

Strategic Professional – Options

# Advanced Taxation – Cyprus (ATX – CYP)

Tuesday 4 June 2019



ATX CYP ICPAC

**Time allowed:** 3 hours 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – BOTH questions are compulsory and MUST be attempted

**Tax rates and allowances are on pages 2–5**

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

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

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X

Think Ahead



The Association of Chartered  
Certified Accountants

The Institute of Certified Public  
Accountants of Cyprus

## SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances for the tax year 2018 shown below will apply for the foreseeable future unless you are instructed otherwise.
2. Calculations and workings need only be made to the nearest € unless you are instructed otherwise.
3. All apportionments should be made to the nearest month.
4. All workings should be shown.

## TAX RATES AND ALLOWANCES

The following rates and allowances for the year 2018 are to be used in answering the questions

### Income tax

€0 – €19,500	0%
€19,501 – €28,000	20%
€28,001 – €36,300	25%
€36,301 – €60,000	30%
Over €60,000	35%

### Corporation tax

All companies	12.5%
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### Special modes of taxation of certain kinds of income

Pensions of residents from services rendered outside the Republic (which exceed €3,420)	5%
Gross amount of royalties, premiums, compensation, etc of non-residents	10%
Films rental, etc of non-residents	5%
Profits of non-resident professionals, artists, etc	10%
Widow's pension (in excess of €19,500)	20%

### Capital allowances

#### Annual (wear and tear) allowances

Tractors, trenchers, excavators, bulldozers, transcavators, self-propelled shovels and loaders, drums, oil tanks	25%
Motor vehicles other than saloon cars	20%
Computer hardware and operating software	20%
Application software	
(a) if not exceeding €1,710	100%
(b) if exceeding €1,710	33.3%
Agricultural machinery and tools	
– acquired in the years 2012 to 2018	20%
– otherwise	15%
Other plant and machinery	
– acquired in the years 2012 to 2018	20%
– otherwise	10%
Hotel, industrial and agricultural buildings	
– acquired in the years 2012 to 2018	7%
– otherwise (maximum 25 years)	4%
Commercial and other buildings (maximum 33 years)	3%
Glass houses, metallic skeleton	10%
Glass houses, wooden skeleton	33.3%

### **Amortisation allowance**

On the cost of purchase or development of intellectual property rights (from 1 January 2012 to 2 June 2016) – transitional provisions apply to 31 December 2016

20%

### **Interest and surcharge on unpaid tax**

Interest on income and corporation tax assessments (Interest is calculated on the basis of completed months.)	3·5% p.a. <sup>1</sup>
The same rate applies to overpayments of tax.)	
Additional tax	5% of tax due
PAYE assessments	3·5% <sup>2</sup> interest p.a. plus a surcharge of 1% per month

**Notes:**

1. Although the interest rate on income and corporation tax assessments has decreased to 2% with effect from 1 January 2019, the rate of 3·5% provided here for the year 2018 continues to be examinable and should be used in answering these questions.
2. Although the interest rate on PAYE assessments has decreased to 2% interest p.a. plus a surcharge of 1% per month with effect from 1 January 2019, the rate of 3·5% interest p.a. plus a surcharge of 1% per month provided here for the year 2018 continues to be examinable and should be used in answering these questions.

### **Special defence contribution**

On dividends received (where applicable)	17%
On interest received	
– standard rate	30%
– reduced rate (applicable under specific circumstances)	3%
On rental income (on 75% of the gross rental income)	3%

### **Value added tax (VAT)**

Registration limit	€15,600
Deregistration limit	€13,669
Standard rate	19%
Reduced rates	5%, 9%

### **Social insurance**

Self-employed	14·6%
Employer	7·8% <sup>1</sup>
Employee	7·8% <sup>1</sup>
Maximum annual insurable income for employees	€54,396

**Note 1:** Although the social insurance contribution rates for employers and employees have increased to 8·3% with effect from 1 January 2019, the rates of 7·8% provided here for the year 2018 continue to be examinable and should be used in answering these questions.

### **Other contributions by employers**

Social cohesion fund	2%
Redundancy fund	1·2%
Industrial training fund	0·5%
Central holiday fund (if not exempt)	8%

### **Capital gains tax**

Rate	20%
<b>Lifetime exemptions</b> (maximum €85,430)	
– General	€17,086
– Farmer in respect of farm land	€25,629
– Residential dwelling	€85,430

### **Stamp duty**

€0.00 for amounts up to €5,000

€1.50 for every €1,000 or part of €1,000 for amounts from €5,001 up to €170,000

€2.00 for every €1,000 or part of €1,000 for amounts exceeding €170,000 with a maximum amount of stamp duty of €20,000

### **Land transfer fees**

€1 to €85,000	3%
€85,001 to €170,000	5%
Over €170,000	8%

#### **Note:**

For contracts concluded on or after 2 February 2011, no transfer fees will be payable when the immovable property to be transferred is subject to value added tax (VAT).

For contracts concluded on or after 16 July 2015, if the immovable property to be transferred is not subject to VAT the transfer fee will be reduced by 50%.

**Retail Price Index For Capital Gains Purposes**  
 Based on the Tax Department table of RPI

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1.1.80	67.15											
1980	67.99	68.53	69.14	71.51	70.56	70.70	72.12	72.16	73.41	74.00	74.50	75.21
1981	76.09	76.72	77.43	77.98	78.02	78.77	79.71	80.21	80.63	81.29	82.49	82.98
1982	82.94	83.70	83.48	84.60	84.40	83.81	83.44	83.99	84.89	85.23	86.22	86.80
1983	87.57	87.70	88.51	89.63	88.95	87.76	87.77	88.49	88.67	89.59	89.88	90.37
1984	91.16	91.78	92.31	92.92	93.73	93.83	94.92	94.41	94.13	95.33	96.81	97.77
1985	97.68	97.75	98.55	98.79	98.57	97.63	97.20	98.76	100.09	101.13	99.73	99.58
1986	100.22	100.12	100.33	99.53	98.44	98.36	99.39	99.37	99.34	100.65	101.92	102.39
1987	101.32	101.08	102.23	101.87	102.58	103.49	102.00	103.37	103.56	103.17	104.02	104.74
1988	104.61	105.44	106.05	107.16	106.06	105.11	104.39	105.09	106.30	107.51	108.92	109.12
1989	110.36	109.81	110.02	110.38	107.74	108.81	109.25	109.53	110.24	112.21	112.25	112.20
1990	111.80	112.84	114.04	115.72	116.19	115.32	114.27	115.11	115.48	116.78	117.16	118.70
1991	119.43	118.49	119.42	120.33	121.14	119.93	120.29	118.51	120.76	123.96	124.40	126.45
1992	127.91	126.18	127.76	129.79	127.72	127.15	127.93	127.18	128.77	130.44	132.09	134.65
1993	135.27	131.93	132.68	135.54	134.07	133.75	134.77	133.55	135.77	138.20	139.22	138.90
1994	138.52	135.29	138.64	139.99	140.23	141.13	141.68	139.57	144.27	146.90	146.57	146.14
1995	144.69	141.09	143.89	144.95	144.99	144.95	145.65	143.33	145.00	147.54	148.63	148.54
1996	148.32	144.76	148.61	149.23	149.68	149.58	150.06	148.10	150.64	151.97	152.04	152.26
1997	152.26	149.90	154.07	155.46	154.29	154.18	155.98	153.45	155.86	157.65	158.66	158.26
1998	155.27	155.06	156.03	157.95	158.20	158.87	158.10	159.15	161.66	161.07	160.35	159.70
1999	158.66	155.71	158.83	159.56	159.85	161.01	161.87	160.26	163.42	164.92	164.85	165.66
2000	165.52	163.60	166.72	167.40	168.05	167.16	167.12	166.74	168.78	169.81	170.68	170.92
2001	167.89	167.53	169.11	170.32	170.90	172.19	168.81	169.74	172.24	174.41	174.09	174.98
2002	172.43	172.05	173.11	174.83	174.93	175.69	174.42	176.15	178.11	178.79	179.06	180.13
2003	179.49	179.68	183.44	184.59	183.87	182.76	180.24	181.33	184.59	186.10	186.32	184.61
2004	182.74	183.03	184.18	185.48	186.61	187.87	186.18	187.13	188.97	190.81	191.88	192.36
2005	188.43	188.16	189.51	191.21	191.17	191.07	189.73	191.07	194.51	196.68	197.38	196.18
2006	193.03	193.26	195.55	197.16	197.33	197.58	195.01	196.12	198.29	199.45	199.87	199.75
2007	196.20	196.07	198.47	200.66	201.67	201.25	199.75	200.88	203.52	205.42	206.92	207.57
2008	204.70	205.73	207.80	209.93	211.64	212.26	210.99	211.74	214.37	216.17	214.02	211.93
2009	206.97	207.09	210.05	211.41	212.99	212.70	209.30	209.64	211.74	214.45	216.94	216.27
2010	212.01	213.04	215.08	216.58	216.41	216.83	214.68	216.44	219.23	220.98	220.17	219.82
2011	218.02	218.96	221.11	223.68	224.80	225.91	222.59	222.71	224.45	227.70	228.43	228.47
2012	224.82	225.72	228.56	230.58	231.43	229.91	227.43	228.66	230.10	231.66	231.18	230.98
2013	228.93	229.43	231.00	229.89	229.83	230.08	226.72	226.49	227.74	227.95	226.32	225.66
2014	222.32	223.51	225.72	226.22	226.70	227.35	225.39	224.86	225.66	226.83	225.97	222.36
2015	219.40	220.36	221.48	221.53	222.19	221.84	218.69	218.86	219.96	221.09	221.19	219.69
2016	216.16	214.43	215.87	216.22	217.57	217.26	217.68	217.50	218.62	218.80	218.67	219.68
2017	217.28	218.03	219.99	220.54	219.86	218.73	216.17	217.17	217.79	219.06	219.29	218.38
2018	215.71	217.34	218.91	220.23	222.64	223.81	221.23	222.68	224.60	225.57	225.13	222.09

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

**1 You should assume that today's date is 8 April 2019.**

Roulla, a client of your firm since 2016, has always been tax resident and domiciled in Cyprus. She owns 100% of the share capital of Fresko Ltd and is the sole director. Fresko Ltd was registered in January 2016 and immediately started business selling natural products from a shop in Nicosia.

Roulla has always been organised and punctual with both her personal tax obligations and those of her company. Recently, she sent the following email with details for the preparation of her personal tax return for 2018:

*Dear Sirs,*

*Please find attached the following:*

- *My salary certificate for 2018 from my company, Fresko Ltd.*
- *My life insurance payments certificate for 2018.*
- *My health insurance payments certificate for 2018.*
- *A statement of income and expenses for rental income I receive from my house in Rockland.*

*I would be grateful if you could assist me in the preparation of my personal tax return for 2018 and settlement of any taxes due.*

*Furthermore, I am extremely concerned that I may have made a mistake in following the advice of my lawyers in late 2015, without seeking any further tax advice. I set up my natural products business through a limited liability company (Fresko Ltd) but think this may not have been wise. After speaking to a friend on holiday, I am concerned that I would have been better off from a tax point of view if I had operated my shop as a sole trader as my friend does. She has a shop the same size as mine and is selling cosmetics. We have the same level of turnover and profitability, but she pays a lot less in taxes than I do.*

*I would be grateful if we could set up a meeting to discuss my concerns in more detail and decide the best way forward. I attach the draft accounts of Fresko Ltd for the year ended 31 December 2018 to help you prepare for our meeting.*

*Yours sincerely*

*Roulla*

From the attachments to Roulla's email, the following information is available:

**Roulla – 2018 salary certificate from Fresko Ltd**

	€
Salary	12,000
Deductions:	
Social insurance	936
PAYE	800

Life insurance policy payments for 2018 totalled €1,329 and the insured sum on Roulla's life is €100,000.

Health insurance payments for 2018 totalled €1,440.

The annual insurable income for social insurance contributions purposes for self-employed shopkeepers such as Roulla if she worked as a self-employed shopkeeper for 2018 was €18,946.

**Income and expenses from Roulla's house in Rockland**

	€	€
Rental income		24,000
Expenses:		
Council tax and water rates	880	
Insurance	350	
Repairs and maintenance	1,280	
Agents' fees	250	
Accountancy expenses	300	
Tax paid in Rockland	2,588	
		<hr/>
		(5,648)
Net income		<hr/>
		18,352

The house was built in 1970. Rockland is a country with no double tax treaty with Cyprus.

From the draft accounts of Fresko Ltd, the following information is available:

**Fresko Ltd – year ended 31 December 2018**

	€
Turnover	280,351
Accounting profit before tax	15,600
after the deduction of the following expenses:	
Business entertainment expenses	5,230
Depreciation of a saloon car (used exclusively for sales)	5,000
Saloon car expenses	1,560
Registrar annual levy for 2018	350
Gross interest income on the company's current account	251
Tax losses from previous years	0

Fresko Ltd is exempt from contributions to the central holiday fund for all its employees.

Fresko Ltd did not pay any dividends since its registration in 2016 due to cash flow difficulties.

**Required:**

**Prepare a memorandum for your tax partner in preparation for the meeting with Roulla.**

**You should include a table of comparison of taxes payable by Roulla and Fresko Ltd for 2018, and the taxes which would have been payable if Roulla had operated her business as a sole trader.**

**Your calculations should include income tax, corporation tax, special defence contribution (SDC), social insurance and other employer contributions.**

**Provide explanations for your calculations and, where necessary, state any assumptions you make in your calculations.**

**The following marks are available:**

**(i) Personal income tax** (17 marks)

**(ii) Corporation tax** (5 marks)

**(iii) Special defence contribution (SDC)** (6 marks)

**(iv) Social insurance and other contributions** (3 marks)

Professional marks will be awarded for the format and presentation of the memorandum and the clarity and effectiveness with which the information is communicated. (4 marks)

**(35 marks)**

**2** Eskafeas Ltd is a successful and profitable dealership, dealing in the best brands of construction machinery available in the Cyprus market. The company is a tax resident of Cyprus, and all of Eskafeas Ltd's shares are owned by individuals who are both resident and domiciled in Cyprus.

Due to its excellent track record, Eskafeas Ltd has been offered a new dealership in Newland, a country with no corporation tax and no double tax treaty with Cyprus. The directors of the company have decided to take up the offer and they are considering whether it would be better to set up the new dealership as a wholly owned subsidiary in Newland, or as a registered branch of Eskafeas Ltd. Whichever structure is chosen, the new dealership will be managed and controlled by the Newland resident directors and staff. If a subsidiary is established, it is intended that it will not be set up to be considered a tax resident of Cyprus.

Although the directors are confident about the longer-term prospects of the new dealership, Newland is a new and untested market for them and therefore they do not expect the business to be profitable initially.

Eskafeas Ltd plans to send some of its key management staff to help run the business in Newland and provide valuable know-how. These employees are currently Cyprus tax resident and domiciled individuals. They plan to go to Newland at different times, and plan to stay for periods ranging from three to eighteen months. Whilst working in Newland, they will not receive any salary from Eskafeas Ltd in Cyprus but will be paid a salary of approximately €50,000 per annum by the new dealership. Some of them plan to rent out their homes in Cyprus when they are in Newland. For all other months when they are in Cyprus, they will be paid their salary as normal from Eskafeas Ltd.

As Newland has a very low personal tax rate of 5% on gross salary and no taxation on interest, dividends and rents, Eskafeas Ltd's management wants to ensure that the contracts for the work in Newland are drafted in such a way that the employees receive the maximum benefit from a Cyprus taxation point of view. Consideration should be given to not only their salary from Eskafeas Ltd, but the work in Newland and any other income they may have from Cyprus sources in the form of interest, dividends and rents.

**Required:**

(a) **From a Cyprus taxation perspective, explain whether operating the dealership in Newland as a wholly owned subsidiary of Eskafeas Ltd is preferable to operating as a branch, assuming the dealership is:**

(i) **profitable;**  
(ii) **initially loss-making then profitable;**  
(iii) **closed down having made only losses.** (12 marks)

(b) **Explain how the taxation in Cyprus of all of the sources of income of the Eskafeas Ltd employees is affected by their length of stay in Newland. Include a recommendation of the optimum period of departure and return for Cyprus taxation purposes.** (10 marks)

(c) **Explain how the management of Eskafeas Ltd can ensure that if a new subsidiary is set up in Newland, it will not be considered a Cyprus tax resident.** (3 marks)

**(25 marks)**

**Section B – BOTH questions are compulsory and MUST be attempted**

**3** Takis, aged 55, is a chemical engineer who has been working for a large plastics production company in Cyprus for many years. Takis is tax resident and domiciled in Cyprus.

Takis earns rental income from a shop he inherited from his father ten years ago. His father bought the shop from a developer for €40,000 in January 1982. In addition, he paid land transfer fees of €1,200 at that time. In accordance with the registration certificate, the value of the shop at 1 January 1980 was €33,800. The cost of construction for capital allowance purposes was €17,800 and full capital allowances have been claimed over the term of ownership by Takis' father and himself, against rental income.

Takis decided to sell the shop and purchase a new office in the same area for €800,000 from the same developer. The developer informed him that he will charge value added tax (VAT) at 19% on the sale as the office is newly built.

To finance the purchase, Takis found a third-party buyer for the original shop who is prepared to offer €500,000, which is its market value in the current market conditions. Takis is planning to sell the shop, pay the capital gains tax due, and then borrow the balance he needs for the purchase of the office. This is the first sale of immovable property which Takis will make.

The developer has heard of the offer Takis has received from the third-party buyer, and so the developer is now offering to take the original shop in exchange for the new office, for the same price of €500,000. The developer explained to Takis that his offer is better than the third-party offer as he will be saving a substantial amount of capital gains tax on the sale.

It is estimated that the sale of the original shop and the purchase of the new office will take place in August 2019 when the retail price index for capital gains tax can be assumed to be 223·0.

**Required:**

**(a) Explain, by reference to the net cash which Takis would need to borrow, which of the following options is preferable:**

(i) Sale of shop to a third party for cash; or  
(ii) Part-exchange with the developer of the new office.

**Notes:**

1. Your answer should include calculations of the net cash which Takis would need to borrow under each option.
2. Your calculations should include value added tax (VAT) and land transfer fees where applicable.

(10 marks)

**(b) Explain the VAT implications for Takis of purchasing the new office and renting it out. Include any options available to Takis, and address specifically what he needs to consider when selecting the tenant of the office, and whether he will need to charge VAT on a future sale of the office.**

(10 marks)

**(20 marks)**

**4** Pantex Ltd, a company registered in Cyprus in 1980, has always been a Cyprus tax resident. All of its shareholders and directors are Cyprus tax resident and domiciled individuals. Pantex Ltd distributes food in Cyprus and has been profitable for the last five years.

In accordance with its draft financial statements as at 31 December 2018, Pantex Ltd had:

- long-term loans of €2.5 million, repayable over a period of eight years, on which interest of €110,000 was paid during 2018.
- cash at bank of €600,000.

This position is likely to remain unchanged during 2019.

Pantex Ltd is currently considering purchasing 100% of the share capital of Ena Ltd for €500,000. Ena Ltd is a small Cyprus resident company which owns a plot of land on the outskirts of Larnaca in Cyprus. The land, Ena Ltd's only asset, is not currently used for any purpose.

It is hoped that due to city planning zone changes in the foreseeable future, it will be possible for the land owned by Ena Ltd to be developed into residential plots and sold at a large profit. Accordingly, Pantex Ltd intends to wait for a few years before it decides what to do with the land. When the price is right, it may sell the land or develop it into residential plots for sale.

The possibility of just buying the land from Ena Ltd instead of the shares for the same price is also being considered, but the board of directors of Pantex Ltd is worried about the value added tax (VAT) implications of such an option. Pantex Ltd is registered for VAT, but Ena Ltd is not.

**Required:**

**Explain the Cyprus tax implications for Pantex Ltd arising from the purchase and subsequent disposal of:**

- (i) 100% of the share capital of Ena Ltd; or**
- (ii) the plot of land directly.**

**Note:** You should assume that the subsequent disposal under each option takes place before the development of the land and generates a profit.

The following mark allocation is provided as guidance for this question:

Corporation tax	9 marks
Special defence contribution (SDC)	3 marks
VAT	4 marks
Capital gains tax	3 marks
Land transfer fees	1 mark

**(20 marks)**

**End of Question Paper**