
Answers

Tutorial note: *These model answers are considerably longer and more detailed than would be expected from any candidate in the examination. They should be used as a guide to the form, style and technical standard (but not length) of answer that candidates should aim to achieve. However, these answers may not include all valid points mentioned by a candidate and credit will be given to candidates making such points.*

1

MEMORANDUM

From: AN Other senior
To: AN Other tax partner
Subject: Topside group tax issues
Date: 6 December 2007

I refer to the recent meeting held at our offices with the managing director of the Topside group, during which we discussed several tax issues affecting the group. These issues are analysed hereinbelow:

- (a) (i) The interest paid by Topside Public Ltd on the bank loan for the acquisition of shares in its subsidiary companies is not a tax deductible expense; the company's investment in subsidiaries is considered to be of a long-term nature, therefore the loan interest for such acquisitions is deemed to be of a capital nature. The treatment of this item in the company's tax computation was wrong and the tax computations for 2006 and prior years will have to be amended.

This will result in additional corporation tax of £3,500 (£35,000 at 10%) for 2006 and £5,000 (£50,000 at 10%) for prior years. These amounts will also be subject to penalties and interest.

- (ii) Interest charged on intercompany loans should be charged at the open market interest rate and not at a reduced rate as in this case, as the transaction cannot be considered as effected at arm's length. The practice will, therefore, not be acceptable to the Inland Revenue and Topside Public Ltd will have to amend its corporation tax and special defence contribution computations for 2006 (and prior years if applicable), in order to reflect the market interest rate.

This will result in additional corporation tax of £5,000 (£200,000 less £100,000 less 50% exemption at 10%) and additional special defence contribution of £10,000 (£200,000 less £100,000 at 10%) for 2006. These amounts will also be subject to penalties and interest as applicable to each tax.

The intercompany loan agreements should be amended, to provide for a market interest rate to be charged; the debtor companies will be able to deduct this interest as a trading, tax deductible expense, since the loans were taken for the purpose of the expansion of their operations

- (iii) The capital gain on the sale of the holding in Downhill (UK) Ltd will be exempt from corporation tax, as gains on the sale of shareholdings are specifically exempt.

The fact that Downhill (UK) Ltd has trading goodwill value does not give rise to any corporation tax liability for Topside Public Ltd, as the company has not disposed of any trading goodwill.

This gain is also exempt from capital gains tax, as Downhill (UK) Ltd does not hold any immovable property situated in Cyprus – according to my notes, the only immovable property of the company is situated in London.

- (iv) The Athens branch profits are not taxable in Cyprus, as profits of a foreign branch which is considered to be a permanent establishment overseas are exempt from Cyprus income/corporation tax, provided such income is not taxed in that other country at rates which are substantially lower than Cypriot tax rates (this is not the case here, as Greek corporate tax rates are higher than Cypriot rates).

However, losses of a foreign branch may be relieved against profits arising in Cyprus, as has been correctly claimed here in previous years.

However, if in future years, the foreign branch realises profits, as in the case of 2006, part of these profits, to the extent of the losses previously relieved (£60,000 in this case) will be taxed in that year (2006)/future year(s) under the recapture of losses provisions. However, double tax relief may be claimed for taxes paid in Greece, which in this case will eliminate any liability, as Greek tax rates are higher.

- (v) Rental income, which consists of the lease premium and the annual rental, less any rental expenses incurred wholly and exclusively will be assessable to corporation tax. However, capital allowances on the original cost of the building at 3% per annum will be given (£100,000 – £30,000) at 3% = £2,100.

Consequently the corporation tax in respect of the rental income will be £32,790 (£350,000 – 20,000 – 2,100) at 10%. In addition the company will be subject to special defence contribution of £7,875 (£350,000 less 25% at 3%).

Both of these tax liabilities will be extinguished through double tax relief obtained by reference to the tax paid in the UK.

- (vi) Dividends received by a Cyprus tax resident company (Downside Ltd) from another Cyprus tax resident company (Up&Down Ltd) are specifically exempt from corporation tax.

They are also exempt from special defence contribution.

- (vii)** A tax group of companies has the following characteristics:
a company controls directly or indirectly more than 75% of another company/companies, or the companies are under the common control of another company; and

the 75% holding is applicable for the whole of the tax year in question; and all the companies are Cyprus tax resident.

In the case of the Topside group, the only company that forms a group with Topside Public Ltd is Downhill (UK) Ltd, which although registered in the UK, is Cyprus tax resident per the 'management and control' test and the holding was more than 75%, during the the whole of 2006.

Downside Ltd does not form part of the Topside group, as it was not a 75% subsidiary for the whole of 2006, and the shareholding in Upsize Ltd is less than 75%.

It must be noted however that Downside Ltd and Up&Down Ltd will form a second group as Downside controls more than 75% of Up&Down, another Cyprus tax resident company, for the whole of 2006.

- (viii)** As Topside Public Ltd and Downhill (UK) Ltd form a group for group loss relief purposes, Downhill (UK) Ltd should surrender its year 2006 loss of £750,000 (£700,000 + £50,000) to Topside Public Ltd. This election will result in corporation tax savings of £75,000 (£750,000 at 10%).

With regards to the Downside Ltd – Up&Down Ltd group, an election to surrender losses from Downside Ltd to Up&Down Ltd is not advisable, as all the profits of the latter company arise from a foreign branch and are therefore exempt from Cyprus corporation tax (as Ukrainian corporation tax rates are higher than Cypriot rates). In light of the expected profits in 2007 and 2008, Downside Ltd's 2006 losses should be carried forward and offset against the first available profits, with potential corporation tax savings of £30,000 (£300,000 at 10%).

- (b) (i)** Topside Public Ltd and Upsize Limited have an obligation to register for VAT in Cyprus, as their sales made in Cyprus clearly exceed the VAT registration limit of £9,000.

Topside Public Ltd's branch in Athens may have an obligation to register for VAT in Greece.

Downside Ltd, although it does not make any supplies in Cyprus, is still considered as making taxable supplies in Cyprus as the place of supply of exported goods is considered to be Cyprus. Since the company's sales are made to local independent wholesalers, no VAT registration will be required in the countries to which it exports.

Downhill (UK) Ltd has two activities. The first activity is the supply of goods to Cyprus and overseas. As the company's sales clearly exceed the registration limit, the company will have to compulsorily register for VAT in Cyprus by reference to both its sales of goods in Cyprus and exports for which the place of supply is Cyprus.

With reference to interior design services, these relate to immovable property, so the place of provision of the service is the country in which the immovable property is situated. Therefore, in respect of the provision of services to Cyprus, there will be an obligation to register for VAT in Cyprus whereas for the provision of services in the UK and other non-EU countries, the company may have to register for VAT in the UK and each of the other countries, if its sales in each of these countries exceed the local registration limits.

Up&Down Ltd clearly provides services in the Ukraine, as these relate to immovable property situated there and are made through a permanent establishment in the Ukraine, if its sales exceed the local registration limit it will have to register for VAT in the Ukraine. This company's outputs are outside the scope of Cyprus VAT law.

- (ii)** The VAT rates applicable for each type of output made in Cyprus by each of the companies of the group are as follows:

Topside Public Ltd: in respect of the imported furniture sold in Cyprus, the standard rate of 15%.

Downside Ltd: zero VAT rate, on exports to non-EU customers.

Upsize Ltd: in respect of foodstuff sold in Cyprus – zero VAT rate as in general the supply of foodstuffs is a zero rated activity.

Downhill (UK) Ltd: in respect of sales of furniture and interior design services provided in Cyprus, the standard rate of 15%.

Downhill (UK) Ltd: zero VAT rate on exports to non-EU customers

Note: As stated above, Up&Down Ltd has no outputs within the scope of Cyprus VAT law.

- (iii)** It is possible to register Topside Public Ltd, Downside Ltd and Upsize Ltd under a VAT group, as they belong to the same group of companies, they are incorporated in Cyprus and have a place of establishment in Cyprus.

Downhill (UK) Ltd cannot be included in the group as it is a UK registered company.

Up&Down Ltd also cannot be included in the group because, although registered in Cyprus, it does not have a place of establishment in Cyprus.

Topside Public Ltd is a net VAT payer, whereas Downside Ltd and Upsize Ltd both make zero rated sales and so will be eligible for VAT refunds.

If a group registration is made, this will have the effect that only one tax return will be submitted, thus enabling the credit VAT balances of Downside Ltd and Upsize Ltd to be offset against the VAT due by Topside Public Ltd. However, as the credit balances of these two companies relate to zero rated sales, it is possible for them to apply and obtain a VAT refund for every tax period individually. There is, therefore, no advantage to registering as a VAT group, as there is no real cash flow benefit in this case and the group will inherit all the administrative and other disadvantages of a group VAT registration, e.g. the limit of £1,000 for correction of errors will refer to the group and not to individual companies.

2 (a) Expected profits on the Peyia and Timi projects

	£	£
Peyia – expected sale proceeds	350,000	
– cost of acquisition	(230,000)	
– land transfer fees on acquisition (4,000 + 130,000 at 8%)	(14,400)	
– bank loan interest (230,000 x 70% at 7% x 6/12)	(5,635)	
– collateral and arrangement fees (230,000 x 70% at 2%)	(3,220)	
	<hr/>	
Net profit		96,745
Timi with Method 1		
– expected sales (150,000 x 7 x (100 – 2)%)	1,029,000	
– cost of land	(250,000)	
– land transfer fees (4,000 + 150,000 at 8%)	(16,000)	
– bank loan interest (250,000 x 70% at 7%)	(12,250)	
– construction cost	(600,000)	
– bank loan interest (600,000 x 70% at 7%)	(29,400)	
– collateral and arrangement fees (600,000 + 250,000) x 70% at 2%	(11,900)	
	<hr/>	
Net profit		109,450
Total net profit (Method 1)		<hr/> 206,195
Timi with Method 2		
Net profit (Method 1)		206,195
Add: Loan interest saved (420,000 – 350,000) at 7%		4,900
Collateral and arrangement fees saved (420,000 – 350,000) at 2%		1,400
		<hr/>
Total net profit (Method 2)		212,495

(b)

**A N tax consultant
Nicosia
Cyprus**

**Chris
London Road
London
UK**

3 January 2007

Dear Chris

Re. Your proposed transactions in immovable property in Cyprus

I refer to our meeting in Nicosia earlier this week and set out below my advice regarding your proposed transactions in land and associated business ventures.

(i) Your business ventures involve only yourself and Costas

1. Business structure

The two projects, Peyia and Timi, are expected to generate a taxable trading profit of £206,195 (ex part (a)) within a period of twelve months. If the two projects are developed in your own names this will mean that the total profit of £206,195 will be taxed at an income tax rate of 30%, since both you and Costas are higher rate tax payers on the basis of your current income, and giving an income tax liability of £61,859. However, if the projects are developed in the name of a Cyprus limited company, the profits of £206,195 will be taxed at the rate of only 10%, giving a corporation tax liability of £20,620. Comparing the income tax liability of £61,859 to the corporation tax liability of £20,620, it is clear that – at the level of the company – it is advantageous to take the company route.

However, at the time these profits will be paid out by the company to you and Costas as dividends, the final tax liability will increase to 30% as you are both Ackland tax residents, and in Ackland dividends are aggregated with other income and taxed at income tax rates i.e. 30% in your and Costas's cases.

2. Pomos land

Since your intention is to sell the Pomos land in order to generate cash, it would be preferable to sell it directly to a prospective buyer instead of first transferring it into the name of any company which you and Costas may decide

to incorporate. The reason for this is that otherwise land transfer fees of £12,000 (£4,000 + £100,000 at 8%) will be paid twice i.e. by the company and later on by the end buyer, as you cannot claim any exemption from land transfer fees from the first transfer due to the fact that the company will not be 100% owned by you. The capital gain of £145,378 (working) will be taxed ultimately in Ackland at your highest income tax rate of 30%, resulting in a liability of £43,613. This will have to be paid by you, whether you transfer the land to a company or sell it directly to a prospective buyer. The only difference is that your contribution to the new business will potentially be lower than Costas's contribution by £43,613.

3. Tax residence

I believe that since you will be spending a lot of time in Cyprus, it will be advisable to move your tax residence to Cyprus as this will save you large amounts of taxation on an annual basis, as follows:

- Your pension income may be taxed (if you so elect) under a special mode of taxation in Cyprus, resulting in a total tax liability of only £1,900 (£40,000 less £2,000 at 5%). Currently this income attracts an income tax liability of £8,250 (£10,000 at 0% plus £5,000 at 20% plus £5,000 at 25% plus £20,000 at 30%).
- Any dividends received from the Cyprus company (see (1) above) will not be subject to income tax but to special defence contribution at the rate of 15% only, giving a tax benefit of 15% (30% – 15%) on dividends received.
- Since you will be actively involved with the company, you may charge remuneration to the company of an amount equal to a market value salary. Assuming this is £10,000, then you can receive this sum free of tax as it is fully within the zero rate tax band, since neither the dividends received nor your pension income from overseas taxed under the special mode of taxation in Cyprus are aggregated with other income received for general income tax purposes. This will also save a further £1,000 (£10,000 at 10%) of corporation tax as far as the company is concerned.

In addition, if a change of residence can be effected prior to the sale of the Pomos land, the capital gain on its disposal (see (2) above) will be taxed at the Cyprus capital gains tax rate of 20%, saving a further £14,538 (£145,378 at (30% – 20%)) in tax (taxed in Cyprus, not in Ackland).

(ii) Peter participates in the Timi project

1. Structure of Peter's involvement

If Peter participates in the Timi project, it will be necessary to acquire the Timi land separately from the other two pieces of land using a business structure in which all three of you participate.

Peter will be in a highly advantageous position if he participates through a direct shareholding in a Cyprus company. As he will not have any income tax liabilities in Byland, no withholding tax will be imposed on the dividends paid out to him by the company and, as he is not a tax resident of Cyprus, he will be exempt from the 15% special defence contribution on dividends received. In this way, his share of the profits will only suffer the 10% corporation tax liability, which will be borne by the company.

If Peter forms a partnership with a limited company in which you and Costas are shareholders then his share of the profit will be taxed in Cyprus at income tax rates ranging from 0% to 30% (mostly 30%) as he will be a physical person trading in immovable property in Cyprus, and therefore taxed in Cyprus at normal tax rates.

If Peter takes part in the partnership through one of his companies overseas, his company's share of the profit will be taxed at the corporation tax rate of 10% but, as Peter's company will be a non-Cyprus tax resident company, the 10% will be the final tax as – just as for a direct shareholding in a Cyprus company by an individual non-resident – Cyprus will impose no withholding tax on dividends paid abroad and no special defence contribution on non-Cyprus resident companies.

Thus it is distinctly preferable for Peter's participation to be via a company and not as an individual, but it does not matter whether this occurs directly or indirectly via one of his existing overseas companies.

2. Loan interest

Loan interest paid to Peter will not be subject to Cyprus income tax as interest income is specifically exempt when received by a physical person.

This income will also be exempt from special defence contribution as Peter is a non-Cyprus resident and non-residents are exempt from the special defence contribution.

I am at your disposal should you require anything further.

Yours sincerely,

A N Other

Working

	£
Capital gain on the transfer of the Pomos land	
Market value	200,000
Indexed cost £15,000 * 104.00/34.96	<u>(44,622)</u>
Capital gain	155,378
Annual exemption	<u>(10,000)</u>
Chargeable gain	<u>145,378</u>

- (c) As Peter wishes to invest in the Timi project only, a new company will have to be formed in which all three of them are shareholders and to which the Timi land will be transferred. As the development of this land is a trading activity, the tax liabilities arising on the transfer of the land will be:

- Corporation tax of £5,000 (£250,000 x 20% at 10%) payable by the existing company.
- Land transfer fees of £20,000 (£4,000 + £200,000 at 8%) payable by the new company.

If all three of them – Chris, Costas and Peter – were to be shareholders in the new company, as Peter will be acquiring 50% of the shares i.e. Chris and Costas will not have the majority of the shares, there will be no way to mitigate the tax due.

However, if the new company is formed only with Chris and Costas as shareholders and Peter becomes the company's partner, it is possible to apply for an exemption from paying corporation tax (or capital gains tax) and land transfer fees with reference to the transfer of the land to the new company in exchange for shares, through a scheme of re-organisation, as the shareholders in the two companies will be the same people (Chris and Costas) and the land development can be considered as an autonomous part of the organisation.

- 3 (a) Since the corporate tax rates in the three countries in which the two partners maintain companies through which they run their business is 30%, and the corporate tax rate of a Cyprus tax resident company is only 10%, it would clearly be advantageous for them to run as much as possible of their business through a Cyprus company, thereby saving corporate taxes on taxable profits of 20% (30% less 10%).

- (b) It would not be advantageous for Jack to change his status to a Cyprus tax resident, as he is taxed in the UK on a remittance basis. This means that although income tax rates are higher in the UK he can 'control' the amount of income tax he pays in the UK by simply not remitting all of his income to the UK. In addition, if he is not a Cyprus resident, his future dividend income from the Cyprus company will not be subject to special defence contribution at 15%. Also, as a non-resident Jack will not be liable to Cyprus income tax on remuneration received for services provided to the company outside Cyprus. Therefore, if his income from the UK company is enough to support all or most of his cost of living in the UK then, to the extent that he does not need to remit other income to the UK, any profits of the Cyprus company that he is entitled to will only attract tax at the Cyprus corporate tax rate of 10%, whichever mode of withdrawal of these profits he decides i.e. remuneration for services provided to the company outside Cyprus or dividends. However, it would be advantageous for Jack to receive at least some remuneration as the Cyprus company's taxable profits will be reduced by such remuneration, thus providing a further 10% tax benefit overall.

Marisa is taxed in the Netherlands on her worldwide income, which would include income from the Cyprus company, either in the form of remuneration or dividends. At the same time, if she takes up residence in Cyprus, she will be taxed in exactly the same way i.e. her income from her involvement in the companies in the three other countries concerned will be taxable in Cyprus.

The following differences between Cyprus and the Netherlands are crucial, however:

- (i) Dividend income in the Netherlands is taxed as part of total income for the year, whereas in Cyprus dividend income is exempt from income tax but subject to special defence contribution at 15% only. This fact makes Cyprus more attractive as a place of residence as taxes will be 41% (56% less 15%) lower on dividend income.
- (ii) The top rate of tax in Cyprus is 30% compared to 56% in the Netherlands. Thus, as a Cyprus tax resident, if Marisa takes income in the form of remuneration from the Cyprus company she will be taxed at an income tax rate 26% lower in Cyprus than in the Netherlands.
- (iii) As the Netherlands has a particularly high top rate of income tax (56%) changing her residence to Cyprus may also lower the rate of tax on Marisa's income from her other companies with Jack, as well as on any other investment income she has, even if this is subject to tax in the source country (e.g. top rates of tax in the UK and SA are only 30%).

Therefore, it is more advantageous for Marisa to take up residence in Cyprus.

- (c) It is obvious from the analysis in part (b) above that the two partners have different tax profiles. If Jack and Marisa decide not to change their tax residence, there is no scope for using intermediary personal company(ies), as both remuneration and dividend income are taxed in the same mode both in the Netherlands and the UK.

As stated above, it is not in Jack's interest to become a Cyprus tax resident so long as he is taxed in the UK on the remittance basis. However, although this means he is indifferent at his personal level as to whether he receives a salary or dividends, he is still better off receiving a salary as the companies' taxable profits will be reduced by such a salary, giving a tax benefit of 30% for each of the non-Cyprus companies and 10% for the Cyprus company.

However, if Marisa changes her tax residence to Cyprus, then there is some scope for using an intermediary personal company for Marisa only, as Marisa is likely to be subject to an income tax rate of (mostly) 30% on her salaries from the four trading companies and a 15% special defence contribution rate on dividends received.

As a Cyprus tax resident, Marisa would prefer to receive dividends than salary. However, Marisa's 'preference' would cost the companies corporation tax on a reduced salary (at 30% outside Cyprus and 10% within Cyprus). For example, if Marisa's salary in each company is £20,000 and this salary is reduced to zero, then the three non-Cyprus companies will collectively incur additional corporation tax of £18,000 (£60,000 at 30%), with Marisa saving tax in Cyprus of £9,000 (£60,000 x (30% – 15%)).

It is therefore vital that the salary profile of Marisa either directly in her name in the three non-Cyprus companies, or indirectly through a personal Cyprus company, is maintained. This could be achieved through using another company wholly owned by Marisa to hold the shares on her behalf and charging these companies a management fee equal to her salary. The company could well be another Cyprus company, which would then pay Marisa dividends after paying corporation tax at 10% in Cyprus. In this case Marisa's overall tax liability would be at the reduced rates of 19.45% (10% corporation tax + (90% x 70% at 15% special defence contribution)) to 23.5% (10% corporation tax + (90% at 15% special defence contribution)), depending on the proportion of income actually distributed, as opposed to the 30% income tax rate.

- 4 (a)** If a company were formed by Anatoli as proposed, that was tax resident in Cyprus, it would be taxed as follows:
- Dividends received from private companies would not be expected to attract any corporation tax or special contribution for the defence (SDC), as presumably the holding is over 1%. However, dividends received from public companies will possibly attract SDC as the holding will presumably be less than 1%.
 - Income from immovable property will be subject to corporation tax at 10% and SDC at 3% after a deduction of a 25% allowance, and with any taxes paid overseas deductible from the Cyprus tax liabilities (double tax relief (DTR)).
 - Interest income, as it arises from bank deposits, will be considered as investment income and will be 50% exempt from corporation tax, with the remainder charged at 10%, but it will also be subject to SDC at 10% (resulting in a total tax liability of 15%) and again with any tax withheld at source deductible from the Cyprus tax liabilities (DTR).
 - Potential gains from the sale of investments in shares or immovable property will be exempt from capital gains tax, as they will fall outside the scope of Cyprus capital gains tax provided that the companies in which Anatoli is invested do not in any way involve interests in Cyprus immovable property, as the profit on the sales of shares in companies not holding interests in immovable property are specifically exempt from corporation tax.
 - As presumably all of the company's beneficial shareholders will be non-Cyprus residents, there will be no SDC liability on the payment of a dividend, nor are there any provisions for withholding taxes on dividends paid overseas.
- (b)** A trust is subject to tax in terms of income tax, special defence contribution (SDC), capital gains tax and any other taxes relating to property, in the same way as its beneficiaries would have been taxed. However, although the beneficiaries are liable to tax, the tax assessments are raised in the name of the trustee, who has the obligation of submitting the tax return and settling the tax liabilities. However, in the case of an international trust, provided all of the trust property is situated outside Cyprus and all of the beneficiaries are non-Cyprus residents, the trust income and its property will be fully exempt from any form of taxation in Cyprus.
- (c)** From the analysis in parts (a) and (b) above, one can see that in the case of an international trust, there will be no tax liabilities in Cyprus, whereas in the case of a limited company tax liabilities will be generated. However, it is possible that taxation will be paid in the countries of residence of Anatoli's investments that will possibly cover the Cyprus tax liabilities of a potential limited company in Cyprus. More information on the current location of the various assets would be needed for a definitive answer to be given on this point. Even if the position is tax neutral, it is necessary to consider the legal position, given that three of the shareholders of this company will be minors, which will make the normal operation of the company impossible, unless a trust is set up within the company's shareholding, with the trustee acting on behalf of the minors.

It is clear therefore that in Anatoli's case, the most suitable vehicle, taking into account both tax and non-tax matters, would be the creation of a trust. It should be noted that this would also have the advantage that while the activities of a limited company will have some exposure to the public, through its annual returns and financial statements filed at the Registrar of Companies office, a trust's documents and accounts will not in any way be open to public inspection.

- 5 (a)** The provision of consultancy services to Cyprus residents will be a standard rated supply, as the provider belongs in Cyprus, the recipient also belongs to Cyprus and, therefore, the place of supply is Cyprus.

On the other hand, the place of provision of consultancy services to Greek VAT registered residents will be in Greece, as these consultancy services fall within one of the special rules re: the place of supply and are considered to be provided in the country where the recipient belongs. Therefore they will be outside the scope of Cyprus VAT.

It should be noted, however, that Andithesis Ltd may still have an obligation to register for VAT purposes in Greece with reference to services provided there. The place of supply of artistic activities including concerts is the country where the concerts are organised, as the place of provision of such services, is the place where these are physically carried out. Therefore, concerts in Cyprus will be standard rated supplies in Cyprus, concerts in Greece will be standard rated supplies in Greece and the same may apply for Lebanon. Thus Andithesis may also have to register for and apply VAT in these two countries.

The place of supply of the provision of the services of organising conferences in Cyprus (as in the case of concerts) is the place where these are physically carried out i.e. Cyprus. These services will therefore also be standard rated for VAT.

The sale of the magazine in Cyprus is a supply made in Cyprus but which is taxable at the lower rate of 5%. The sale to EU distributors constitutes an intercommunity supply. In this case, if the simplified procedure which includes obtaining and confirming the VAT registration number of the EU distributor is followed, the supply will be considered as zero rated. The sale of the magazine to EU distributors who are not VAT registered in their own country or for whom their VAT registration number cannot be confirmed, constitutes a supply made in Cyprus, again at the reduced rate of 5%. The sale of the magazine to non-EU distributors constitutes an export of goods from Cyprus and therefore, it is a zero rated supply.

- (b)** Cypriot participants will not be entitled to a VAT refund if not VAT registered. However the VAT paid will form part of the input VAT of persons who are VAT registered.

The position regarding foreign participants is dependent on whether they are VAT registered in their own countries and are or are not from the European Union (EU).

Persons who are not VAT registered in their own countries will not be entitled to a VAT refund.

EU VAT registered participants will be entitled to a VAT refund on provision of proof of VAT registration in their own countries. An application must be submitted to the Cyprus VAT authorities.

Non-EU VAT registered participants, in addition to the provision of proof of VAT registration in their own countries, will have to prove that their country's VAT law includes similar provisions to Cyprus VAT law and allows VAT refunds to Cypriot traders on similar occasions in their home country.

- (c)** The income of non-resident professionals and artists is taxed in Cyprus under a special mode of taxation. Under these income tax provisions, income tax should be withheld at source at the rate of 10% of gross income, including any amounts paid for hotel, accommodation etc. The Cypriot payer of the income has an obligation to withhold the tax and pay it to the taxes collection before the end of the month which follows the month of payment.

	<i>Marks</i>
1 (a) (i) Treatment of interest, with reason	1.0
Computation of additional tax	0.5
Refer to penalties and interest	0.5
	<u>2</u>
(ii) Identify treatment as incorrect, with reason	1.0
Computation of additional tax	0.5
Refer to penalties and interest	0.5
Identify need to amend the agreements	0.5
Deductible in debtor companies, with reason	0.5
	<u>3</u>
(iii) Treatment of gain on sale for corporation tax, with reason	0.5
Position of trading goodwill value, with reason	0.5
Treatment of gain on sale for capital gains tax, with reason	1.0
	<u>2</u>
(iv) Treatment of profits, with reasons	1.5
Identify previous treatment of losses as correct	0.5
Explain the effect of the recapture of losses, with reason	1.0
	<u>3</u>
(v) Treatment of rental income, including the availability of capital allowances	1.0
Computation of liabilities (incl SDC)	1.0
Position re double tax relief	1.0
	<u>3</u>
(vi) Treatment of dividends (incl SDC)	1.0
(vii) Identification of Topside group, with reasons	2.0
Identification of Downside group, with reason	1.0
	<u>3</u>
(viii) Surrender of losses by Downhill (UK) Ltd, (incl tax saving)	1.0
Explain why the surrender of losses by Downside Ltd is not beneficial	2.0
	<u>3</u>
(b) (i) Position of Topside Public Ltd and Upsize Ltd, with reason	0.5
Position of Athens branch	0.5
Position of Downside Ltd, with reasons	1.5
Position of Downhill (UK) Ltd:	
– re supply of goods, with reason	1.0
– re supply of services, with reasons	1.5
Position of Up&Down Ltd, with reasons	1.0
	<u>6</u>
(ii) Topside Public Ltd	0.5
Downside Ltd	0.5
Upsize Ltd	0.5
Downhill (UK) Ltd	1.5
	<u>3</u>
(iii) Identification of potential VAT group, with reasons	2.0
Explain the potential benefits of group registration	2.0
Explain why in fact group registration is not actually beneficial	1.0
	<u>5</u>
Presentation and format of the memorandum	1.0
Effectiveness of communication	1.0
	<u>2</u>
Total marks	<u>36</u>

	Marks
2 (a) Peyia: land transfer fees	0.5
bank loan interest and associated fees	1.0
Timi (method 1): expected sales	0.5
land transfer fees	0.5
bank loan interest and associated fees	1.5
Timi (method 2): adjustments	1.0
	<u>5</u>
(b) (i) Business structure:	
Tax rate applicable, with reason	1.0
Company structure preferable, with reason	1.0
Effect when dividends are paid	1.0
	<u>3</u>
Pomos land:	
Recommend direct sale to third party	0.5
Effect on land transfer fees, with reason (incl computation)	2.0
No effect on the capital gains tax position (incl computation)	2.0
Potential effect on Chris's contribution to the business	0.5
	<u>5</u>
Tax residence:	
Recommend becoming Cyprus tax resident	0.5
Treatment of pension income (incl computation)	1.5
Treatment of dividend income	1.0
Treatment of remuneration (incl in the company)	2.0
Treatment of Pomos land capital gain	1.0
	<u>6</u>
(ii) Structure for Peter's participation:	
Identify need for a separate business vehicle for the Timi project	1.0
Position with direct shareholding, with reasons	1.5
Position with partnership, with reasons	1.5
Position with indirect investment via a foreign company, with reasons	1.5
Conclude in favour of participation via a company	0.5
	<u>6</u>
Loan interest:	
Treatment for income tax, with reason	1.0
Treatment for SDC, with reason	1.0
	<u>2</u>
Presentation and format of the letter	1.0
Effectiveness of communication	1.0
	<u>2</u>
(c) Identify need to form a new company and transfer Timi land	0.5
Identify the resulting liability (incl computation) and by whom payable to:	
– corporation tax	1.0
– land transfer fees	0.5
Determine that no mitigation is possible if holdings in the new company are 50:25:25, with reason	1.0
Explain the structure required for taxes to be mitigated	2.0
	<u>5</u>
Total marks	<u>34</u>

	Marks
3 (a) Identify the effect of differential tax rates	<u>1</u>
(b) Jack:	
Explain the effect of the remittance basis of taxation	1.5
Identify other tax effects re receipts from Cyprus company:	
– dividends	1.5
– salary	1.5
Conclude not beneficial to become a Cyprus tax resident	<u>0.5</u>
Marisa:	
Identify tax base as identical in both jurisdictions	1.0
Explain benefits of differential tax rates re:	
– dividend income from Cyprus company	1.0
– salary income from Cyprus company	1.0
– other non-Cyprus income	0.5
Conclude is beneficial to become Cyprus tax resident	<u>0.5</u>
	<u>9</u>
(c) Identify no benefit to either from personal companies with current tax residencies	0.5
Confirm not in Jack's interest to change his tax residence	0.5
Identify that it is still beneficial overall for Jack to receive a salary, with reason	0.5
Identify potential benefits of using a personal service company to Marisa	0.5
Explain/illustrate the conflict between Marisa's and the companies' tax position/objectives with regard to receipt of a salary	1.5
Explain how a personal service company could be of use and illustrate the potential tax savings	<u>1.5</u>
	<u>5</u>
Total marks	<u>15</u>
4 (a) Treatment of dividends (incl SDC)	1.0
Treatment of income from immovable property (incl SDC)	1.5
Treatment of interest income (incl SDC)	1.5
Treatment of gains	1.0
Treatment of dividends paid	<u>1.0</u>
	<u>6</u>
(b) Identify the applicable taxes	2.0
Explain the responsibilities of the trustee	2.0
Explain the special position of an international trust	<u>2.0</u>
	<u>6</u>
(c) Summarise the Cyprus tax position (from analysis in (a) and (b))	0.5
Consider possible effect of overseas taxation	0.5
Identify the need for more information re this	0.5
Identify the problem of minor shareholders/legal need for a trust	1.0
Conclude in favour of a trust	0.5
Identify other non-tax advantages of using a trust – potential BONUS mark	<u>(1.0)</u>
	<u>3</u>
Total available marks	<u>15</u>

		Marks
5	(a) Treatment of consultancy services:	
	– provided to Cyprus residents, with reason	0·5
	– provided to Greek residents, with reason	1·0
	Treatment of the organisation of concerts:	
	– in Greece, with reason	1·5
	– in Cyprus, with reason	1·0
	– in Lebanon	0·5
	Treatment of the organisation of conferences, with reason	0·5
	Treatment of the publication of the magazine:	
	– in Cyprus	0·5
	– to EU distributors (inter-community supply), with reasons	2·0
	– to non-EU distributors, with reason	0·5
		8
		<hr/>
	(b) Treatment of Cypriot participants	1·0
	Treatment of non-registered overseas participants	0·5
	Treatment of registered EU participants	1·0
	Treatment of registered non-EU participants	1·5
		4
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	(c) Identify and explain special taxation provisions	2·0
	Explain obligations of Cypriot payer	1·0
		3
		<hr/>
	Total marks	15
		<hr/>