some answers stated that since the Israeli company was 'using and enjoying' the transport, then the place of supply was outside of Cyprus. Other answers incorrectly discussed rules of supply of goods – in the present case, the transaction was transportation – a service – it does not matter where the goods are sold. Where candidates argued that Cyprus VAT should be charged because the true customer of the service was the branch, full marks were awarded.

Part (b)(v) was worth five marks and required candidates to discuss the tax issues with Panikos's proposal number 1. Two issues were at the heart of this question part. The first related to a transfer pricing issue with regards to CGC's free use of the warehouse and silos that belonged to its shareholders, NKG and LGT. In fact the majority of answers did not address this. They stated the issue with group relief only. Those that addressed the use of the warehouse and silos correctly referred to the related parties and need for arm's length and market rates.

The second issue relates to group relief. Candidates were expected to define a tax group and conclude that NKG, LGT and CGC do not form a tax group and that, for 2014, CGC would not have been part of the tax group for the entire year. Although the majority of answers correctly understood this last point, still a significant number of answers stated that in 2014 the losses could be used given that CGC is a 100% subsidiary of NKH and LGT in 2014, and referred to the 100%-subsidiary exception when a company is incorporated during the year. This is incorrect as the 100%-subsidiary exception applies to exactly just that – 100% subsidiaries. Here, CGC is a 50% subsidiary of two companies and the 100%-subsidiary exception would not apply.

A number of scripts discussed the reorganisation schemes as part of their answer in part b (v) and then again repeated this in b (vi). Once again, this shows that candidates are rushing to produce answers to each question part without having read all the requirements and plan their answers accordingly. The motto 'think more and write less' makes an appearance in most of the examiner reports over the last few sittings. Where points were made in candidates' answers to b (v) that actually related to the requirement in b (vi), the relevant marks were awarded.

Part (b) (vi) for five marks required an explanation by candidates of the reasons why Panikos's Proposal Number 2 did not constitute either a 'merger' or a 'transfer of assets' reorganisation scheme. The result of implementing this proposal would thus have been the application of capital gains tax, balancing statements and land transfer

fees. A significant number of candidates rushed to answer this question by stating the general requirements for the two types of reorganisations, without applying them to the question, as well as listing all the tax benefits where a reorganisation scheme applied. Some candidates simply did not consider that in the present scenario, the reorganisation that Panikos proposed did not meet the exemption requirements for the two schemes.

Part (b) (vii) for three marks asked candidates to advise whether an expansion by CGC into Africa should have been undertaken through a subsidiary or a branch. Candidates should have firstly noted that in both cases Ildorian tax at 12,5% would arise. The subsidiary offered a method to delay the deemed distribution rules as well as legal independence and so was the preferred structure. Many answers produced a generic 'branch vs subsidiary' answer by stating that a branch should be used in the initial years in order to make use of the losses, even though the project was expected to make profits from the first year. Therefore spending half a page and several minutes explaining the recapturing rules resulted in loss of time and no marks. Candidates must tailor their answers to the facts contained within the scenario, and not provide generic answers that may not be appropriate to the question and which gain few or no marks. The majority of answers correctly stated that the subsidiary is preferred as it provides better legal protection, given that this was a 'risky venture'. Satisfactory answers also explained the benefit that the foreign subsidiary offered to 'control' the dividend distribution.

Question Two

This 25-mark question was based on Gruli Systems Ltd, a company that sells computer systems, and covered the topics of management and control, permanent establishments, and cross border debt vs equity funding.

Part (a) for two marks required candidates to define 'management and control'. This has been examined several times in the past and has generally produced satisfactory answers. Some candidates discussed more detailed actions that were either unnecessary, such as signing resolutions in Cyprus, or not truly relevant, such as operating the bank accounts from Cyprus.

Part (b) for three marks required a definition and six examples of a permanent establishment (PE). PE's have featured in past exam sittings but this is the first time in many years that a definition and examples were requested in a standalone question part. The quality of answers was mixed. The majority of candidates were able to give three or four examples of a PE but did now know the definition. A significant number of candidates gave a 'subsidiary' as an example of a PE which shows a lack of understanding of what a PE is.

Part (c) was worth 20 marks. It required candidates to answer three questions stated in the scenario. Question 1 was worth 16 marks, and questions 2 and 3 were worth two marks each. This question part produced less satisfactory answers. In many cases, it was not clear when the answer was referring to MIL and when to Gruli, which complicated the marking process. Most importantly, there was clear evidence of candidates rushing to put pen to paper and answering without having read the scenario properly and without planning their answers. Candidates that scored well clearly presented their answers under subheadings such as 'Gruli – equity, Gruli debt, MIL equity, MIL debt', which in turn allowed them to focus on the points that needed to be stated. It is suggested to future candidates that this question would be a good one to practise under exam conditions in order to improve exam technique. Some candidates produced answers which appeared to be thinking-on-the-go rather than planning the answer. This was not an appropriate approach to this question as candidates were required to consider all the evidence and the relevant double tax treaty provisions before being able to give appropriate advice.

Question 1 for 16 marks required a comparison of the tax profiles of Gruli and MIL, in order to conclude whether they should use debt or equity to structure the investment. The conclusion to be reached was that both MIL and Gruli would have an incentive to structure the investment through equity and receive dividend income.

Specifically for MIL, the interest income would attract 10% tax whereas the equity would result in dividend income which would be tax-free. A significant number of candidates referred to MIL as a Cyprus tax resident company, even though this is very clear in the scenario that it was not resident in Cyprus. This resulted in answers outside of the scope of the question and appeared to be caused by candidates rushing to answer the question before fully reading and understanding the scenario. This is a comment that is frequently made in examiner reports and yet it continues to be a recurring issue in the P6 (CYP) exam. A significant number of answers correctly stated that MIL was Boxorian tax resident, but then stated that a 5% withholding tax would arise on interest received by it as per the "relevant double tax treaty". This signals yet again a lack of focus and a rush to answer.

For Gruli, it was important for candidates to consider the relevant double tax treaty provisions and apply them to the structuring. By incorporating a 100% Boxorian tax resident company to hold its investment in NewCo 1, Gruli could also deduct the interest on the loan to invest in the 100% subsidiary, and at the same time, reduce the 10% withholding tax on dividends to nil. This was the key tax planning analysis and advice that the question part requested, and was worth 9,5 marks. Answers were, on the whole, lacking in structure, lacking in thought and, in many cases, reproduced entire sentences from the scenario question without applying any tax planning advice. Another common error was for answers to state that the dividend that Gruli would receive would be subject to special defence contribution (SDC).

The analysis of Gruli using debt should have highlighted how providing a loan directly to NewCo would have resulted in a 4,5% withholding tax in Boxoria increasing the tax to €90.000. Advice to offer the loan indirectly through a newly incorporated Boxorian company explaining that this would reduce the overall tax was required to obtain the majority of the five marks available for this part of the answer. The majority of answers did not pick up on this point. Many answers stated that the interest income for Gruli would be assessed to SDC rather than corporation tax, which meant that such answers failed to discuss the tax deduction for the interest payable and the ensuing 1% margin. This is incorrect. The loan is sufficiently significant in value to merit being assessed to corporation tax as being part of the main business activities of Gruli.

Candidates were expected to conclude that Gruli had a better incentive to structure the investment through equity rather than debt, stating the overall tax saving. Generally answers did not arrive at a conclusion. A conclusion which followed from the reasoning of the answer, would obtain a half mark, even if that reasoning was incorrect. This is an important point to note as regards exam technique.

Question 2 for two marks required candidates to explain that any financing would reduce the rental income by 6% but subject the interest income itself to tax at 10%, meaning an overall tax leakage of 4%. As such, introducing any form of financing would not be tax efficient. Only a handful of answers correctly pointed this out. The majority of answers simply stated that the interest income would be beneficial as it was tax deductible.

Question 3 for two marks required an explanation that the five employees stationed at the desalination plant would constitute a PE in Boxoria, which means that the Boxorian tax authorities could attribute income of NewCo 2 to that PE. Where candidates failed to score marks, this was largely because they did not discuss a PE at all, but instead explained the notion of management and control, which would have been the case had the Cyprus company sent its directors to Boxoria. However the requirement stated that it would send five employees, not directors, hinting towards a PE. Therefore, a long explanation of management and control was not justified by the scenario. A significant number of candidates took this question part to relate to VAT and discussed various VAT aspects of the proposed transaction with the employees. Another common error in answers to this question part was discussion of the personal tax of the five employees, which was not required.

Question Three

This 20-mark question was based on Ntinos and his family. The question tested the areas of trust law, use of losses, tax on services in Cyprus by a non-resident professional and tax on director's debit balances in a company.

Part (a) for two marks required candidates to explain that Ntinos could not settle the shares of Semeli Ltd into a Cyprus International Trust as he and the beneficiaries did not meet the requirements, which also had to be explained. This was generally well answered by the majority of candidates. A common error was to state that the settlor and beneficiaries had to be non-Cyprus tax residents on the date of creation of the trust, which is not the case. Some candidates confused the role of the trustees with that of the settlor.

Part (b) for two marks required candidates to explain how the income of a Cyprus trust is taxed. The transparency of the trust for tax purposes, as well as the trustees carrying out the tax administration on behalf of the beneficiaries were the key concepts here to get down on paper. This was generally well answered by the majority of candidates.

Part (c), worth four marks examined the use of losses in Semeli Ltd. The thing to note here is that, although Semeli Ltd would undergo a substantial change in the nature of its business, it could still utilise the losses brought forward given that there had not been a change in ownership. The latter arises from the fact that a trust is transparent and therefore the settlement constituted a gift from Ntinos to his twin daughters which did not constitute a change of ownership. However, the large majority of answers mistakenly concluded that these anti-avoidance provisions applied. More satisfactory answers also stated the five-year restriction on losses carried forward.

Part (d) for one mark required candidates to state that the settlement in the trust constituted a gift from Ntinos to his daughters and so no capital gains tax would arise. The majority of answers correctly stated this.

Part (e) for three marks required candidates to explain how a non-Cyprus tax resident professional working in Cyprus should be taxed. The 10% withholding by Semeli, as well as the method of payment were the central requirements for scoring well. Most answers correctly explained the withholding tax but the administrative requirements of how to effect payment were often insufficiently outlined. Some candidates discussed that Alexia's Cyprus source income would be subject to the normal tax bands which is incorrect.

Part (f) for five marks required candidates to explain how BalCas Ltd's taxable income, a life-insurance company, is calculated. Life-insurance companies have a special mode of taxation which is what this question part examines. Around half of candidates were aware that a special mode of taxation existed. However, of these candidates only a minority were able to explain it fully, whereas the majority referred only to the head office deduction as well as the minimum tax that should be paid. The remaining candidates gave generic answers referring to the wholly and exclusively criteria for deductions. Unsatisfactory answers only discussed the interest income the company would have from the loan to Pavlina.

Part (g), worth three marks required candidates to explain the tax benefit that Pavlina would receive from maintaining a debit balance with BalCas Ltd. The market rate of 7% mentioned in the question was a red herring, in that when it comes to the taxation of related party debit balances, the 9% legislative rate is the only one that matters for the calculation of the benefit, reduced by any actual interest charged.

Question Four

This 20-mark question was based on Eleni and Paris and tested candidates' knowledge of taxation of intellectual property rights as well as of filing dates for tax declarations and objections.

Part (a)(i) for one mark required candidates to calculate Eleni's taxable income for 2013. This should have included the benefit in kind as well as the social insurance contributions. Generally answers to this part were satisfactory. However, a common error was not to include the social insurance in the calculation.

Part (a)(ii) for two marks required candidates to correctly explain that Eleni had an obligation to file an income tax return, because her gross income exceeds the tax-free bracket of €19.500. Many answers focused on the net taxable income, which lead to the incorrect answer.

Part (a)(iii) for one mark examined candidates knowledge of the filing date for employees where the tax return is filed manually. The correct date is by 30 April 2014. Most candidates answered this correctly.

Part (b)(i) for one mark examined the filing date for a self-employed person, being Paris, where his gross annual turnover is less than €70.000 and the return is filed manually. The correct date is by 30 June 2014. Again, most candidates were aware of this date. A minority of answers discussed the temporary tax dates which were irrelevant.

Part (b)(ii) for one mark examined the date by which an objection to a tax assessment, received start of October 2013, should be filed. This is by the end of the month, following the month of the objection, being 30 November 2013. A significant number of candidates incorrectly stated that the deadline was 30 days following the assessment.

Parts (a)(iii), (b)(i) and (b)(ii) were deliberately placed in the question to examine candidates' understanding of the relevant dates in the collection and assessment legislation. These are not examined often and have produced mixed answers in the past. Although answers were generally satisfactory this sitting, it is also clear that there is room for improvement.

Part (c) for two marks required the calculation of the expected taxable income to be attributed to Eleni and Paris from their proposed partnership in 2014. Candidates had to state that the partnership was a transparent entity for income tax purposes and produce the net calculations by extrapolating the value added tax (VAT) contained in the gross lecture price.

Part (d) was worth five marks and required candidates to explain that Eleni and Paris have two different tax profiles with Eleni being a lower rate taxpayer and Paris being a higher rate taxpayer. If their joint venture business were to be incorporated under a company, the new effective tax rate would have been higher for Eleni and lower for Paris. Although the majority of answers were along the right lines, a common error was to compare the personal tax rates of Paris and Eleni with the corporation tax rate of 12,5%, disregarding the SDC impact. This then led to the wrong effective tax rate for comparing, and thus the wrong conclusion.

Candidates were then asked to propose a solution, which could have been for Eleni to continue in the partnership as a self-employed person but for Paris to create his own personal company, through which he could then become the 75% partner.

Part (e), worth seven marks, required candidates to discuss the tax and VAT consequences relating to intellectual property (IP) income.

The special tax treatment of IP should have been the focus of discussion for tax treatment. Answers were generally unsatisfactory with only a minority of candidates discussing the 80% deemed deduction.

With regards to the VAT, candidates had to explain the basic business to business (B2B) place of supply rule and subsequently differentiate between the EU and the non-EU clients. Answers were generally satisfactory to this

question part. Satisfactory answers discussed the need to validate the UK VAT registration number of the UK universities.

Question Five

This 20-mark question was based on Gregory and tested candidates' knowledge of the badges of trade, income tax from property income, and calculating capital gains tax.

Part (a) for five marks required candidates to list the badges of trade. Generally answers were satisfactory. Where the requirement uses the verb 'list', candidates should do exactly that – produce a list. A significant number of candidates also provided an explanation of each badge of trade. Explaining each requirement was unnecessary (the requirement would have used the verb 'explain' if this was the intention) and constituted bad time management.

Part (b)(i) for nine marks required a calculation of Gregory's income tax payable for the 2013 tax year. In order to be able to calculate this, candidates had to conclude that the sale of the plot of land in Limassol was subject to income tax, using the badges of trade, and, more specifically, mainly as a result of the two week length of ownership. The calculation itself required candidates to note that the sales price of the plot of land was the market value of the house with which the plot was exchanged. The market value of the house would include the 18% VAT. The majority of answers did not account for this. Another part of the calculation was the estimation of the land transfer fees which are tax deductible for Gregory, and which were worth 0,5 mark. Only a small number of answers included the land transfer fees in their calculation.

At this stage of their studies, candidates should be aware that where a form of income is exempt, this should be stated in the answers to confirm that they have this knowledge. For example, the rental income from the preserved building should be shown on the computation as being exempt in order to gain the 0,5 mark allocated to this point.

The other important aspect of the computation was the double tax relief that Gregory could claim, and for which 2,5 marks were available. The double tax relief on the UK rental income was as per the double tax treaty, whereas with Indonesia, it was provided unilaterally in Cyprus, given that no relevant double tax treaty exists. In both cases, candidates had to calculate the Cyprus tax on that income, and deduct the foreign tax form that. In the case of the UK rental income, some of the foreign tax remained unrelieved and could be carried against the SDC liability. Where candidates did not obtain full marks, this was due to a lack of understanding how double tax relief works. Many answers included the relief as a deduction against taxable income, which is not the case. The relief operates by reducing the Cyprus tax by the foreign tax, and not the Cyprus income by the foreign tax. Another common error was not to calculate the specific Cyprus tax that arises on the foreign income, in order to ascertain how much relief could be provided.

A very common structure witnessed in answers was to discuss each property separately and produce income tax and SDC calculations separately in each discussion. Although this could work for SDC calculations, this could not work for the income tax computation as candidates need to know the total taxable income in order to calculate the ensuing tax for Gregory, which in turn would make it impossible to correctly calculate the double tax relief. Therefore use of this structure was another example of bad exam technique.

Part (b)(ii) for two marks required the calculation of Gregory's 2013 SDC computation. This was a straight forward calculation which most candidates performed well. However, common errors included not including the rental income from the preserved building in the SDC calculation (the exemption is only available for income tax), and not accounting for the double tax relief still available for the UK rental income.

Part (c) for four marks required a calculation of the capital gains tax for Gregory that arose from the sale of the farmhouse. A significant number of candidates incorrectly considered that the car had no impact on this

calculation, whereas in fact it had to be included as part of the price of disposal. A common error was for candidates not to deduct the general life-time exemption but instead use the life-time exemption relating to agricultural land as this was only available for owners whose main occupation was in agriculture, which was not the case for Gregory. Another common error was to subject the Limassol house to capital gains tax instead of income tax.