

Professional Level – Options Module

Advanced Taxation (Cyprus)

Monday 1 June 2009

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 2008 tax rates and allowances are to be used in answering the questions

Income tax

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

Corporation tax

All companies	10%
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Special modes of taxation of certain kinds of income

Income from the rendering ship management services	4.25%
Pensions of residents from services rendered outside the Republic	5%
Gross amount of royalties, premiums, compensation, etc	10%
Films rental, etc of non-residents	5%
Profits of non-resident professional men, artists, etc	10%

Capital allowances

Annual (wear & tear) allowances

Tractors, trenchers, excavators, bulldozers, transcravators, self-propelled shovels and loaders, drums, oil tanks	25%
Motor vehicles other than saloon cars	20%
Computer hardware	20%
Computer software	33%
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 assessments	8% p.a. (Interest is calculated on the basis of completed months)
Additional tax	5% of tax due
PAYE assessments	8% p.a. plus a surcharge of 1% per month

Value added tax

	€
Registration limit	15,600
Deregistration limit	13,669

Capital gains tax

Rate	20%
Life time exemptions:	
	€
General	17,086
Agricultural	25,629
Residential dwelling	85,430

Immovable property tax

On every Euro not exceeding €170,860	nil
On every Euro from €170,861 to €427,150	2.5‰
On every Euro from €427,151 to €854,300	3.5‰
On every Euro from €854,301	4‰

Immovable property transfer fees

€	
First 85,430	3%
85,431 to 170,860	5%
170,861 and over	8%

Stamp duty

Ad valorem duty

€2.56 for every €1,709 or part of €1,709 for amounts up to €170,860

€3.42 plus €256.29 for amounts exceeding €170,860 with a maximum amount of stamp duty of €17,086

Social insurance

Self-employed	11.6%
Employer	6.3%
Employee	6.3%
Maximum insurable income of employees (annual)	€46,032

Other contributions by employers

Social Cohesion Fund	2%
Redundancy Fund	1.2%
Industrial Training Fund	0.5%
Vacation Leave Fund (if not exempted)	8%

Retail Price Index for capital gains purposes

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
2008	106.58	107.11	108.19	109.30	110.59	110.51	109.85	110.24	111.61	112.55	111.43	110.04

Section A – BOTH questions are compulsory and MUST be attempted

- 1 Mr Nemeas is the 90% majority shareholder of a company in Cyprus, Nemeas (Cyprus) Limited. The company is the manufacturer and distributor of patented household specialised electronic equipment sold in Cyprus and in Middle East countries. Both the Cyprus and Middle East operations are highly profitable.

Production is all done in Cyprus, under Mr Nemeas's personal supervision, in the company's freehold factory.

Purchase orders and payment for goods, both from Cyprus and overseas, are received from consumers directly through the company's website.

The delivery of goods to Cyprus customers is made through a distribution network that the company has developed over the years, whereby either the company's sales representatives deliver the goods to the customers or customers collect the goods directly from the company's shop network. Some of the shop premises are owned by the company and others are rented.

The delivery of goods in the Middle East is made to warehouses, which the company owns or rents, from where customers collect their goods.

Mr Nemeas is considering expanding the company's operations in other European Union (EU) countries. All such foreign operations will be managed from overseas.

Mr Nemeas has received proposals from a Romanian businessman for a joint venture (50:50 interest) to set up a production line in Romania to satisfy that country's needs, as well as the needs of neighbouring EU and non-EU European countries. The Romanian prospective partner accepts that Nemeas (Cyprus) Limited will receive royalties on the basis of the units produced, the amount to be agreed between the parties involved.

Mr Nemeas estimates that in the initial year, operations will be profitable in some countries and loss making in others due to various different factors.

Mr Nemeas is not familiar with the legal and tax aspects of doing business within other EU countries and has recently visited your office for a meeting during which he discussed his expansion plans with you. He also informs you that he is planning to retire within the next five years after disposing of his shares in the company.

You also ascertain the following:

- (1) Cyprus has the lowest corporation tax rate in the EU.
- (2) Value added tax (VAT) legislation in all EU countries is harmonised.
- (3) Middle East countries do not impose corporation tax, capital gains tax or VAT.
- (4) The Romanian corporation tax rate is 16% and its personal income tax rate is 25%. Romania withholds 10% tax on patent royalty payments and treats partnerships as transparent (i.e. taxed at the level of the partner) for tax purposes.
- (5) Other non-EU European countries do not impose VAT but impose corporation tax at rates considerably higher than those imposed by Cyprus and Romania.
- (6) Gains from the disposal of shares in companies registered in foreign countries are taxable in those countries.
- (7) The use of warehouses as described in the question will not constitute a permanent establishment under local legislation in any of the countries involved.

Required:

Draft a letter to Mr Nemeas, in an appropriate style, addressing each of the following issues. You must provide full reasoning for your recommendations:

(a) Taxes on income, special defence contribution (SDC) and capital gains:

- (i) How, if possible, the corporation tax liability of Nemeas (Cyprus) Limited may be mitigated with respect to the profits arising from its sales to Middle East countries. (4 marks)**
- (ii) Whether operations in other EU countries should be structured through overseas branches, overseas subsidiaries or adopt the same mode as currently used for Nemeas (Cyprus) Limited's Middle East operations. Your response must include reference to any possible tax planning opportunities through the setting of transfer prices between the Cyprus company and its overseas counterparts. (8 marks)**
- (iii) Whether a company or a partnership (registered either in Cyprus or Romania) should be formed for the proposed joint venture. (5 marks)**
- (iv) The exposure of Mr Nemeas to capital gains tax in respect of his planned disposal of shares in Nemeas (Cyprus) Limited. Your analysis must include both the case where Mr Nemeas will directly hold shares in any overseas companies and the case where the shares of any overseas companies will be held by Nemeas (Cyprus) Limited. (3 marks)**
- (v) Whether there is any scope for registering a Cyprus holding company, to hold the shares of Nemeas (Cyprus) Limited and possibly of any overseas subsidiary/connected companies. (6 marks)**

(b) Value added tax (VAT):

Whether, Nemeas (Cyprus) Limited, its branches or connected companies will have an obligation to register for VAT in other EU countries. Your response must refer to the VAT position of the company in Cyprus as well as the overseas entities.

Note: for the purposes of this part you may assume that a separate entity will be established in Romania. (6 marks)

Professional marks will be awarded in question 1 for the appropriateness of the format and presentation of the letter, and the effectiveness with which the information is communicated. (2 marks)

(34 marks)

2 Assume that today's date is 30 April 2009.

Andreas, a friend of your tax partner has recently had a meeting with you during which he informed you that he recently inherited a 50% interest in a piece of land with a value of €5 million, the other half (50%) interest going to his brother.

The land was inherited a few months ago from his late father, who had inherited it in December 1996 from his mother (Andreas's late grandmother), who had bought it in January 1980 for €350,000. The value of the land in December 1996 was €1 million.

Andreas and his brother are considering the following options:

1. Sell the land for €5 million.
2. Exchange the land for a new building comprising shops and offices with an agreed value of €5.3 million (1 January 1980 value €380,000), paying the difference of €0.3 million in cash. Andreas and his brother would then sell some of the units and keep the rest for rental income generation purposes.
3. Develop the land into residential accommodation for renting out. The project would be financed partly by a bank loan and partly by the exchange of part of the land with the construction company that will undertake the development.
4. Proceed with the parcellation of the land into 30 building plots. Ten plots will be partly exchanged for the construction company's costs for parcellation purposes. Fourteen plots will be sold and the remaining six plots will be reserved for the owners' (Andreas' and his brother's) children.

Required:

Write a memorandum to your tax partner, addressing each of the following issues:

(a) Taxes on income, capital gains, immovable property and special defence contribution (SDC):

- (i) Under option (1), how the gain arising on the sale of the property will be taxed. (2 marks)
- (ii) Under option (2), how the exchange will be taxed, referring to any possibility of deferral of taxes payable. (2 marks)
- (iii) Under option (2), how any capital allowances to be deducted from rental income will be determined and what other deductions will be granted for income tax and SDC purposes. (3 marks)
- (iv) Under option (2), under which law the gain from the sale of some units will be taxable and how the deductible cost will be determined. (3 marks)
- (v) Under option (3), how the part-exchange will be treated by the tax authorities and on what basis the taxable amounts will be determined for both parties to the transaction. (3 marks)
- (vi) Under option (4), the basis and the timing for determining the taxable gain for the plots sold and the plots exchanged with the developer and the basis for determining the deductible cost of the six remaining plots. (5 marks)
- (vii) Under each of options (1) to (4), how the taxable base for immovable property tax will be determined, assuming that the two brothers do not own any other immovable property.

Note: for the purposes of this sub-part, you may assume that any sale or exchange (options (1) and (2)) will occur in 2009 but that neither of options (3) and (4) will be completed before 2010. (4 marks)

(b) Value added tax (VAT):

The VAT treatment of the transactions as described in option (3), taking into account that Andreas and his brother are considering the possibility of selling the land that would be exchanged in one contract and executing a separate contract with the developer for building on the other part of the land. Your response must include reference to the factors to be taken into account when determining if the ultimate buyer of the property has contracted with the land owner and the developer separately. (12 marks)

Professional marks will be awarded in question 2 for the appropriateness of the format and presentation of the memorandum, and the effectiveness with which the information is communicated. (2 marks)

(36 marks)

Section B – TWO questions ONLY to be attempted

3 Assume that today's date is 5 April 2009.

Loucas, aged 67 has lived and worked in the UK for 47 years. He recently moved permanently to Cyprus, after selling his home and some other immovable property in the UK. During 2009, he expects to have the following income and gains:

	€
UK state pension (UK tax deducted at source €2,000)	12,000
Private pension (UK tax deducted at source €5,000)	16,000
UK rental income (UK tax to be paid €5,000)	20,000
Gain on the sale of his home (no capital gains tax paid in the UK)	300,000
Gain on the sale of other immovable property (UK tax to be paid €100,000)	500,000

The UK does not impose capital gains tax on gains realised on the sale of an individual's principal private residence, nor gains arising on the disposal of UK assets by non-UK tax residents.

Loucas is currently holding cash in the sum of €750,000 which he wishes to invest in Cyprus.

Required:

Advise Loucas as to the following:

- (a) The investment options available to him taking into account his limited investment horizon.** (5 marks)
- (b) The basis on which the income generated from the investment options mentioned in part (a) will be taxed.** (5 marks)
- (c) The possible elections that Loucas can make in order to reduce his overall tax liability, demonstrating how this can be achieved.** (3 marks)
- (d) The action that Loucas could have taken before disposing of his UK property in order to reduce his total exposure to capital gains tax.** (2 marks)

(15 marks)

- 4 Georgina has recently won a large sum of money from a lottery. She has decided to invest her capital in different businesses ranging from the provision of financial services (exempt for VAT purposes) to manufacturing and distribution of office furniture and trading in foodstuffs. The reason for her planned diversification is that she knows that some operations will be profit making and some loss making in the initial years.

Tax planning for the correct structuring of her planned operations is also very important as she has never paid any taxes in her life before and she has heard that in general, relief for trading losses is granted to taxpayers. She also has heard that trading through a limited company or companies is more tax efficient and she has therefore decided to keep all planned operations in limited company(ies).

However, Georgina is not sure as to whether she should incorporate one company only, or whether to incorporate her different operations in different companies, which will form a group.

Required:

Explain to Georgina the following:

- (a) **In the context of a group of companies, the relief available for trading losses and the conditions that must be satisfied by the respective taxpayers.** (2 marks)
- (b) **How group registration for value added tax (VAT) purposes may affect a group's cash flow, indicating how the group's cash flow may be assisted by such a registration.** (3 marks)
- (c) **How capital gains tax planning can be facilitated through the use of a group structure.** (2 marks)
- (d) **The possible disadvantages of operating through a group structure.** (3 marks)
- (e) **The advantages and disadvantages of having all operations in one single company (divisional structure).** (5 marks)

(15 marks)

- 5** Dina and Fani are both bank employees earning annual salaries exceeding €50,000 each. They have decided to set up jointly a new business which will be involved in the preparation of student theses.

The student (client) will submit his/her order electronically, a price will be quoted and the thesis will be prepared and sent electronically to the client after a credit card payment is processed.

The two prospective partners estimate that during the first two years of operations, the business will incur losses, that it will break even in the third year and become highly profitable from the fourth year onwards, mainly due to the fact that it is expected that after three years of operation, the business will become known to students overseas, resident both inside and outside the European Union, who will be tempted to use its services. They also estimate that in the fifth year of operations, the business will be in a position to purchase in cash its own premises, situated in a historic 50-year-old office building.

Dina and Fani are not familiar with tax legislation and practice and require your advice.

Required:

Advise Dina and Fani, as to the following:

- (a) **By reference to income and corporation tax and special defence contribution (SDC), whether they should operate the new business through a partnership or through a limited liability company.** (5 marks)
- (b) **The social cohesion fund implications of choosing between a partnership and a limited liability company.** (1 mark)
- (c) **Assuming that they decide to form a company, whether it would be more tax efficient to register the business premises (to be acquired during the fifth year) in the name of the company or in their own names, in which case they could charge rent to the company. Your answer should include consideration of any implications of the building being a 'preserved' building.** (5 marks)
- (d) **Whether the new business will have an obligation to register for value added tax (VAT) in Cyprus and/or overseas and on what basis.** (4 marks)

(15 marks)

End of Question Paper