RELEVANT TO ACCA QUALIFICATION PAPER P6 (CYP)

Amendments to the Paper P6 (CYP) syllabus
Relevant for students taking exams in June or December 2013

The syllabus for the June and December 2013 papers for the Cyprus variant of Paper P6 includes tax legislation that has been published in the Cyprus Official Gazette on or before 30 September 2012. As a result of austerity measures, actions to combat fraud as well as measures aiming to promote business, there are significant amendments to tax legislation and consequently to the syllabus for the 2013 sittings. In addition, there are changes to the format of the paper. The purpose of the present article is to explain these changes and amendments. A series of technical articles will follow over the coming months to help better explain to candidates some of these changes in more detail.

A. INCOME TAX LAW 118(I)/2002 AS AMENDED

1. Sources of Income

In addition to the existing sources of income (business income, employment income, dividends, interest, income from immovable property, pension, and income from sale of goodwill), a new form of income is recognised in the income tax law.

When a *physical person* maintains a debit balance in the books of a company in which he/she is a shareholder or a director, then that person is deemed to have a *monthly* benefit, equal to 9% pa of the value of the debit balance. The benefit also applies to spouses and to up to second-degree relatives of shareholders or directors, if they also maintain a debit balance in the company's books.

The benefit is added to the person's total taxable income and taxed according to the income tax brackets. The company is obliged to estimate and pay the tax every month through the PAYE system. Thus, if that person also receives a salary from the company, the tax will be deducted from the salary. (*A forthcoming technical article will fully explain this amendment*.)

The previous article in the Law (Article 33), which created deemed interest income for the company, equal to 9% of the value of the debit balance, is abolished as of 1 January 2012 and, thus, has been removed from the 2013 syllabus.

It is worth highlighting that this only applies to physical persons. In the case where a *legal* entity maintains a debit balance in the books of another legal entity, in which the former is a director or a shareholder, interest should be charged on that debit balance based on arm's length principles, if such debit balance is considered to be financing. No such interest should be charged if the debit balance is created as a result of a commercial transaction.

2. Tax exemptions
A new exemption in the law applies to employment that commences on or after 1 January 2012. The exemption provides for an incentive to attract new businesses or highly paid employees to existing businesses in Cyprus and applies to physical persons who were based overseas, and who were not Cyprus tax-residents before the commencement of their employment in Cyprus. The exemption states that if their total emoluments exceed €100.000, then 50% of such emoluments will be exempt from taxation for five years starting from the first year of their employment.

If we look at the strict position of the law, this incentive is *in addition* to the lower of €8.550 or 20% exemption for employment in Cyprus for persons who were non-resident persons before commencing their employment. However, the Cyprus Income Tax Office is not of the same opinion. The exam syllabus will follow the strict legal position.

3. Tax deductions
(a) New legislation provides that salaries, for which social insurance contributions were unlawfully not paid, will not be tax deductible. This includes contributions payable by the employer (social cohesion fund, etc).

However, in the year that the contributions are finally paid (with interest and penalties), the salaries will be tax deductible in *that* year. There is a time limit when this can occur, being two years. This means that if social insurance contributions are not paid within two years from the date they are due, and are finally paid afterwards, the salaries to which the contributions relate will not be an allowable deduction for tax purposes in any year.

(b) The following deduction was originally communicated through a Circular of the Income Tax Office but which was later recalled and annulled, and the deduction was explicitly made in the law through an amendment. It applies from 1 January 2012.

Where a Cyprus company borrows in order to invest in the share capital of another company that is a 100% subsidiary, either directly or indirectly, then any interest payable on such loan is tax deductible.

If the Cyprus subsidiary has assets that are not being used in the business, then the amount of interest payable that will be considered deductible at the parent level will be restricted based on the cost of those assets not being used in the business.

This is a very important amendment as it impacts back-to-back loans and tax losses. *(A forthcoming technical article will look at back-to-back loans, detailed in (c) below, incorporating an analysis of this deduction*.)

(c) Although there is no change in the law, clarifications have been given by the Income Tax Office regarding the treatment of back-to-back loans and the acceptable margins.

(d) From 1 January 2012, tax incentives have been given relating to intellectual property ('IP rights'). The main changes are that any expense to purchase or develop intellectual property is now tax deductible. An amortisation allowance (this is not a capital allowance as per Article 10 of the Law) will be given at a rate of 20% per annum with a full year's charge in the year of purchase for any capital costs of purchase or development.

In addition, any profit (=income *less* direct expenses for the production of income) derived from the IP rights, as well as any gain from the sale of the IP rights, will both be considered income and taxable under income tax/corporation tax, and in both cases there will be a deemed expense equal to 80% of such profit or gain. *(A forthcoming technical article will explain and analyse this very important amendment to the legislation.)*

4. Capital allowances
From 1 January 2012, for all machinery and fixtures and fittings that are purchased during the tax years 2012, 2013 and 2014, capital allowances will be given at a rate of 20%, unless a higher rate is normally available. Previously, the rate for the majority of these capital assets was 10%. Also, any additions relating to industrial and hotel buildings, made during the tax years 2012, 2013 and 2014, will attract a capital allowances rate of 7% instead of the previous 4%.

5. Group relief
From 1 January 2012, where a parent company *incorporates* a subsidiary company during a tax year, the subsidiary *will be deemed to be* a member of the tax group, for group relief purposes, for the entire year. Previously, no group tax relief was available unless the company was physically a member of the group for the entire tax year.

B. SPECIAL DEFENCE CONTRIBUTION LAW 117(I)/02 AS AMENDED
1. Dividend: Rate of SDC tax on dividends increases to 20% as of 1 January 2012. This increase is valid only for the tax years 2012 and 2013. As such candidates should be aware that this is the case and be in a position, if appropriate, to recommend payment of dividend on or after 1 January 2014, when the rate reverts back to 17%.

2. Dividend: There is an exemption from SDC on dividends received by one Cyprus tax-resident company from another Cyprus tax-resident company. However, such dividends are not exempt if the dividend is derived indirectly following the passage of four years from the end of the year in which profits were made, from which the dividends are derived. This applies only to profits from 1 January 2012 onwards. (*A forthcoming technical article will give examples*.)

3. Dividend and interest: Candidates should also be aware that SDC on dividends and interest received from sources outside of Cyprus is payable by self assessment every six months – ie by 30 June for overseas dividend or interest income from the first six months of the year, and by 31 December for the last six months of the year.

4. For the purposes of the deemed distribution rules, for the tax years 2012, 2013 and 2014, any cost of acquisition of plant and machinery, fixtures and fittings and buildings, excluding saloon cars, can be deducted from the accounting profits.

C. VAT LAW 95(I)/2000 AS AMENDED

1. From 1 March 2012, the standard rate of VAT is increased from 15% to 17%.

2. From 9 March 2012, the basic law was amended with the introduction of Paragraph 11(B), whereby the reverse charge principle applies to the supply of services, or to the supply of services together with the supply of goods, when these are supplied within the construction industry, on a business-to-business (B2B) basis. Candidates need only have a basic understanding of this. The VAT authorities have issued clarifications as well as a very detailed analysis of the services for which this part of the law applies. Candidates will **not** be expected to have knowledge of this analysis or of the clarifications.

3. A reduced rate of 5% applies to physical persons (from Cyprus, EU or non-EU countries) who purchase or build a property that will be used as their main and permanent residence.

   Candidates need only be aware that for new residences that are used or will be used by qualifying persons as their main and permanent residence, a lower rate of 5% VAT will be applicable, so long as approval is obtained from the Cyprus VAT authorities.

   Candidates will **not** be required to know the definition of a qualifying persons, or the pre-requisites that the property must satisfy in order to qualify for the lower rate (which include size and type of housing).

4. From 16 January 2012, an amendment to the VAT legislation was made, which provides the following: businesses that are VAT registered in Cyprus and provide supply of goods or services to consumers (ie business-to-consumer (B2C) transactions) will be obligated to issue and deliver a receipt to the consumer. If they fail to do this the business will be subject to a penalty equal to 20% of the value of the transaction.

D. CYPRUS INTERNATIONAL TRUST LAW 69(I)/1992 AS AMENDED

The Cyprus International Trust Law has been amended. Some of the amendments are too specific to be considered examinable. However, the following amendments are considered key and are examinable:

1. Previously, the settlor of a Cyprus International Trust could not be Cyprus resident. The amendment now states that the settlor must not have been a Cyprus resident in the year preceding the year of establishing the Cyprus International Trust. Effectively, a non-resident settlor could become Cyprus resident following the trust's establishment.
2. The same applies for beneficiaries as in (1) above. Beneficiaries now should only be non-resident in the year preceding the year of establishing the Cyprus International Trust.
3. Immovable property in Cyprus can now be included in the trust fund/trust property.
4. The trust can have perpetual life, not being limited to 100 years from the date of establishment as was the case previously.

The law applies retrospectively to all Cyprus International Trusts whenever created.

E. IMMOVABLE PROPERTY TAX LAW 24(I)/1980 AS AMENDED

The changes in the rates for immovable property tax that Parliament passed on 26 August 2011, relating to the changes in the rates for immovable property tax, and which was specified as being not examinable in the June or December 2012 exams, will now be examinable for the 2013 exam papers. As such, the table rates for immovable property tax for the 2013 papers is shown below.

Immovable property tax is Cyprus's only wealth tax and applies only to the owners, whoever they may be, of immovable property that is physically situated in Cyprus. The tax is levied on the total value, of all Cyprus immovable properties held by a legal or physical person, that such properties would have had as at 1 January 1980. This is why it is often referred to as the 1.1.1980 tax. The new rates are as follows:

1.1.1980 Property value	Tax rates (thousandths)
The first €120,000	0‰
From €120,001 to €170,000	4‰
From €170,001 to €300,000	5‰
From €300,001 to €500,000	6‰
From €500,001 to €800,000	7‰
Over €800,000	8‰

F. PROPOSED ITEMS TO BE STATED IN THE SYLLABUS AS BEING NOT EXAMINABLE

The following items will ***not*** form part of the examinable syllabus:

1. Special contribution by private sector employees

Government and semi-government employees, as well as private sector employees and pensioners, will make a special contribution amount that will depend on their gross emoluments for the 2012 and 2013 tax years. This is not examinable.

2. Amnesty on interest and penalties for any tax assessments or self assessment for tax years up to and including 2008

This measure was initially in place until 30 March 2012 but was then given an extension until 31 October 2012. It has more recently been modified and extended until 31 December 2013. The measure provides that where taxes are paid during the period of the amnesty, any related interest and penalties will be capped at a fixed rate (initially 5%) of the capital amount of the tax, with the balance written off. This is not examinable.

3. Exemption of certain properties from land transfer fees

On 2 December 2011 a law came into force in an attempt to stimulate the Cyprus immovable property market, which has slowed significantly as a result of the economic crises. The law provided an exemption, or part exemption, from land transfer fees of certain types of properties. It was to remain in force initially for a period of six months – ie until 1 June 2012, but has then been extended until 31 December 2012. This is not examinable.

4. VAT law for group registration

The VAT law was amended to clarify when two entities could be considered for group registration. The amendment was only made to harmonise the Cyprus VAT Legislation with that of the EU VAT Directive. This will not be examinable as it does not change the basic group registration provisions candidates should know.

G. STRUCTURE OF THE EXAM

The new format of the exam paper in 2013 is very similar to the existing one. It will still be divided into Section A and Section B. However, Section A will contain 60 compulsory marks from two questions – Question 1 being a 35-mark question and Question 2 being worth 25 marks. Question 1 includes four marks for format and presentation.

Section B will continue to offer a choice of two from three questions. These total 40 marks, with each question attracting 20 marks. The pass mark for all ACCA Qualification papers is 50%.

In addition, the *Study Guide* has been restructured. Section B, relating to the importance of taxation to personal and corporate financial management, has been removed entirely, with some parts reallocated to the previous Section C (now renamed B). Remaining Sections C to E have been renamed B to D.

Written by a member of the Paper P6 examining team