

Professional Level – Options Module

# Advanced Taxation (Cyprus)

Monday 2 June 2008

**Time allowed**

Reading and planning: 15 minutes

Writing: 3 hours

This paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

**Tax rates and allowances are on pages 3–5**

**Do NOT open this paper until instructed by the supervisor.**

**During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.**

**This question paper must not be removed from the examination hall.**

The Association of Chartered Certified Accountants

The Institute of Certified Public Accountants of Cyprus

**ACCA**

**IFAC**

Paper P6 (CYP)

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The question paper begins on page 3.**

## SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future.
2. Calculations and workings need only be made to the nearest €.
3. All apportionments should be made to the nearest month.
4. All workings should be shown.

## TAX RATES AND ALLOWANCES

The following tax rates and allowances are to be used in answering the questions.

Income	Cumulative income	Income tax rate
€	€	
First 19,500	19,500	nil
Next 8,500	28,000	20%
Next 8,300	36,300	25%
Balance		30%

### Corporation tax

Statutory bodies	25%
All companies	10%

### Special modes of taxation on certain kinds of income

Income of a person from the rendering of ship management services	4·25%
Pensions from services rendered outside the Republic	5%
Gross amount of royalties, premiums, compensation, etc	10%
Film rental, etc of non-residents	5%
Profits of non-resident professional men, artists, etc	10%

### Capital allowances

Annual (wear & tear) allowances:

Tractors, trenches, excavators, bulldozers, transcatavators, self-propelled shovels and loaders, drums, oil tanks	25%
Motor vehicles other than saloon cars	20%
Computers and operating software	20%
Application software	
– if not exceeding €1,710	100%
– if exceeding €1,710	33·3%
Agricultural machinery and tools	15%
Other plant and machinery	10%
Hotel, industrial and agricultural buildings	4%
Commercial and other buildings	3%
Glass houses – metallic skeleton	10%
Glass houses – wooden skeleton	33·3%

### Interest and surcharge on unpaid tax

Income and corporation tax:

Interest on income and corporation tax assessments	9% p.a.
Surcharge in cases of unjustifiable omission	5% of tax due.
PAYE assessments	9% interest plus surcharge of 1% per month
Special defence contribution	9% p.a.

	<b>Value added tax</b>
Registration limit	€15,390

	<b>Capital gains tax</b>
Rate	20%
Life time exemptions (maximum €85,500):	
General	€17,100
Agricultural land	€25,650
Residential dwelling	€85,500

	<b>Immovable property tax</b>
Not exceeding €171,000	nil
From €171,001 to €427,500	2.5‰
From €427,501 to €855,000	3.5‰
€855,001 and above	4‰

	<b>Stamp duty</b>
<i>Ad valorem</i> duty	
Not exceeding €171,000	2.6 cents on every €17 or part of €17
Exceeding €171,000:	
First €171,000	€171.00
Balance	3.4 cents on every €17 or part of €17

	<b>Land transfer fees</b>		
<b>Value per property</b>	<b>Rate</b>	<b>Fees</b>	<b>Cumulative fees</b>
		€	€
Not exceeding €85,500	3%	2,565	2,565
From €85,501 to €171,000	5%	4,275	6,840
€171,001 and above	8%		

A collateral fee of 1% is also due to the land registry department on the value of a secured loan

	<b>Social insurance</b>
Employer	6.3%
Employee	6.3%
Maximum insurable income of employees:	
– weekly paid	€42,588 p.a.
– monthly paid	€42,600 p.a.

Self-employed persons (minimum income/contribution)

Weekly income	Annual income	Quarterly contribution	Annual contribution
€	€	€	€
190	9,880	286.50	1,146
260	13,520	392.00	1,568
327	17,004	493.00	1,972
520	27,040	784.25	3,137
819	42,588	1,235.00	4,940

Other contributions by employers:

Social cohesion fund	2%
Redundancy fund	1.2%
Industrial training fund	0.5%
Vacation leave fund (if not exempt)	8%

**Retail price index**  
**(for the purposes of capital gains tax)**  
**Base 2005 = 100 (Monthly index)**

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1.1.80	34.96											
1980	35.40	35.68	35.99	37.23	36.74	36.81	37.54	37.57	38.22	38.53	38.79	39.16
1981	39.62	39.95	40.32	40.61	40.62	41.01	41.50	41.76	41.98	42.33	42.95	43.20
1982	43.18	43.58	43.46	44.05	43.95	43.63	43.44	43.73	44.19	44.38	44.94	45.19
1983	45.59	45.66	46.08	46.66	46.31	45.69	45.70	46.08	46.17	46.64	46.80	47.06
1984	47.46	47.78	48.06	48.38	48.80	48.86	49.21	49.15	49.01	49.63	50.41	50.90
1985	50.85	50.89	51.31	51.44	51.31	50.84	50.60	51.42	52.11	52.65	51.92	51.85
1986	52.18	52.13	52.24	51.83	51.25	51.21	51.75	51.73	51.71	52.40	53.06	53.31
1987	52.76	52.63	53.23	53.04	53.41	53.88	53.10	53.82	53.91	53.71	54.16	54.53
1988	54.47	54.89	55.22	55.79	55.22	54.73	54.35	54.71	55.35	55.97	56.71	56.82
1989	57.46	57.17	57.28	57.47	56.87	56.66	56.88	57.02	57.39	58.43	58.44	58.42
1990	58.21	58.75	59.37	60.25	60.50	60.04	59.50	59.93	60.12	60.80	61.00	61.80
1991	62.18	61.69	62.18	62.65	63.08	62.44	62.63	61.71	62.87	64.54	64.77	65.83
1992	66.60	65.68	66.52	67.57	66.50	66.20	66.61	66.21	67.05	67.91	68.78	70.11
1993	70.43	68.69	69.08	70.57	69.80	69.64	70.17	69.54	70.48	71.95	72.49	72.32
1994	72.12	70.44	72.18	72.89	73.01	73.48	73.77	72.64	75.11	76.48	76.32	76.09
1995	75.34	73.46	74.92	75.47	75.49	75.49	75.83	74.62	75.49	76.82	77.38	77.33
1996	77.22	75.37	77.37	77.70	77.94	77.88	78.13	77.11	78.43	79.12	79.17	79.27
1997	79.27	78.05	80.21	80.94	80.33	80.28	81.21	79.89	81.15	82.09	82.61	82.37
1998	80.84	80.73	81.24	82.23	82.37	82.71	82.32	82.86	84.17	83.86	83.49	83.15
1999	82.80	81.66	82.96	83.19	83.42	83.54	83.78	82.99	84.72	85.42	85.65	85.99
2000	86.17	85.18	86.80	87.16	87.50	87.04	87.01	86.81	87.88	88.41	88.87	88.99
2001	87.41	87.23	88.05	88.68	88.98	89.65	87.89	88.38	89.68	90.81	90.64	91.10
2002	89.77	89.58	90.13	91.03	91.08	98.07	90.81	91.71	92.74	93.09	93.23	93.78
2003	93.45	93.55	95.51	96.11	95.73	95.15	93.84	94.41	96.11	96.89	97.01	96.12
2004	95.14	95.29	95.90	96.57	97.16	97.82	96.94	97.43	98.39	99.35	99.91	100.15
2005	98.29	98.03	98.62	99.70	99.62	99.85	98.36	99.00	100.84	102.38	102.96	102.33
2006	100.50	100.62	101.81	102.65	102.74	102.87	101.53	102.07	103.24	103.84	104.06	104.00
2007	102.15	102.08	103.33	104.47	105.00	104.78	104.00	104.59	105.96	106.95	107.73	108.07

## Section A – BOTH questions are compulsory and MUST be attempted

- 1 Your tax partner has recently passed on to you an enquiry she has received from a tax consultant based in London. The tax consultant is advisor to the Kentavros Trust, whose trustee has heard that it could be advantageous to use a Cyprus tax resident company as an investment vehicle. The enquiry is urgent because the Trust is in the process of finalising an increased investment in three Czech companies, thus a response is required as soon as possible.

The current position and investment proposals can be summarised as follows:

- (1) Kentavros Trust is a Jersey registered trust, holding 100% of the shares of a Jersey limited company (JerseyCo). JerseyCo currently holds 100% of the shares of three limited companies registered in the Czech Republic (CzechCo1, CzechCo2 and CzechCo3), all of which have been operating for some years.
- (2) CzechCo1 is a provider of mortgages to individuals purchasing residential homes, CzechCo2 is a land developer and CzechCo3 is a trader in land and other immovable property. All the activities of these three companies are carried out in the Czech Republic. The trustee of the Kentavros Trust has decided to invest in the expansion of the activities of these three Czech companies, contemplating increased profitability due to economies of scale.
- (3) The immediate capital financing requirements of the three Czech companies is estimated at €35million, out of which €30million is currently available in a bank account held by the Kentavros Trust and €5million has already been taken out as a five year loan from a Jersey bank in the name of JerseyCo. JerseyCo is to issue loan notes to the Kentavros Trust for the €30million that it needs to receive for the purposes of financing the Czech subsidiaries.
- (4) It is planned for the financing of the Czech companies to come mainly in the form of a loan, but for €50,000 to be in the form of the subscription of additional share capital. This arrangement is acceptable to the Czech tax authorities.
- (5) The Jersey bank will charge a 0.5% fee for early repayment.
- (6) It is not expected that the Czech companies will have the necessary cash flow to actually pay any interest or dividends until at least eighteen (18) months after the commencement of the expanded operations.
- (7) It is planned to sell the three Czech companies to a third party in five to seven years' time at a considerable profit.

You also ascertain the following:

- The Czech Republic imposes a 25% withholding tax on interest and dividend payments to non-treaty countries such as Jersey.
- According to the double tax treaty between Cyprus and the Czech Republic there is a 10% withholding tax on interest payments and a 15% withholding tax on dividend payments from the Czech Republic to Cyprus.
- The withholding tax provisions are not applied by the Czech Republic, if at least 25% of the share capital of the remitter Czech company has been held by a resident of another European Union country for at least twenty four (24) months.
- Withholding tax is imposed in the Czech Republic on an arising rather than on a remittance basis.
- The corporation tax rates in the Czech Republic and Jersey are 25% and 2%, respectively.

**Required:**

**Draft a memorandum in appropriate style for discussion with your tax partner as to whether it would be tax advantageous to use a Cyprus tax resident company (or companies) as a replacement for JerseyCo in the above structure.**

**The memorandum should address the following specific issues:**

- (a) How the tax residence of a company is determined in Cyprus. (2 marks)**
- (b) The basis on which dividends and interest receivable in Cyprus from the Czech companies will be taxed in Cyprus. (4 marks)**
- (c) The effect of the tax treatment of interest income as trading, as opposed to investment income and whether using two Cyprus companies with distinct activities is preferable to using just one company. Illustrate your arguments with numeric examples of the tax liabilities under each alternative. (9 marks)**
- (d) The arrangements that should be made in respect of the loan of €30million to be received by the Cyprus company(ies) from the cash currently held by the Kentavros Trust in order to ensure the tax deductibility of the interest expense, taking into account the tax treatment of loan relationships between group companies. (5 marks)**
- (e) The method by which the €5million bank loan taken out by JerseyCo can be 'transferred' to the Cyprus company(ies) in order to ensure the tax deductibility of the interest expense on this loan, taking into account the early repayment fee. (1 mark)**
- (f) Whether the dividends and interest paid by the Cyprus company(ies) to the Kentavros Trust or any other non-resident or resident party will be subject to Cyprus withholding tax. (4 marks)**
- (g) Whether any stamp duty will be payable on the transfer of ownership of the Czech companies' shares from JerseyCo to the Cyprus company(ies) and the issue of the loan notes to the Kentavros Trust (or any other party as per your advice in (d) above) by the Cyprus company(ies). (5 marks)**
- (h) Whether there will be any tax consequences in Cyprus as a result of the projected subsequent sale of the three Czech companies to a third party. (3 marks)**

**Format and presentation of the memorandum and the effectiveness with which the information is communicated. (2 marks)**

**Note: you should refer to any relevant tax anti-avoidance provisions as appropriate.**

**(35 marks)**

## 2 You should assume that today's date is 31 March 2008

Andreas, Alkis and Jack have visited your office seeking advice as to how best to structure their prospective business. During the meeting, you ascertained the following:

- (1) Andreas has recently returned to Cyprus after spending six years in the USA studying computer science. On his return to Cyprus he agreed with Alkis, one of his former classmates at secondary school and Jack, one of his former university professors (who is a permanent resident in the USA), to create a common business providing web design and other related services electronically to other businesses and individuals mostly outside of Cyprus, including both European Union and non-European Union residents.
- (2) The three partners have agreed the following:
  - (a) Andreas will work on a full-time basis for the business at an annual remuneration of €34,000, whereas Alkis will work on a part-time basis at an annual remuneration of €12,000. Jack, who will remain a USA tax resident, will not be directly involved in the business's operations and will not receive any remuneration, but he will receive an introducer's fee of 10% of the gross fee charged by the business to any clients resident outside of Cyprus introduced by him. Jack's total annual introducer's fees are estimated to be €10,000 per annum.
  - (b) The business will operate from offices in Nicosia already purchased by Jack for €250,000, one third of this figure representing the land element. Jack will charge the business a monthly rental of €1,000 for these premises.
  - (c) The initial working capital requirement will be €60,000 and the partners will contribute equally to this. Andreas does not have any money and will have to borrow from a bank, whereas Alkis and Jack can both contribute out of their own funds. Alternatively a business bank overdraft can be obtained for the full amount at an annual interest rate of 7.5%. Interest paid by the partnership on partners' capital will be 6% per annum.
  - (d) Any net profit after providing for salaries and interest on capital will be split equally among the partners.
- (3) Andreas has other income in the form of dividends from overseas of circa €20,000 per annum, from which 10% withholding tax is deducted at source.
- (4) Alkis, a Cyprus tax resident, has other income in the form of employment income from a third party of circa €30,000 taxed under the PAYE system, and annual trust income taxed at source of circa €10,000. The income of the trust comprises dividend income from Cyprus companies (50%) and Cyprus bank deposit interest (50%).
- (5) Jack's only other income is his salary from the USA university which is equivalent to circa €200,000 per annum.
- (6) For the first three years of operation, the annual profits of the business – before partners' salaries, interest on capital/bank overdraft interest, introducer's fees and the rent charged by Jack – are estimated at €150,000. This figure is expected to rise from the fourth year onwards.
- (7) It is expected that the partners will withdraw only 50% of the available profits each year.
- (8) It is estimated that the business will generate trading goodwill of circa €700,000 at the end of six years of operation at which time the partners are hoping to sell the business as a going concern.
- (9) It is anticipated that partners' salaries, interest on capital and rent charged, and the individual partners' income from other sources will all remain the same throughout the six year period.

**Required:**

Write a letter to Andreas advising the prospective partners on their and the business's tax positions. Your advice should address the following issues considering, in each case, the position if the business structure adopted is (1) a partnership; and (2) a limited company.

- (a) The tax treatment of Jack's introducer's fee as far as both Jack and the business are concerned. (2 marks)
- (b) The tax treatment of Jack's rental income as far as both Jack and the business are concerned. (6 marks)
- (c) The tax treatment of interest on the partners' contributed capital and whether it would be preferable to obtain a business bank overdraft for this amount. (4 marks)
- (d) The tax positions of each of the partners during the planned six years of operation, and which of the two alternative business structures is the most tax efficient in each case. You should support your advice in this part with relevant calculations of taxable income. (16 marks)
- (e) The tax treatment of the trading goodwill on the sale of the business in the case of the sale by the partnership; a sale by the limited company of its business as a going concern; and the transfer of shares in the limited company to the buyer. (4 marks)
- (f) Whether value added tax (VAT) will need to be charged on the sale of the trading goodwill if the business is transferred to the buyer as a going concern. (1 mark)

Format and presentation of the letter and the effectiveness with which the information is communicated.

(2 marks)

**Notes:**

1. Your advice should refer to income and corporation tax, special defence contribution, capital gains tax and stamp duty as appropriate, and where indicated, value added tax (VAT).
2. You should ignore social insurance and social cohesion fund contributions.

**(35 marks)**

**Section B – TWO questions ONLY to be attempted**

- 3 Mr Larsson, the managing director of Scandisure AB, a Swedish group of insurance companies with its head office in Malmoe, has recently visited your office as at a recent board meeting it was decided to open two branches in Cyprus. One branch will be operating a general insurance business and the other one, a life assurance business.

The following estimates for the year 2008 are available in relation to the activities of the two Cyprus branches:

	<b>General insurance €'000</b>	<b>Life assurance €'000</b>
Gross premiums receivable in Cyprus	250	900
Interest receivable	50	0
Commissions receivable	10	0
Other income	5	0
Net investment income	0	120
Return of insurance premiums on cancellation	30	0
Premiums for re-insurance	117	450
Reserves for unexpired risks at 31 December 2008	50	120
Net claims	60	150
Payments for policy surrenders	0	80
Branch overheads (excluding depreciation and social cohesion fund contributions)	50	100
Capital allowances	10	10

In addition, head office expenses for 2008 are estimated at €2million.

**Required:**

- (a) **Explain the Cyprus tax treatment of life assurance companies and insurance companies other than life.** (4 marks)
- (b) **Compute the taxable income of Scandisure AB's Cyprus branches, together with the corporation tax and special defence contribution liabilities payable (if any), clearly indicating the effect of any loss relief provisions available to the group.** (7 marks)
- (c) **Outline the provisions relating to the timing of the submission of tax returns and the payment of tax liabilities as they will apply to the two branches.** (2 marks)
- (d) **State, giving reasons, whether either of the two branches will have an obligation to register for value added tax (VAT).** (2 marks)

**(15 marks)**

- 4 Martine, a famous film director, is a permanent resident in Hollywood, US. She has recently taken up residence in London in order to engage in film production in Europe, which is expected to last for a period of three to four years. She also plans to buy a house in London, to be used partly as her main residence and partly as her office. Martine expects to sell this property at a considerable gain on completion of her projects in Europe. The acquisition of the house will be financed 10% from her own funds and 90% by a mortgage loan.

Martine's income derives from dividends received from her US royalty companies and director's remuneration from her US film producing companies.

Under US tax law she will not be taxed in the US for the period of her residence in London. In addition, as she is not domiciled in the UK, she will only be taxed in the UK on the income remitted there.

A large portion of her US royalty companies' income comes from European Union (EU) countries, which impose withholding taxes at source on the payment of film rentals to the US.

Martine has been advised by her London accountant to set up companies in Cyprus in order to reduce her total tax burden (as UK and US corporate and personal tax rates are considerably higher than Cyprus corporate tax rates) and improve her companies' cash flow, in terms of both the film rental income and fees relating to film production received and to avoid any capital gains chargeable in the UK on the sale of her house, as non-UK tax residents are exempt from UK capital gains tax.

**Required:**

- (a) **State the circumstances in which a Cyprus tax resident company receiving film rental income from other EU countries will be exempt from withholding tax, assuming that these countries apply the relevant EU directive in the same way as Cyprus does.** (3 marks)
- (b) **Assuming that Martine follows her London accountant's advice and sets up a Cyprus tax resident company to receive the film production fees while she is resident in the UK, advise on the most tax efficient method of withdrawing income from this company. Your answer must refer to any relevant anti-avoidance provisions.** (3 marks)
- (c) **Assuming the house in London is acquired in the name of a Cyprus tax resident company, identify and explain:**
- (i) **the Cyprus income and corporation tax implications if Martine (1) uses the house rent free; and (2) pays the company rent for partly using the house as her main residence.** (6 marks)
- (ii) **the tax implications of selling the property and distributing the proceeds to Martine on completion of her projects in Europe.** (3 marks)

**(15 marks)**

**5** Exxonmore Limited is a Cyprus registered international business company with administrative offices both in Cyprus and in some other countries in which it carries out operations.

Among other personnel, the company employs, pays a salary and provides benefits to the following people in Cyprus and overseas:

- (1) Mr Exxon, the managing director who is based in the Warsaw office. He spends only ten days in Cyprus every year combining a holiday with the annual board of directors' and shareholders' meetings. During his stay in Cyprus, the company pays for all his accommodation and meals. The company also pays for his air tickets.
- (2) Nicos, one of the directors of the company, who spends most of his time in Cyprus but is also required to spend approximately 120 days every year in other countries in which the company maintains an office for business purposes. The company pays for his air tickets, and all his accommodation and meals during these overseas stays.
- (3) Elli, the marketing director of the company who spends most of her time in Cyprus, is also required to spend approximately 150 days every year in other countries in which the company does not yet have any operations, to search for prospective clients. The company pays for air tickets, accommodation and meals during these overseas stays.
- (4) Alice, a British citizen, who works as a secretary and translator in the Cyprus office on a full-time basis.
- (5) Boris, a Russian citizen, who is employed on a special alien two-year working visa as a computer expert in the Cyprus office on a full-time basis.

Mr Exxon, Nicos and Elli are all citizens of Cyprus.

The company also provides at its cost, a company saloon car to Nicos, who uses it partly for business and partly for private purposes. The company also pays for the college tuition fees of Elli's daughter Anna, aged 16, and for the accommodation and meals of Boris. Both Alice and Boris are considered as not being ordinary residents of Cyprus for social insurance and social cohesion fund purposes.

**Required:**

- (a) **State which of the expenses referred to above are tax deductible for Exxonmore Limited.** (3 marks)
- (b) **For each of the five employees referred to above, explain if and to what extent their salaries and benefits are assessable to income tax in Cyprus.** (7 marks)
- (c) **For each of the five employees referred to above, explain whether or not the individual and Exxonmore Limited, as employer, are liable to social insurance and social cohesion fund contributions and, if so, on which amounts.** (5 marks)

**(15 marks)**

**End of Question Paper**