
Answers

1 Svetlana

- (a) Kyri will be hiring the car as a consumer, thus the transaction will be business-to-consumer (B2C), although in this case the place of supply rule is the same whether the supply is B2B (business-to-business) or B2C. The service supplied is for the short-term hiring of a means of transport as it is for less than 30 days. The place of supply will be where the car is made available to Kyri, which is in Cyprus. Thus the transaction will be subject to Cyprus VAT.

(b) Memorandum

To: Svetlana
From: A Tax Senior
Date: 25 May 2011
Re: Proposed business ventures with Kyri Tata

Following our recent meeting, I detail below the information relating to the items discussed. I would be happy to address any queries you may have.

(i) Proposed venture of trading shares and bonds (titles)

Through a Cyprus tax-resident company

Any gain from the trading in shares and bonds, if undertaken through a Cyprus tax-resident company, will not be taxable as such gains are specifically exempt. Also, any loss will not be allowable.

As per our meeting, you stated that 10% of the profits will be donated to a charity. No tax advantage would result from this in Cyprus, given that there will be no taxable profits, and the Mayfair Foundation is not a registered and approved charity in Cyprus (see further on this at (v) below). Thus for every €100 of trading profit, €4 will be paid in interest leaving €96 of profit after interest. From this €9,60 will be donated to the Foundation, leaving €86,40 of cash available for distribution.

We understand that you pay tax at the rate of 16% on dividends received in Russia. Thus you will pay 16% tax on the dividends received from the Cyprus company. Kyri will pay tax at the rate of 20% in Ildoria. Your net income for every €100 of trading profit will thus be €86,40 x 75% x 84%, i.e. net income of €54,43. You would also receive €4 in interest income which would be taxed at 12% in Russia, leaving you €3,52 net interest. Overall, for every €100 of trading income, you would receive €57,95. Kyri would receive €86,40 x 25% x 80%, which is €17,28.

Through an Ildorian tax-resident company

If the trading of titles were to be placed through an Ildorian tax-resident company, the company would be able to deduct the 10% donation to the Mayfair Foundation for tax purposes. Thus for every €100 of trading profit, €4 will be paid in interest leaving €96 of profit after interest. From this €9,60 donated to the Foundation will be deductible, leaving €86,40, which will be taxed at 5%. The remaining €82,08 will be available for distribution.

Again, you will pay tax at 16% on the dividends received from the Ildorian company. Kyri, however, will not pay anything further as dividends from an Ildorian company to an Ildorian tax-resident person are tax free. Your net income for every €100 of trading profit will thus be €82,08 x 75% x 84%, i.e. net income of €51,71, i.e. you will be €2,72 worse off when compared to trading through a Cyprus company. In addition, you would receive €4 in interest which would suffer 20% withholding tax in Ildoria, but which would be credited against the 12% Russian tax on the same income. Thus you would receive net interest of €3,20. Overall you would receive €54,91 and be €3,04 worse off. Kyri on the other hand will receive €82,08 x 25%, i.e. €20,52 and be €3,24 better off.

Summary

It is better for you to trade in shares and bonds through a Cyprus tax-resident company. For every €100 of trading profit you will be €3,04 better off using a Cyprus company. However, this will create more tax for Kyri who will be €3,24 worse off for every €100 of trading profit compared to using an Ildorian tax-resident company. This is what Kyri meant when he stated that using a Cyprus company would not be fair for him.

(ii) Recommendation

If you wish to use a Cyprus company for the first venture, one solution which would help would be to place Kyri's 25% shareholding through Latvex Ltd (Lavgex). Thus Latvex would receive €86,40 x 25% of profits = €21,60, from the Cyprus company. Latvex would pay a further 5% Ildorian tax on these, but then could give the remaining amount to Kyri as dividends without any further taxes. Thus Kyri would receive €21,60 x 95% = €20,52 which is the same amount as if an Ildorian tax-resident company were used.

(iii) Value added tax (VAT) matters regarding the NewCo chicken feed business

Treatment of invoices from Latvex Ltd to NewCo

Latvex will invoice NewCo for a finder's fee, based on a percentage of the turnover of the Cyprus company. It will thus act as an intermediary and invoice the commission. The transaction is business-to-business (B2B). The place of supply of the service will thus be where the recipient is based, i.e. NewCo in Cyprus. So NewCo will be required to undertake

the reverse charge procedure on receipt of the invoice and, as the anticipated fee exceeds €15.600, to register for VAT in Cyprus.

On applying the reverse charge, NewCo should be able to reclaim in full the input VAT given that the service is directly related to the sale of chicken feed to Russia, for which related input VAT would be allowed, given that such a sale would be a vatable transaction if it took place within Cyprus.

Treatment of purchase and sale of corn by NewCo

The corn purchased from South Africa and sold to Russia would not pass through Cyprus. It would be shipped directly from South Africa to Russia, so the entire transaction will take place outside of Cyprus. The place of supply would also be outside of Cyprus, and no Cyprus VAT would be applicable on the sales or the purchases. In addition, no reverse charge would be applied to the purchases.

(iv) Potential risk to Genady Limited from purchasing corn from NewCo

NewCo will be a 100% subsidiary of Genady Limited (Genady), thus the two companies will be related for tax purposes. It is therefore important that the sale price of the corn charged to Genady by NewCo be at arm's length so as not to create any tax issues for Genady in Russia. Given that there is also an active market for chicken-feed products in Russia, it will not be difficult for the Russian tax authorities to assess if the transfer pricing is at arm's length.

(v) Structuring of donations to South African schools

As stated in (i) above, because Cyprus tax law only allows deductions made to Cyprus registered and approved charities, the 10% donation to the Mayfair Foundation would not be considered an allowable deduction for tax purposes in Cyprus. Given the potentially large contributions that will be given, I would recommend that you and/or Kyri set up a Cyprus charity, registered for the same purpose as in the case of the Mayfair Foundation, and submit it for approval with the Cyprus Income Tax Office (ITO). In this way, future donations may be considered as tax deductible for Cyprus corporation tax purposes.

Furthermore, the donation should be made by a company that has profits taxable in Cyprus. This is only the case for NewCo because, as already stated, in the case of the first venture, any gains from the sale of titles is not subject to corporation tax in Cyprus. There is no reason why NewCo's charitable contribution could not be based on 10% of the value of trading profits from the first venture, if all parties agree.

2 Julia

(a)

BRIEFING NOTES

To: A Tax Partner
From: A Tax Senior
Date: 5 October 2011
Briefing notes re: Various Tax Matters re Julia

Following our recent meeting with Julia, I detail below the matters that were raised for discussion and provide my feedback on these.

(i) Value added tax (VAT) treatment of equipment purchase

Since Julia is a registered doctor, she will be supplying exempt services and will not have the right to reclaim the input VAT on equipment purchased for the purpose of her business.

If Julia purchases the equipment from the Cyprus supplier, he will charge her 15% Cyprus VAT, i.e. VAT of €160.000 x 15% = €24.000. As such, the total cost of the equipment from the Cyprus supplier will be €184.000.

If the equipment is sourced from the US then, upon importation, Customs will also charge Julia 15% Cyprus VAT on the value of the equipment including the shipping cost, which again Julia will not be able to reclaim. In this case the VAT will be (€155.000 + €10.000) x 15% = €24.750 and the total cost to Julia will be €189.750.

Thus it will be €5.750 cheaper to buy the equipment from the Cyprus supplier.

(ii) Tax treatment of saloon car expenses

Any expenses relating to saloon cars are specifically not allowable for income tax purposes, regardless of whether Julia will use the car partly for business purposes.

(iii) Tax treatment of Julia's rental income if she joins Ortasa Ltd

Rental income from the letting of preserved buildings is exempt for income tax purposes. Also no capital allowances would remain, given that the house was built 50 years ago. However, the rental income would still be subject to special defence contribution (SDC) tax.

In 2011, Julia would be in Cyprus for fewer than 183 days in the tax year, therefore she will not be a Cyprus tax resident and as such no SDC will be payable in that year.

However, Julia is likely to be a tax resident in 2012 and future years, so SDC of 3% on 75% of the monthly gross rent of €3.000 would be payable, being €67,50. Ortasa Ltd (Ortasa) is required to deduct the SDC from the gross rent and pay the net amount of €2.932,50 to Julia. It would then have to pay the SDC to the income tax office through self-assessment by the end of the following month. Ortasa would also have to complete a certificate detailing the SDC that was deducted at source. This certificate should be given to Julia, who will then submit it to the income tax office with her tax declaration for the year.

(iv) Income tax consequences of Julia's two options for joining Ortasa Ltd

As stated above, Julia is not a Cyprus tax resident in 2011. Thus if she is employed at Ortasa Ltd, she will be eligible for an exemption of 20% of her emoluments (up to a maximum of €8.550). This exemption will be available for the tax years 2012, 2013 and 2014.

As Julia will be a Cyprus tax resident as of the 2012 tax year, any dividends received in March 2012 and future years will be subject to SDC at 17%.

In 2011, Julia will only be employed for two months so, regardless of which salary option she chooses, her emoluments will be below the nil rate tax band of €19.500 and there will be no tax to pay.

If Julia chooses option 1 and remains on the €20.000 annual salary until 31 December 2014, social insurance contributions will amount to €1.360 per annum (6,8% x €20.000). She will also deduct €4.000, being the 20% non-resident deduction for the tax years 2012–2014 inclusive. Thus she will not pay any tax as her salary, net of the first time employment exemption and social security contributions, at €14.640 will still be within the nil-rate tax bracket of €19.500.

If Julia chooses option 2, then she will receive an annual salary during the tax years 2012 to 2014 of €49.500, on which she will pay social insurance contributions at 6,8% of €3.366 per year, and she will be able to claim the exemption for first time employment of €8.550 (as stated above).

In addition, Julia will be able to claim capital allowances on the equipment she will own, at a rate of 10%, given that the useful economic life is ten years, of €18.400 per year. In order to do this, however, Julia's employment contract with the clinic must **expressly** state that Julia has to use the equipment in the performance of her duties.

Assuming the appropriate provision is included in her employment contract, Julia's taxable income for the tax years 2012 to 2014 will also be below €19.500, and the tax payable nil, as shown in the Appendix to these notes.

Therefore, from an income tax point of view, Julia will be indifferent between options 1 and 2. However, given Julia's apprehension of having business partners, it is perhaps better for her to choose option 2. Should the cooperation with the clinic not work out, Julia would still own the equipment vital for her job.

In making the decision, Julia should also consider how the purchase of the equipment will be financed. If it will be through a loan, Julia will need to consider her disposable income following any loan repayments, and how potentially exiting the clinic business may affect her ability to make such payments.

Julia should also consider how options 1 and 2 will affect the net profit of Ortasa Ltd as this in turn will impact on her dividend income.

Appendix

Taxable emoluments for tax years 2012–2014 for Julia

	€	€	€
Gross emoluments		49.500	
Less exemption for first time employment (capped)	(8.550)		
Less capital allowances on medical equipment (184.000 x 10%)	(18.400)	<u>(26.950)</u>	
Taxable emoluments before personal allowances		22.550	
Social insurance (49.500 x 6,8%)		<u>(3.366)</u>	
Taxable income			19.184
Tax payable			nil

(b) Tax implications of three Amir plc options

Option 1

If Julia and the other doctors sell their shares outright to Amir plc, then the gain from the sale of the shares is specifically tax exempt for income tax purposes.

However, Ortasa Ltd owns the clinic building. According to Julia, the value of the building has increased greatly. This will result in a capital gain for Ortasa's shareholders. The capital gains tax computation will be as if Julia and the other shareholders held the company's immovable property in their own names personally, and have disposed of it *pro rata* to their shareholdings. Julia's cost for capital gains tax purposes would be the market value of the property at the time she purchased the shares, adjusted for inflation.

Option 2

The second option would result in Ortasa Ltd transferring its net assets to Amir plc in exchange for shares in Amir plc. This scheme could fall under a 'transfer of assets' reorganisation scheme. The result would be that no taxes would be imposed on Ortasa Ltd as a result of the transfer.

In future, any dividend received by Ortasa Ltd from Amir plc will be tax free, although it will be included in its accounting profits for the purposes of deemed dividend distribution. Ortasa Ltd may sell Amir plc shares with no tax consequences to itself. However, any subsequent dividend distribution will be subject to SDC at 17%, as usual.

Option 3

The third scheme proposed by Amir plc has the characteristics of a 'merger' reorganisation scheme. However, the fact that Ortasa will not be dissolved, as well as the fact that the cash payment paid by Amir plc to Julia will exceed 10% of the nominal value of the new shares, means that this option will not constitute a reorganisation scheme.

The result would be for Ortasa Ltd to be subject to capital gains tax on the disposal of the clinic building. Given the increase in the value of the building, this may be substantial. In addition, the capital gain will increase the accounting profits for the purposes of deemed dividend distribution.

Secondly, Ortasa Ltd will be required to prepare a balancing statement for all the assets it holds. The resulting balancing charge or balancing allowance will increase or decrease its taxable profits accordingly.

Finally, the goodwill value of the assets will also be included in Ortasa Ltd's taxable profits and taxed at 10%. The goodwill will further increase the accounting profits for deemed dividend distribution purposes.

Amir plc is a listed company. Gains on listed shares are specifically exempt from capital gains tax. Gains on the sale of shares are also exempt from income tax. As such, in the future, Julia and the other shareholders will be able to sell a part of their shares in Amir plc if they require funds, and any gain made would be exempt from both income and capital gains tax.

3 Andreas

- (a) Given that Savvinos Limited will be managing the hotel, it will eventually be required to register for value added tax (VAT) when it commences its business and surpasses the registration threshold. However, it would be advantageous to register voluntarily as soon as possible. Savvinos Ltd will receive services from the construction company and the architects. The company can only reclaim input VAT on services it received in the six months before the date of registration. Given that the construction phase will last four years, it is imperative to register for VAT as soon as possible in order to reclaim all the input VAT arising during the construction.
- (b) Nicole & Co will be providing architectural services relating to a hotel that will be constructed in Cyprus. The client will be Savvinos Limited and the transaction will be business-to-business (B2B). The place of supply of the service follows the special rule of where the hotel is physically located and thus will be Cyprus. Thus the service is subject to Cyprus VAT. If Savvinos Ltd registers for VAT, then Nicole & Co will not have to register for VAT in Cyprus, and Savvinos Ltd will apply the reverse charge on the invoices it receives from the architects.
- (c) The purchase price would be €3 million. The land transfer fees would thus be €233.166, calculated as follows:

	€
First €85.430 at 3% =	2.563
Next €85.430 at 5% =	4.272
Final €2.829.140 at 8% =	226.331
<u>€3.000.000</u>	<u>233.166</u>

- (d) Demetris's proposal constitutes tax evasion and is illegal. It is not ethical for a taxpayer to knowingly avoid disclosing a part of a taxable gain in order to evade tax, as this penalises those honest citizens of Cyprus who do pay their taxes. Tax evasion reduces the income of the government, which in turn adversely affects public services that the government procures, such as education, healthcare and improving the country's infrastructure. If the proposal were to materialise, this would leave no option for Andreas's accountancy firm but to resign as his professional advisers, and this should be made clear to Andreas.
- (e) Immovable property tax taxes the 1 January 1980 value of the land and any immovable property situated thereon as at 1 January of each tax year. During the construction phase, Andreas must estimate, for every tax year, the 1 January 1980 value of the building work-in-progress as at 1 January of that tax year and pay through self-assessment the resulting tax by 30 September of the same year. The problem that Andreas will face is in determining the 1 January 1980 value of the work-in-progress during the course of construction.
- (f) The rental income that Andreas receives for the land every month will be chargeable to income tax and special defence contribution (SDC) tax.

For income tax the statutory deduction of 20% of the gross rent will not apply as this is given in the case of rental buildings, but not land. SDC will be payable on 75% of the gross amount at the rate of 3%. This will be deducted at source by Savvinos Ltd which will in turn pay it by self-assessment to the income tax authorities.

In addition, given that the hotel will become the ownership of Andreas following the expiry of the 20-year lease period, Andreas will receive a benefit which is taxable. The value of the benefit will be calculated by the Commissioner of the Cyprus Inland Revenue and will start in the year of construction. The total value of the benefit cannot exceed the cost of construction and should also be spread equally over the life of the lease, which is 20 years. This amount will be included in Andreas's taxable income every year.

Andreas can claim capital allowances on the value of the benefit. This would allow for an annual deduction equal to 4% of the value of the benefit.

The benefit is not treated as rental income and as such is not subject to SDC nor does the statutory deduction of 20% apply. In addition, Andreas will have to submit a balancing statement at the end of the tenancy period.

Tutorial note: *The Cyprus Inland Revenue Department released circular 2012/15, relating to leases that are registered with the Land Registry Office, dated 6 July 2012. Therein, the Commissioner of the Inland Revenue states that for leases that are registered with the Land Registry Office, as would be the lease described in question 3, the lease payments are not deemed to be rental income for the purposes of Special Defence Contribution (SDC) tax, and thus not subject to SDC tax. The Income Tax Office has also signalled (not part of the circular) that it will not subject the lease payments to income tax. As such the rent under the lease, if deposited at the land registry office, would be exempt from income tax and SDC. The subsequent disposal of the lease, as per the circular, will be subject to capital gains tax. This constitutes a change of tax policy for the Cyprus Inland Revenue. This exam paper is based on legislation (and interpretation thereof) that was passed before 30 September 2011, and accordingly the model answer is correct.*

4 Alexander

- (a) In order to make the company Cyprus tax resident, Alexander should move the management and control of Alfie Shipping Ltd (Alfie) to Cyprus. There is no definition of management and control in the law. It is in practice taken to mean the place where:
- the majority of directors reside;
 - the board meetings of the company take place; and
 - the general policy of the company is formulated.

The co-existence of all three criteria is essential.

- (b) With regards to the ship management business, Alfie has a choice of two possible tax methods. It can be taxed in the normal way like any other Cyprus tax-resident company, being a 10% corporation tax levy on taxable profits, or it may opt to be subject to the tonnage tax system (TTS) under the merchant shipping law.

If Alfie opts to pay tonnage tax, the option must remain in force for at least ten years. Such an option would offer income tax and special defence contribution (SDC) tax exemptions as follows:

- exemption from income tax in respect of Alfie's business profits from the ship management activity;
- exemption of interest income other than on monies kept for investment, from both income tax and special defence contribution (SDC), i.e. interest income on bank accounts used to pay ship management expenses; and
- exemption from SDC in respect of dividends paid directly or indirectly out of the ship management profits.

- (c) The branch will constitute a permanent establishment in Cyprus and any profits that it makes will be deemed to be Cyprus source income, taxable in Cyprus.

For both types of business, income from premiums, bank interest (which is considered to be earned in the course of business), investment income (including profits from the sale of investments) and commissions will be taxable income. From this all business expenses, including re-insurance premiums, net claims and surrenders, are deductible. In addition, any transfer to or from reserves for unexpired risks will be considered as a deductible expense or taxable income respectively.

In the case of the non-life insurance business, a deduction for head-office expenses, not exceeding 3% of premiums received in the Republic less premiums paid on re-insurances, will be given.

In the case of the life insurance business, a deduction for head-office expenses, not exceeding 2% of premiums received in the Republic less premiums paid on re-insurances, will be given.

For both types of insurance business, any losses that arise can be offset against profits from any other form of business, including losses of life insurance business against profits of non-life insurance business, and *vice-versa*. Unrelieved losses will be carried forward in the normal way, and relieved against the first available profits from any source.

The life-insurance business will be subject to a minimum tax of 1,5% of the gross premiums.

- (d) Alexander's yearly premium on his life insurance policy would be an allowable deduction in arriving at his net taxable income. However, the allowable premium is restricted to 7% of the capital insured, i.e. €35.000. The remaining €15.000 would be lost.

Life-insurance premiums make up part of a taxpayer's personal allowances, along with social insurance contributions and certain other medical or pension schemes. All personal allowances are restricted to one-sixth of the chargeable income before allowances.

No allowance would be given for the life insurance policy that Alexander would take out on his wife's life. It would be better for her to take out the policy in her own name, in which case she could obtain the benefit of the tax deduction against her own income.

5 Oxana

- (a) A partnership is taxed as a transparent vehicle. As such, any taxable profits or expenses incurred in a tax year by the partnership will be considered as belonging to the partners in their respective proportions.
- (b) The initial sale of 50% of the land by Luda Ltd ('Luda') will most certainly be considered as an adventure in the nature of trade and as such will be subject to corporation tax at the rate of 10%. This will result in a corporation tax charge of €10,000, being 10% of the difference between the purchase price of 50% of the land, and its sale price (€400,000 – €300,000).

Based on the badges of trade, the main reasons that the sale will be considered as trading are:

- *Length of ownership*: the short time frame of just over one month between the time of purchasing the land and selling it.
 - *Circumstances responsible for sale, motive and knowledge of the owner*: the reason for selling the land is to enter into a joint-venture with a well-known developer in order to develop bungalows which will be sold off for a profit.
- (c) If Oxana takes the loan out in her own name, she would still have to pay 5% interest on €500,000 which is €25,000 per year for three years, regardless of whether any income was generated by the project. In addition, at the end of the three-year period, Oxana would also have to pay off the capital borrowed. The construction of the bungalows is estimated to last 18 months, however, if no sales are made during this period, there could potentially be an adverse timing mismatch between the income generated by the project and the responsibility of Oxana personally to the bank.

An added consideration is that if Oxana takes the loan out in her name, she will personally be liable for the loan in the case of default. If she is unable to repay it, then, in theory, the bank may also lay legal claim to other assets held by her such as her shares in listed banks or other properties. If the loan is taken out in the name of Luda, given that Oxana will not have to give any personal guarantees, then Oxana's financial risk will be limited to the share capital of the company which she has purchased.

Finally, consideration should also be given to the interest-rate risk. This is the risk that over the next three years the London Inter-Bank Offer Rate (LIBOR) will rise and thus the loan will become more expensive for Oxana. It is difficult to predict how LIBOR will move, however, Oxana, being an investment banker, will be aware of the implications of this.

(d) Comparison of options:

Option 1

If Oxana invests the entire amount as share capital in Luda, this means that the only income she will be able to receive from the company is through dividends. This has the following implications:

Dividend income will be taxed at source under special defence contribution (SDC) tax at the rate of 17%. Dividends are exempt from income tax.

Any declaration of dividends follows a 10% corporation tax levy on the profits of the company. Given that Luda would be subject to deemed distribution rules, the effective tax rate for Oxana would be a minimum of 20,71% if Luda distributes 70% of its after-tax accounting profits, or a maximum of 25,3% if Luda distributes 100% of its after-tax accounting profits.

Tutorial note: *the 20,71% is calculated as being 10% corporation tax, plus 17% SDC on 70% of profits distributed which are 90% of the pre-tax profits. The 25,3% is calculated as being 10% corporation tax, plus 17% SDC on 90% of the pre-tax profits available for distribution.*

In order for dividends to be declared, Luda must have distributable reserves which means that the partnership will have to make sales greater than the cost of development. This may take longer than anticipated given the struggling development sector in Cyprus.

If dividends cannot be claimed, theoretically the only other method for Oxana to receive money back from the company is either to decrease the share capital, or to liquidate the company. This can occur, for example, if the money is still in the company and has not yet been given to the partnership, but no profit has been made to declare a dividend. Both processes (decrease in share capital or liquidation) will take several months to be approved and executed, delaying significantly the return of any funds to Oxana.

This option does not offer flexibility in terms of getting money out of the company. In addition, at the end of the project, there will still be a very high capital amount retained in the company. If Oxana is happy for the funds to remain in the company for use in other ventures then this may not be an issue.

The interest payable by Oxana to the bank offers no tax advantage.

Option 2

This option would mean that Oxana would have interest income of €65.000 ($6,5\% \times \text{€}1.000.000$). This would be taxed under SDC at 15%, i.e. €9.750 tax per year. In addition, Luda would be allowed a tax deduction for the interest paid on the loan, so Luda would benefit from the corporation tax saved, at 10%, offering a corporation tax benefit of €6.500.

The effective rate is significantly less than if the income were received through dividends, as in Option 1. As such, the loan to the company will reduce the overall effective tax that Oxana would pay.

Other considerations include the fact that the tax on the interest income would arise regardless of whether Oxana actually received the interest from Luda or not. If no income is generated by the project, this tax would add to Oxana's existing costs, being the interest on the loan.

The bank mortgage on the land, which constitutes the only asset that Luda has, will prevail over Oxana's loan to the company as a preferred creditor. As such, option 2 does not offer Oxana any additional advantages over Option 1 in terms of preferential treatment if Luda was to become insolvent. However, the loan does allow Oxana a means to take money out of the company, as a repayment of the loan, in a more straightforward manner than for Option 1.

Option 3

As for Option 2, the interest paid by Luda would be considered a tax-deductible expense.

As for Option 1, Oxana would only be able to receive money from Luda in the form of dividends, at the effective rates described above. However, she will no longer have the legal obligation of the loan, which will now burden Luda alone. If income is not generated by Luda, it will be easier to convince the bank to hold off for a period than in the case where the loan was in Oxana's own name, offering more flexibility perhaps.

Professional Level – Options Module, Paper P6 (CYP)
Advanced Taxation (Cyprus)

June 2012 Marking Scheme

	Available	Maximum
1 Svetlana		
(a) Short-term hiring of means of transport with reason	1	
Place of supply where car is made available	1	
Transaction is subject to Cyprus VAT	1	
	<u>3</u>	3
(b) (i) Gain from sale of bonds (titles) exempt in Cyprus	1	
Calculation of net income if Cyprus company used	3	
Calculation of net income if Ildorian company used	4	
Explanation of why Kyri feels Cyprus is 'unfair'	1	
	<u>9</u>	9
(ii) Recommendation to place Kyri's holding through Latvex	1,5	
Calculation of tax paid by Latvex	0,5	
Calculation of net benefit to Kyri with comparison	1	
	<u>3</u>	3
(iii) Correct discussion of place of supply of services from Latvex	1	
Application of reverse charge by NewCo	1	
Obligation to register for VAT in Cyprus	0,5	
Discussion of claiming input VAT from reverse charge	1,5	
Discussion of VAT treatment of purchase and sale of corn	2	
	<u>6</u>	6
(iv) NewCo and Genady related companies, with reason	1	
Explanation of potential transfer pricing risk/need for arm's length pricing	2	
	<u>3</u>	3
(v) Explanation of why donation is not allowable	1	
Recommendation to create charitable foundation in Cyprus	2	
Recommendation for NewCo to make the donation	1	
	<u>4</u>	4
Format and presentation	<u>2</u>	<u>2</u>
		<u>30</u>

	Available	Maximum
2 Julia		
(a) (i) Explanation of why no input VAT can be claimed by Julia	1	
Calculation of total cost from Cyprus supplier	0,5	
Calculation of total cost from US supplier	1	
Recommendation	0,5	
	<u>3</u>	3
(ii) Tax treatment of saloon car expenses	<u>1</u>	1
(iii) Exemption of rental income	0,5	
No capital allowances remain	0,5	
Rental income subject to SDC	0,5	
In 2011 Julia exempt from SDC, with reason	1	
Calculation of SDC as of 2012	0,5	
Explanation of deduction at source	1	
Explanation of annual SDC certificate	1	
	<u>5</u>	5
(iv) Availability of first time employment exemption	1	
Dividends subject to SDC only	0,5	
Explanation of position in 2011	0,5	
Explanation of tax consequences/calculation of net taxable income for option 1 for 2012 onwards	1	
Explanation of tax consequences of option 2	1	
Employment contract requires express provision so as to claim capital allowances	0,5	
Calculation of net taxable income for option 2	1	
Conclude indifferent from purely tax viewpoint	0,5	
Other non-tax considerations for Julia (maximum)	3	
	<u>9</u>	8
Format and presentation	<u>2</u>	2
(b) Option 1		
Gain from sale of shares exempt under income tax	1,5	
Explanation of capital gains tax implications	2,5	
Option 2		
Transfer of assets scheme with no tax consequences	2	
Future tax implication for dividend and sale of shares	1	
Option 3		
Reason why not a reorganisation scheme	1	
CGT and SDC implications of disposal of clinic building	0,5	
Discussion of balancing statement	1	
Tax and SDC implications of goodwill	1	
Future sales of Amir plc listed shares will have no tax consequences	0,5	
	<u>11</u>	11
		<u>30</u>

	Available	Maximum
3 Andreas		
(a) Explanation of six-month restriction and that construction will last four years	<u>2</u>	2
(b) Transaction is B2B service	0,5	
Special rule means place of supply is Cyprus, so transaction subject to Cyprus VAT	1,5	
If Savvinos Ltd is VAT registered:		
– no need for Nicole & Co to register	1	
– the reverse charge procedure applies	<u>1</u>	
	<u>4</u>	4
(c) Correct calculation of land transfer fees	<u>1</u>	1
(d) Proposal constitutes tax evasion and is illegal	1	
Discussion of potential consequences for other citizens/provision of government public services	1,5	
Firm should resign if proposal materialises	<u>1</u>	
	<u>3,5</u>	3
(e) Immovable property taxes 1 January 1980 value of land with building	1	
Tax is payable every 30 September based on value as at 1 January	1	
Andreas will need to estimate the value of the construction work in progress	<u>1</u>	
	<u>3</u>	3
(f) Rent chargeable to income tax and SDC	1	
20% statutory deduction does not apply, with reason	1	
Andreas also receives benefit which is taxable	0,5	
Value of benefit calculated by the Commissioner	0,5	
Value of benefit cannot exceed cost of construction	1	
Value of benefit to be spread equally over lease period	1	
Benefit included in taxable income	0,5	
Explanation of capital allowances treatment	1	
Benefit not treated as rental income (no SDC or 20% deduction)	0,5	
Andreas will have to submit balancing statement at the end of the lease period	<u>1</u>	
	<u>8</u>	<u>7</u>
		<u>20</u>

	Available	Maximum
4 Alexander		
(a) Need to move management and control to Cyprus	1	
Explanation of management and control	<u>2</u>	
	3	3
(b) Business can be taxed in the normal way at 10%	1	
Option to tax under TTS	1	
TTS option must stay in force for ten years	1	
Tax exemptions under TTS (1 mark each)	<u>3</u>	
	6	6
(c) Explanation of branch being permanent establishment	1	
Explanation of computation of net taxable profits	2	
Explanation of tax treatment to and from reserves	1	
Maximum deduction of head office expenses for non-life	1	
Maximum deduction of head office expenses for life	1	
Explanation of treatment of tax losses	1	
Minimum tax of life insurance business	<u>1</u>	
	8	8
(d) Tax treatment of premium on Alexander's life	1,5	
Reference to one-sixth restriction re personal allowances	0,5	
No allowance available to Alexander for premium on his wife's life	1	
Recommendation to place wife's policy in her own name	<u>0,5</u>	
	3,5	3
		<u>20</u>

	Available	Maximum
5 Oxana		
(a) Partnership is taxed as a transparent vehicle with explanation	<u>2</u>	2
(b) Transaction will be considered trading with tax calculation	1	
Explanation of reasons based on the main badges of trade	<u>2</u>	
	<u>3</u>	3
(c) Explanation of cash flow issue between income and expenses	1	
Explanation of Oxana's personal legal obligations for loan	1	
Explanation of risk of increase in interest rate	<u>1</u>	
	<u>3</u>	3
(d) Option 1		
Dividend income taxed under income tax and SDC	1	
Explanation of Oxana's effective rates of tax	1,5	
Discussion of distributable reserves	1	
Discussion of reduction of share capital or liquidation	1,5	
Option lacks flexibility/high capital amount retained	1	
Interest payable is of no tax benefit	0,5	
Option 2		
Interest income taxed under SDC at 15%	1	
Interest tax deductible for Luda, thus effective rate even less when compared to dividends	1	
SDC on interest income is payable regardless of receipt of income	1	
Discussion of bank mortgage being preferred creditor	1	
Option offers greater flexibility for extracting monies via repayment of the loan	0,5	
Option 3		
Interest is tax deductible for Luda	1	
Oxana can only receive dividends	1	
Legal obligation of loan falls solely on Luda offering perhaps more flexibility with the bank	<u>0,5</u>	
	<u>13,5</u>	<u>12</u>
		<u>20</u>