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# Answers

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1 MEMORANDUM

Gatos Ltd – Taxes payable

To: Tax partner

From: Tax assistant

Date: 1 December 2018

Table showing taxes payable, amounts due, due dates for payment, taxes overdue now and taxes becoming payable after today

Due date	Description	Schedule	€
31 December 2015	SDC on dividend from TRX (€2,000 x 17%)		340
1 August 2017	Corporation tax for 2016	A	3,315
14 November 2017	Capital gains tax on sale of land	D	25,067
30 November 2017	PAYE on interest on director's debit balance 31 October 2017 (€50,000 x 9 % x 20%)/12		75
31 December 2017	PAYE on interest on director's debit balance 30 November 2017 (€50,000 x 9 % x 20%)/12		75
31 December 2017	SDC on interest on Triland bank account (€250 x 30%)		75
31 January 2018	PAYE on interest on director's debit balance 31 December 2017 (€50,000 x 9 % x 20%)/12		75
28 February 2018	PAYE on interest on director's debit balance 31 January 2018 (€50,000 x 9 % x 20%)/12		75
1 August 2018	Corporation tax for 2017	A	38,588
	Total overdue taxes		<u>67,685</u>
31 January 2019	SDC on deemed dividend distribution – 2016 profits	C	23,276
31 January 2020	SDC on deemed dividend distribution – 2017 profits	C	54,534
	Total taxes payable in the future		<u>77,810</u>
	Total taxes due		<u>145,495</u>

(i) Corporation tax due

Schedule A shows the corporation tax computation for Gatos for the 2015, 2016 and 2017 tax years, after making corrections from the information provided.

Interest on the cost of purchase of the saloon car has been disallowed at the average cost of borrowing for each year as shown in schedule B.

The gain on the sale of TRX shares is exempt from corporation tax. The gain on the sale of the land is exempt from corporation tax as it will be taxed under capital gains tax.

Loss relief from the 2013 and 2014 tax years of €70,000 and €55,000, respectively, has been fully utilised against profits arising in the 2016 tax year. There are no losses available for relief in the 2017 tax year, resulting in a substantial tax liability which is now overdue.

No provisional tax has been paid for the 2015, 2016 and 2017 tax years and therefore the total corporation tax liability is due.

The balance of any corporation tax due not paid provisionally during the year is payable by 1 August of the following year.

(ii) SDC on deemed dividend distribution

John is tax resident and domiciled in Cyprus, therefore, unless 70% of the after-tax accounting profits of Gatos are distributed within two years of the year end and SDC thereon deducted at source and paid, 70% of the after-tax accounting profits are deemed to have been distributed as per the provisions of the SDC legislation, and the relevant SDC is due and payable by Gatos.

The after-tax accounting profits have been calculated in schedule C. The accounting profit on the sale of the plot of land has been included in accounting profits for SDC purposes, and the capital gains tax deducted to arrive at after-tax accounting profits (schedule D).

The result for 2015 is a loss and therefore not caught by the deemed dividend provisions.

The 2016 and 2017 tax years show accounting profits after tax. Losses made in earlier years cannot be deducted from accounting profits for the purposes of calculating the deemed dividend. As Gatos does not plan to pay dividends in the next five years, SDC on deemed dividends amounting to 70% of profits will have to be paid by Gatos.

SDC is payable by the end of the month following the month when the dividend is deemed to have been paid.

### **SDC on dividends from TRX**

The dividend from TRX is exempt from corporation tax.

The dividend is subject to SDC at 17% because TRX Ltd is a portfolio investment company as more than 50% of its activities generate investment income, and is resident in Triland, which imposes no tax on listed companies so that the foreign tax burden is substantially lower than the Cyprus tax burden.

SDC on a foreign dividend is payable by self-assessment at the end of the six-month period the dividend is received. The dividend was received in November 2015, which falls in the six-month period ending 31 December 2015, therefore the SDC was due and payable on 31 December 2015.

### **SDC on Triland bank account interest**

The interest is exempt from corporation tax but is subject to SDC at 30%.

As SDC was not deducted at source it is payable by self-assessment every six months. The interest was received in the six-month period ending 31 December 2017, therefore the SDC was due and payable on 31 December 2017.

### **(iii) Capital gains tax**

Gatos signed a contract to sell a plot of land for €500,000 on 15 October 2017.

The capital gains tax due on the sale has been computed in schedule D. Indexation does not apply to the transfer fees paid when acquiring the property.

Capital gains on the disposal of immovable property in Cyprus must be declared and paid within 30 days of sale (i.e. the signing of the contract). The date the transfer is recorded at the land registry department is not relevant. Gatos should have declared the sale and paid the capital gains tax due on the basis of contract date of 15 October 2017 by 14 November 2017.

### **(iv) PAYE**

Gatos has paid all PAYE due on salaries, including the PAYE due on John's salary, on time.

However, the director's current account debit balance of €50,000, created when John borrowed the advance received from the sale of the land from the company, creates an additional PAYE liability.

Deemed interest should have been calculated at the rate of 9% per annum on John's debt to the company, and added to his other income each month as a benefit in kind, with PAYE deducted accordingly.

The monthly interest is €375 ( $€50,000 \times 9\%/12$ ).

The total deemed benefit for the 2017 tax year is €1,125 (3 x €375). John's taxable income for 2017 is €25,816 (gross salary of €28,000 less social insurance contributions at 7.8% of his salary, €2,184 ( $€28,000 \times 7.8\%$ )). Adding the deemed interest of €1,125 brings his taxable income to €26,914, which falls within the 20% income tax band.

The total deemed benefit for the 2018 tax year is €375. John's taxable income for 2018 is also €25,816 (as above). Adding the deemed interest of €375 brings his taxable income to €26,191, which also falls within the 20% income tax band.

PAYE of €75 per month is due ( $€375 \times 20\%$ ).

### **(v) Ethical considerations**

The following ethical threads can be identified based on information provided:

#### **Tendency not to comply with tax legislation**

Our firm should avoid entering into an engagement with a client who intentionally does not comply with tax legislation or fully settle their tax liabilities.

Gatos did not file a tax return or pay any taxes due for 2015, 2016 and 2017. In mitigation, it is noted that Gatos has entered into financial difficulties in 2013 (as did most companies in Cyprus during this period for reasons outside their control). Up to 2012, the company has fully complied with the legislation and paid any taxes due. Also, PAYE and social insurance have been paid on time. Furthermore, now that the business has recovered, the company is seeking to fully comply with tax legislation and pay any overdue taxes.

The amount of taxes payable for the three years is quite significant. If Gatos intends to comply with tax legislation and to make arrangements to settle their tax liabilities, our firm may enter into the engagement with his company.

#### **John has taken money from the company**

It is worrying that John has taken the €50,000 deposit for the sale of the land from the company to repay a personal debt. This has created a significant PAYE liability for the company. In mitigation, John's balance with the company was nil before he took the money and returned to nil after a few months when the money was refunded. Again, we should carefully consider his reaction to the fact the taxes have to be paid on the money he borrowed before making a decision whether to engage his company.

**Schedule A – Corporation tax payable by Gatos Ltd for 2015, 2016 and 2017 tax years**

	2015	2016	2017
	€	€	€
Tax allowable (loss)/taxable profit per draft results	(50,000)	190,000	295,000
<i>Add</i> capital allowances claimed on saloon car (€47,600 x 100/119 x 20%)	–	8,000	8,000
Interest on saloon car not allowable (per schedule B)	–	2,023	1,904
<i>Add</i> saloon car running expenses not allowable	–	1,500	3,800
Taxable profit before loss relief	(50,000)	201,523	308,704
Loss from 2013	–	(70,000)	–
Loss from 2014	–	(55,000)	–
Loss from 2015	–	(50,000)	–
Taxable profit	–	26,523	308,704
Corporation tax at 12.5%	–	3,315	38,588

**Schedule B – Interest on saloon car not allowable**

	2016	2017
	€	€
Interest expense	23,417	25,280
Total borrowings	551,000	632,000
Average interest cost	4.25%	4%
Total cost of car including VAT	47,600	47,600
Interest not allowable	2,023	1,904

**Schedule C – SDC payable on deemed dividend distribution for 2015, 2016 and 2017 tax years**

	2015	2016	2017
	€	€	€
Accounting (loss)/profits	(20,000)	200,000	305,000
<i>Less:</i> Depreciation on saloon car VAT which should now be capitalised (€47,600 x 19/119/7 years)	–	(1,086)	(1,086)
<i>Add:</i> Accounting profit on sale of land (€500,000 – €300,000 – €17,165)	–	–	182,835
Dividend on Triland shares	2,000	–	–
Interest on Triland bank account	–	–	250
Profit on sale of Triland shares (€50,000 – €15,000)	–	–	35,000
Accounting profits before tax	(18,000)	198,914	521,999
Corporation tax per schedule A	–	(3,315)	(38,588)
Capital gains tax per schedule D	–	–	(25,067)
SDC on TRX dividend (€2,000 x 17%)	(340)	–	–
SDC on interest on Triland bank account (€250 x 30%)	–	–	(75)
Accounting (losses)/profits after tax	(18,340)	195,599	458,269
Deemed dividend 70%	–	136,919	320,788
SDC due on deemed dividend at 17%	–	23,276	54,534
Deemed date of dividend	–	31 December 2018	31 December 2019
Due date of SDC	–	31 January 2019	31 January 2020

**Schedule D – Capital gains tax due on sale of land**

	2017
	€
Sales proceeds	500,000
Indexed cost of purchase (excluding transfer fees) (€300,000 x 217.79/182.76)	(357,502)
Transfer fees	(17,165)
Capital gain	125,333
Capital gains tax at 20%	25,067

## 2 (a) Andri's tax residency

When applied to an individual, 'resident in the Republic' means an individual who stays in the Republic for a period or periods exceeding in aggregate 183 days in the year of assessment. For Andri to be considered tax resident in Cyprus, she has to be physically present in Cyprus for more than 183 days per year of assessment (which is a calendar year). As she travels on a regular basis, the following is also important in calculating the number of days:

- (a) the day of departure from the Republic is deemed to be a day outside the Republic
- (b) the day of arrival in the Republic is deemed to be a day in the Republic
- (c) arrival in the Republic and the departure from the Republic on the same day is deemed to be a day in the Republic
- (d) departure from the Republic and arrival in the Republic on the same day is deemed to be a day outside the Republic.

The Tax Department may request the submission of supporting evidence in connection with whether an individual is or is not a resident of the Republic in any year, including copies of passport pages or air/sea tickets or boarding passes which show the dates of entry or exit. With the above in mind, Andri can only become tax resident in Cyprus during 2019 provided she can prove physical presence in Cyprus for more than 183 days during 2019.

It may be possible for Andri to be considered tax resident in Cyprus sooner using the '60 days' rule. From the year of assessment 2017 and later years, an individual may be deemed a tax resident in the Republic if he or she does not remain in any other state for one or more periods for more than 183 days in the same year of assessment, and who is not a tax resident in any other state for the same year provided that such individual meets cumulatively the following:

- remains in the Republic for at least 60 days in the year of assessment;
- carries out any business in the Republic and/or is employed in the Republic and/or holds an office in a company resident in the Republic at any time during the year of assessment;
- maintains a permanent residence in the Republic which is owned or rented by such individual.

It may be possible for Andri to take advantage of the '60 days' rule but it is important to note that she must not 'remain in any other state for one or more periods for more than 183 days' and she must not be considered a tax resident in any other state in the same year. It may be easy for her to remain outside Greece for more than 183 days in 2019 but, subject to Greek tax legislation, it may be difficult for her not to be considered tax resident in Greece in 2019. In this respect she will need the advice of her Greek tax consultants.

The rest of the requirements for the '60 days' rule can be met as she is a director of Inelixis Ltd, and she does at least rent accommodation to stay in Cyprus.

With the above in mind, Andri can be considered tax resident in Cyprus as early as the beginning of March 2019 provided she leaves Greece in December 2018 and stays in Cyprus for the whole of January and February 2019. It is even possible to obtain a tax residency certificate before the expiry of the 60-day period under certain conditions.

## (b) Taxation of dividend income

Dividend income is specifically exempt from income tax in Cyprus in the hands of a physical person irrespective of its source.

However, special defence contribution (SDC) may be payable by physical persons who are tax resident and domiciled in Cyprus. To be considered domiciled, a physical person must first be considered resident for income tax purposes. Although Andri can be considered tax resident in Cyprus as early as the beginning of March 2019, Andri will still not be considered domiciled in Cyprus immediately. Even though she was born in Cyprus from a Cypriot father, so her domicile of origin is Cyprus, she has not been resident in Cyprus for 17 out of the last 20 tax years and she was not resident in Cyprus for the period 1995 to 2014. It is therefore irrelevant if she has changed her domicile of origin. As a result, she will not have to pay SDC on any dividends until she is resident in Cyprus for 17 out of the last 20 years.

**Tutorial note:** *In accordance with Circular 2016/8 issued by the Tax Department on 28 June 2016, persons who have Cyprus as their domicile of origin even though they have not been residents in Cyprus for 17 out of the last 20 years are considered domiciled on their return unless they had changed their domicile to a domicile of choice or they have not been resident for 20 years when the law comes into force, i.e. for the period 1995 to 2014 (this period is specifically described in the Circular). In Andri's case, there is no information to suggest she has changed her domicile to a domicile of choice – in any case Andri is exempted because she was not resident in the period 1995 to 2014. If Andri had changed her domicile of origin to a domicile of choice outside Cyprus and she was away from (say) 1997 onwards (so had been resident outside Cyprus for more than 20 years in 2019), she would be considered domiciled as soon as she becomes Cyprus tax resident for income tax purposes.*

## (c) Why Estia Ltd (Estia) will be considered Cyprus tax resident

The term 'resident in the Republic' when applied to any company means a company whose management and control is exercised in the Republic, irrespective of its place of registration. There is no definition of management and control but in practice it can be taken to be:

- where the majority of the directors reside, and
- where board meetings are held, and
- where the general policy of the company is formulated.

The co-existence of all three criteria is essential. The place where the meetings of the directors are held, although essential, may not be conclusive. It is the place where real management and control of a company is exercised, which may sometimes,

in fact, be exercised by one person, in which case his or her place of residence will be the company's place of residence. There are no clear-cut rules – each case is decided on its own facts. Where the company's central office is located or where the annual general meetings are held is not a material deciding factor.

All three criteria will be met when Andri relocates to Cyprus.

#### **Cyprus tax implications for Estia of becoming Cyprus tax resident**

When Estia becomes Cyprus tax resident, it will be taxed in Cyprus as any other Cyprus resident company on its worldwide income, irrespective of the fact that it is not registered in Cyprus. This will mean that Estia will have to comply with Cyprus legislation for filing tax returns and payment of tax.

Even though there is no double tax treaty between Farland and Cyprus, Cyprus gives tax credit on a unilateral basis on tax suffered abroad. Under the credit method, the foreign tax paid in the foreign country on income arising in that country is credited against the Cyprus tax on the same income. The Cyprus tax law provides specifically that the foreign tax is credited against the Cyprus tax on the same income. The amount of the credit must not exceed the amount which would be ascertained if the amount were to be computed in accordance with the provisions of the law. The foreign income is inclusive of any foreign tax suffered.

In principle, if the corporation tax rate payable by Estia in Farland is higher than the Cyprus corporation tax rate of 12.5% currently applicable on Cyprus tax resident companies, then there will be no more tax to pay in Cyprus but any extra Farland tax not relieved cannot be refunded. On the other hand, if the corporation tax rate in Farland is less than the Cyprus rate, additional Cyprus tax may be payable by Estia.

The taxation of income from the block of flats which Estia owns in Cyprus is taxable in Cyprus anyway as it is Cyprus source income – the Cyprus corporation tax liability on this income will not change if the company's residence changes.

In accordance with the special defence contribution legislation, when a company is considered tax resident for corporation tax purposes it is automatically considered resident for SDC purposes and this has the following tax implications for Estia:

SDC will be payable on its rental income at 3% of 75% of the gross income. On the basis that the gross rental income per year is €50,000, this will amount to €1,125 (€50,000 x 75% x 3%). As all the flats are rented to physical persons, there will be no SDC deducted at source. After it becomes tax resident in Cyprus, Estia will have to pay the SDC due by self-assessment every six months on 30 June and 31 December.

As Estia re-invests its profits and does not pay any dividends, Estia will also be caught by the deemed dividend distribution provisions of the SDC legislation. Cyprus tax resident companies which do not distribute at least 70% of their after-tax accounting profits within two years from the end of the tax year are deemed to have done so and any SDC payable (currently 17%) on such a distribution to tax resident and domiciled persons is payable by the company. As Marios owns 10% of share capital of Estia Ltd and is tax resident and domiciled in Cyprus, SDC on deemed dividends will be payable on his share of the deemed distribution.

The SDC payable on Marios's share of deemed dividends will be an additional tax cost for the company, and arises as a result of Andri relocating to Cyprus and Estia being considered tax resident in Cyprus.

### **3 (a) Income tax and social insurance implications**

The purchase cost of the drill together with any irrecoverable VAT constitutes capital expenditure. The total cost is not immediately deductible from taxable income in the year of purchase, but instead capital allowances will be claimed at 20% per annum. A full year's allowance is given in the tax year of purchase and first use, and none in the tax year of disposal. The purchase will therefore reduce taxable income by €500 per year for five years provided the drill is not sold beforehand.

Currently, Stefanos's turnover is below €70,000, therefore he does not have to prepare audited accounts and may file his tax return either in paper form by 30 September of the following year, or electronically by 31 December of the following year.

When he starts to sell tooth care products his turnover is expected to exceed €70,000 in a tax year and as a result, he will have to prepare audited accounts and will no longer have a choice of filing a return in paper form. He must file his tax return electronically and the deadline for doing so is 31 March – 15 months after the end of the tax year.

There will be no change to the dates of payment of provisional tax (31 July and 31 December) nor the amount of 75% of the total which needs to be paid provisionally during the year to avoid penalties. However, the date of payment of the balance of tax not paid by provisional assessment will change from 30 June to 1 August of the following year.

The profit from the sale of tooth care products will increase Stefanos's taxable income above the level of €60,000, so that part of his income will be subject to the 35% tax rate.

**Tutorial note:** From 2017, all physical persons have to file their tax returns electronically, following a relevant change in the legislation in December 2017. Before the change, Stefanos had the option to file his tax return in paper form by 30 September of the following year or electronically by 31 December of the following year. As the change was after the cut-off date of 30 September 2017 for the December 2018 exam, both answers will be acceptable.

As he is paying social insurance as a self-employed person, neither the increased sales nor taxable income will have any effect on the social insurance he pays or the timing of payment. This is because the insurable income of a self-employed individual is prescribed in accordance with the occupation and place of work. The law provides for minimum and maximum insurable

income for every professional category. If the actual income of a self-employed individual is lower than the prescribed income for the particular professional category, he/she may elect to pay contributions on the actual income.

**(b) VAT implications of sale of tooth care products**

As Stefanos will provide both exempt supplies (services as a dentist) and taxable supplies (tooth care products) he will be considered partially exempt for VAT purposes and will have to follow a special method of computing input VAT which is recoverable.

The standard method of calculating recoverable input tax in the case of a partially exempt business is as follows:

- Input tax on goods and services used wholly for the purpose of making taxable supplies is wholly available for credit.
- Input tax on goods and services used wholly for making exempt supplies is wholly disallowed.
- Input tax which is not directly attributable, e.g. related to overheads, is available for credit on the basis of apportionment, using the fraction Total taxable supplies/Total supplies.

In computing the apportionment fraction the following supplies are ignored:

- supplies of capital goods,
- incidental supplies in connection with the leasing or letting and granting of a licence to occupy immovable property, and financial transactions,
- supplies not subject to output tax under s.20(7), e.g. second hand works of art, except when purchased for resale,
- self-supplies.

If the input tax wholly or partly attributed to exempt supplies (known as exempt input tax) is below the *de minimis* limit then credit for such tax is allowed in full. The limit is an amount not exceeding €171 per month on average and not exceeding 50% of all the input tax for the period concerned. This calculation also has to be made on an annual basis, so that an annual adjustment can be made for any over- or under-declaration made.

As a result of the method of calculation of input tax, Stefanos may be able to recover a proportion of the input VAT on general expenses which cannot be specifically attributed to exempt supplies, for example, power to light and heat the premises where services are provided and products sold, general cleaning and accounting services.

**(c) VAT implications of purchase of tooth drill**

The purchase of the tooth drill is wholly related to exempt supplies, so any input VAT is not recoverable. It does not make any difference if Stefanos buys the drill before or after he is registered – VAT on the purchase will not be recovered in either case.

The apportionment fraction of non-attributable VAT is calculated only with reference to sales (sales of capital goods are excluded) and not purchases, so purchasing the drill after VAT registration will not affect the computation of non-attributable VAT fraction.

However, the purchase of the drill after registration will increase the amount of input tax wholly or partly attributed to exempt supplies (known as exempt input tax) which in turn may increase the exempt input tax above the *de minimis* amount in the relevant period and as a result, some VAT which would otherwise be recoverable under the *de minimis* rules may not be recoverable. This may be a reason to buy the drill before registration.

The Cyprus supplier will charge Cyprus VAT at 19%. This VAT will not be recoverable in any case, so there is no reason to wait if buying from the Cyprus supplier.

If the drill is purchased from the Austrian supplier before he is registered for VAT, the Austrian supplier will charge Austrian VAT because Stefanos will not be able to give him a VAT registration number.

If Stefanos orders the drill from the Austrian supplier after he is registered for VAT, he will be able to purchase the drill without Austrian VAT. He will have to account for the purchase using the reverse charge method, which means that Stefanos will declare 19% of the value of the drill as output tax. However, he will not be able to reclaim the VAT paid as input VAT because it relates to exempt supplies, as explained above.

If the Austrian VAT rate is higher than the Cyprus rate of 19%, then it may be better to buy from the Cyprus supplier if he buys before registering for VAT. Buying after registering will not make any difference other than making the preparation of the VAT return slightly more complex.

**(d) Tax assessment**

The tax department may raise an assessment:

- in accordance with a taxpayer's tax return, or
- according to its best judgement as a result of a tax audit or investigation or examination, or
- in accordance with information at their disposal.

The time limit for issuing such an assessment is within six years from the end of the year of assessment. In case the tax department believes there was willful default or fraud by the taxpayer, the period of six years is extended to 12 years. Not filing a tax return on time is considered as willful default by a taxpayer.

The assessment received by Stefanos was issued within the six-year time limit and shows a higher amount of tax is payable. As Stefanos has filed his tax return and paid all his taxes on time, the assessment would appear to have been issued to disallow expenses and/or to tax a higher amount of income.

Stefanos has two choices:

- accept the assessment and pay the tax due demanded, or
- raise an objection against the assessment by the end of the following month stating the reasons for his objection.

**Tutorial note:** *For assessments received in December, the period for objection is extended by one more month, i.e. in the case of Stefanos, the deadline for raising an objection is extended to the end of February 2019. Candidates were awarded credit for either answer, both of which were acceptable.*

#### **4 (a) Taxes payable by Evi on the sale of XS Ltd shares**

Profit on the sale of shares is specifically exempt from income tax.

However, as XS Ltd (XS) owns immovable property in Cyprus, the sale will be taxable under capital gains tax.

The market value of all the immovable property at the time of sale of the shares will be estimated by the specialist section of the tax department which carries out property valuations.

The cost of the immovable property will be indexed according to normal rules. As XS acquired the land in 1974, the market value of the land as at 1 January 1980 will be used, and indexed from 1 January 1980 until the month of sale of the shares. The cost of construction of the warehouse will also be indexed. Construction took several months to complete, in which case indexation will be applied from each month of payment to the costs of construction. Indexation is not applied to transfer fees.

The theoretical capital gain will be computed by deducting indexed costs and any transfer fees from the estimated market value of the immovable property at the time of sales of the shares. If 80% of the shares are sold, then Evi will have to pay capital gains tax at 20% on 80% of the theoretical capital gain. The capital gains tax should be declared and the tax paid within 30 days from the date of disposal of the shares.

As the market value of the property has appreciated significantly, the capital gains tax on the disposal of the shares is expected to be high.

#### **(b) Effect on XS corporation tax and SDC liability**

XS and its new owner, Apre Ltd (Apre), will form a group for loss relief purposes.

Two companies are deemed to be members of a group if one is a 75% subsidiary of the other or both, each one separately, are 75% subsidiaries of a third company. Group companies may be a mixture of resident and non-resident companies, provided the non-resident company owns at least 75% of a resident company.

In order for XS to be able to utilise Apre's losses, Apre must own at least 75% of XS, which it will do.

As it is resident in the EU, Apre may surrender losses to XS but after it has exhausted all the possibilities of set-off or transfer of its losses in France (or in another member state where an intermediate holding company may be based).

It is only current year losses which can be surrendered, and the companies must be members of the group for the whole of the tax year.

The SDC payable by XS on rental income, interest receivable and foreign dividends (not exempt from SDC) will not be affected by the change in shareholding.

In case XS does not pay 70% of its after-tax accounting profits as dividends in two years from the end of the tax year, it is deemed to have done so and must pay SDC of 17% on deemed dividends. SDC will only need to be accounted for on deemed dividends payable to Evi because the dividends payable to Apre are exempt from SDC as the company is resident in France.

#### **(c) Tax implications of Evi transferring the immovable property to herself**

The transfer of the immovable property to Evi will be taxable under capital gains tax as if the property was being sold to a third party. As it is a transaction between related parties, the market value of the immovable property at the time of disposal will be used for computing the capital gains tax payable by the company. The method of calculation of the cost is as in (a) above.

VAT will not be payable as the property is used.

Land transfer fees will also be payable by Evi on the transfer, based on the market value of the property at the time of disposal but at half the relevant rates.

The accounting profit on disposal, which will be quite high, will form part of the after-tax accounting profits of XS for deemed dividend distribution purposes. By the end of the second year following the year of disposal there will be an SDC liability of 17% of 70% of the accounting profit on the disposal.

If the disposal takes place at a price below the market value, the difference between the declared price and market value is treated as a dividend and SDC at 17% will be payable.



The rental income which Evi will receive less 20% of the gross rent will form part of her personal taxable income; this may take her taxable income into the 35% tax band. Capital allowances on the original cost of construction will no longer be available as 33 years have elapsed since the date of construction.

Evi will have to pay SDC at 3% of 75% of the gross rent which XS will deduct at source.

The rent payable to Evi will be deductible from taxable profits of XS, thereby reducing both its corporation tax liability and the potential SDC on deemed dividends.

**Tutorial note:** VAT may also be chargeable on the rent in accordance with a change in the VAT legislation made in December 2017. As the change was after the cut-off date of 30 September 2017 for the December 2018 exam, this point was not examinable.

**(d) Use of a re-organisation scheme to separate the immovable property from XS Ltd**

**Transfer of assets re-organisation**

Under the 'transfer of assets' type of re-organisation, assets must be given in exchange for shares. This means that the immovable property will be given by XS to a new or existing company in exchange for shares. XS will therefore become a shareholder of this new or existing company and indirectly own a proportion of the immovable property. In the case of a new company being registered specifically for acquiring the property in exchange for shares, this company will end up as a 100% subsidiary of XS. This type of re-organisation scheme will not help.

**Partial division re-organisation**

Under the 'partial division' type of re-organisation, the immovable property can be transferred to a new company with the same shareholder. For such a re-organisation to be approved, the transferring company must retain at least one branch of activity whilst transferring another branch of activity to the new company. 'Branch of activity' means all the assets and liabilities of a division of a company which constitute an independent business from an organisational point of view, in other words an entity capable of functioning by its own means.

On the one hand, it can be argued that XS's immovable property (warehouse) cannot be considered as a separate 'branch of activity' because it is an integral part of XS's distribution business. On the other hand, there is an economic reason for the re-organisation because the immovable property of the company has appreciated to such an extent that it now forms a large part of the company's assets, that it prohibits the company from attracting key partners to expand its business. Furthermore, the immovable property can be seen as a completely separate section of the business with a different risk profile, different prospects, and earning different (rental) income.

**5 (a) Salary increase**

From a personal income tax point of view, George could increase his salary to €19,500, which is the tax-free amount of personal income per year, without income tax becoming payable. The dividend he receives from Axonas Ltd is exempt from income tax and is not added to his taxable income.

Social insurance is payable on George's salary both by himself, at 7.8% (which Axonas deducts from his salary) and by Axonas as his employer, which pays a total of 11.5% on his salary. There is no tax-free amount for social insurance, therefore an increase in his salary to €21,000 will give rise to increased social insurance payable by himself and Axonas of €1,737 ((€21,000 – €12,000) x (7.8% + 11.5%)).

Axonas's share of social insurance contributions are allowed as a deduction from taxable profits. The total increase of salary cost for Axonas which will be deductible from taxable profits will be €10,035 (€9,000 x 111.5%). This will save corporation tax of €1,254 (€10,035 x 12.5%).

The increase in salary will result in an increase of €1,737 in social insurance payable and a decrease of €1,254 in corporation tax payable, a net increase in taxes of €483 for Axonas Ltd.

The increased salary cost of €10,035 will reduce after-tax accounting profits and therefore reduce the dividend which Axonas pays to George (the minimum as per the SDC legislation). The saving in dividend SDC is €1,045 ((€10,035 – €1,254) x 70% x 17%).

The net effect of all taxes, including SDC on dividends, is a saving of €562 (€1,737 – €1,254 – €1,045), i.e. increasing George's salary to €21,000 will reduce total taxes for Axonas and George by €562.

As personal social insurance contributions are deductible from personal taxable income, increasing George's salary to €21,000 per year will give rise to personal social insurance contributions of €1,638 (€21,000 x 7.8%). His taxable income will therefore be €19,362 (€21,000 – €1,638), which is below the tax-free personal income amount of €19,500.

A non-tax advantage to George of increasing his salary to the level of €21,000 is that he will be replacing payment of taxes with personal and employer social insurance contributions, which will count towards a higher pension or increased benefits being available through the social insurance system.

**(b) Tsiao's services**

Normally, the supplier of a service is the person who must account to the tax authorities for any VAT due on the supply.

However, taxable persons established in the Republic who receive services from overseas must account for them under the reverse charge method as the place of supply of these services is deemed to be in Cyprus.

The services provided by Tsiao are taxable. Axonas must account for VAT on the services it receives from Tsiao using the reverse charge method. This means that it will treat Tsiao's invoice as both a sale and a purchase of services, and account for Cyprus output and input VAT on the invoice. The two amounts will cancel one another out. (As the services relate to taxable supplies of car parts, it is safe to assume that all input VAT will be recoverable.)

**Tutorial note:** *A business which is not registered for VAT and receives services from overseas to a level that they exceed the Cyprus registration threshold of €15,600 will be required to register for VAT in the Republic as it will be deemed to be making taxable supplies to itself.*

For income tax purposes, Tsiao provides the services of a professional but he is not supplying the services in Cyprus. No withholding tax should therefore be deducted at source in accordance with Cyprus income tax legislation.

**Tutorial note:** *The case should be differentiated from that of a professional who performs their services in Cyprus.*

**(c) Local sales to tourists**

The place of supply of goods is where the goods are located at the time ownership or title of goods passes from the seller to the buyer. At the time of sale of the parts, the tourists are in Cyprus and the place of supply is Cyprus. As sales of car parts are not exempt, zero rated or taxable at a lower rate, Cyprus VAT at the rate of 19% should be charged on these sales.

It is irrelevant that the parts will not be used in Cyprus or/and will be taken/exported overseas by the tourists.

If tourists arrive from outside the EU, after they have seen and selected the parts they like, George can offer to post or ship them to their address in their country of destination, in which case they will not pay VAT. George must keep proof of export together with his zero rated invoice. If they come from within the EU, this can also be done for business customers who provide George with their EU VAT registration number.

EU non-business customers will have to pay Cyprus VAT, even if the parts are dispatched by Axonas to their country of destination.

	<i>Available</i>	<i>Maximum</i>
<b>1 (i) Corporation tax</b>		
<b>Corporation tax computation</b>		
Capital allowances on saloon added back	1	
Interest on saloon car not allowable/computation of average interest cost and relevant interest	2	
Saloon car expenses not allowable	1	
Loss relief in 2016 from 2013/2014/2015	1.5	
Application of correct corporation tax rate	0.5	
<b>Corporation tax commentary</b>		
Gain on sale of TRX exempt	0.5	
Gain on sale of land exempt	0.5	
Interest and dividends exempt	0.5	
Correct payment dates – 0.5 each	1	
	<u>8.5</u>	<b>8</b>
<b>(ii) SDC</b>		
<b>SDC on deemed dividends calculation</b>		
Depreciation on saloon car VAT	1	
Accounting profit on sale of land	1	
Dividend on TRX shares	0.5	
Interest on Triland bank account	0.5	
Profit on Triland shares	0.5	
Deduction of corporation tax	0.5	
Deduction of capital gains tax	0.5	
Deduction of SDC on TRX dividend	0.5	
Deduction of SDC on Triland interest	0.5	
Deemed dividend correct %	0.5	
Deemed dividend correct SDC %	0.5	
Correct payment dates on table – 0.5 each	1	
<b>SDC on deemed dividends commentary</b>		
John tax resident and domiciled thus deemed div for SDC	0.5	
Apply deemed dividend provisions to Gatos	1	
Loss not deducted from accounting profits	0.5	
TRX dividend not exempt from SDC with reasons	2	
Payment date/self-assessment	1	
Triland interest SDC	1	
Payment date/self-assessment	1	
	<u>14.5</u>	<b>13</b>
<b>(iii) Capital gains tax</b>		
<b>Capital gains tax calculation</b>		
Indexed purchase cost	1	
Correct capital gains tax %	0.5	
<b>Capital gains tax commentary</b>		
Explanation of due date per contract	1	
Transfer at land registry irrelevant	0.5	
No indexation on transfer fees	0.5	
	<u>3.5</u>	<b>3</b>
<b>(iv) PAYE</b>		
Calculate/explain monthly benefit in kind is deemed interest 9% on end of month debit balance of director's current account	2	
Taxable income calculation to establish correct tax rate	1.5	
Calculate monthly PAYE tax	0.5	
Correct dates of payment	1	
	<u>5</u>	<b>5</b>

	<i>Available</i>	<i>Maximum</i>
<b>(v) Ethical considerations</b>		
Intentionally not to comply with tax legislation and pay tax due but financial crisis – paid taxes in the past and now wants to comply fully	2	
John took the deposit for the sale of land – but money returned after a few months and balance returned to nil	1	
	<u>3</u>	2
Format and presentation of the memorandum	1	
Clarity and effectiveness of communication	2	
Logical flow of calculations	1	
	<u>4</u>	<u>4</u>
		<u>35</u>

**Note to markers:** *Candidates should be awarded the mark if they correctly explain in the commentary something which is (correctly) NOT included in the computation, but not if they fail to mention in the commentary (i.e. no mark for leaving out of the calculation without explaining why).*

<b>2 (a)</b>	Andri can become tax resident in 2019 per normal 183 day rule – definition of tax resident for a physical person	1.5	
	Details of how days are calculated – 0.5 each	2	
	Definition of 60 days rule as it applies from 2017:		
	Must stay in Cyprus for 60 days	0.5	
	Does not remain in other state for 183 days	0.5	
	Not tax resident in another state in the same year	0.5	
	Carries out business or employed or holds office	0.5	
	Maintains permanent residence	0.5	
	60 days can be used by Andri she will work for Inelixis – rent flat but may be problem with Greek residency in 2019 – if so can be resident from early March 2019	1.5	
	Tax department may require evidence	0.5	
	Following 60 days rule certificate of tax residency may be obtained before the expiry of the 60 days subject to conditions	1	
		<u>9</u>	8
<b>(b)</b>	Dividend income received by physical person is exempt from income tax	0.5	
	Subject to SDC if tax resident and domiciled	0.5	
	Must be tax resident to be domiciled – Andri not immediately domiciled	1	
	Andri has Cyprus domicile of origin	0.5	
	Not resident in Cyprus for 17 out of last 20 years	0.5	
	Not resident for the period 1995 to 2014	0.5	
	No SDC on dividends for the next 17 years	1	
		<u>4.5</u>	4
<b>(c)</b>	Explain when a company is considered tax resident – management and control principle – criteria	2	
	Explanation of real management and control – no clear-cut rules	1	
	All criteria will co-exist when Andri moves to Cyprus	1	
	Estia taxed on worldwide income/file returns and payment of tax	1.5	
	Explanation of unilateral credit for foreign tax even though no double tax treaty – no refund	1.5	
	Comparison of Farland tax rate with Cyprus rate – if lower, additional tax will have to be paid in Cyprus	1	
	Rent already taxed in Cyprus – no change	1	
	Company will automatically be considered resident for SDC when it becomes resident for income tax	1	
	SDC on rental income with rough estimate and payment dates	1.5	
	Caught by deemed dividend provisions of SDC – definition	1	
	As Marios resident and domiciled, SDC on deemed dividend on his share payable because of no dividend payments	1	
		<u>13.5</u>	<u>13</u>
			<u>25</u>

	<i>Available</i>	<i>Maximum</i>
<b>3 (a)</b> Capital allowances on cost of drill plus irrecoverable VAT – 20% per annum – reduce tax liability in next five years	1·5	
Current turnover below €70,000 no audit – can file return in paper form – dates	1·5	
If over €70,000 then no longer paper form – 15 months electronically	1	
Dates of payment and amount of provisional tax do not change	0·5	
Dates of payment of balance of tax due change from 30 June to 1 August following year	1	
Increased profit will take to 35% band	0·5	
Self-employed social insurance does not depend on income or profit – insurable income of self-employed individual prescribed by occupation and place of work – minimum and maximum insurable income for every professional category – if actual income lower can elect to pay contributions on actual income	2	
	<u>8</u>	7
<b>(b)</b> Will become partially exempt	0·5	
Special method recoverable input tax – attributable, non-attributable	2	
What is not included in partial exemption fraction	1	
Annual adjustment required	0·5	
<i>De minimis</i> limit of €171 per month and 50% of total input VAT	1	
Stefanos may be able to recover tax on overheads	0·5	
	<u>5·5</u>	5
<b>(c)</b> Input VAT on drill relates to exempt supplies therefore not recoverable – therefore does not make a difference if bought before or after on recoverability of VAT on purchase	1	
Non-attributable VAT fraction not affected by purchases	0·5	
If purchase after registration <i>de minimis</i> amount may be affected	1	
Cyprus supplier will apply 19% VAT – not recoverable – timing not important	0·5	
If not registered when purchase from Austria, then Austrian VAT	1	
If registered, then reverse charge with 19% Cyprus VAT – output tax declared – input cannot be recovered	1·5	
If Austrian VAT higher and purchase before registration, then buy from Cyprus supplier	0·5	
	<u>6</u>	5
<b>(d)</b> Assessment raised per return or best judgement on basis of investigation or information	1·5	
Time limits 6/12 years if wilfull default or fraud	1·5	
Pay tax or raise objection explaining why/within end of following month	1·5	
	<u>4·5</u>	3
		<u>20</u>

	<i>Available</i>	<i>Maximum</i>
<b>4 (a)</b> Profit of sale specifically exempt from income tax	0.5	
Taxable under capital gains tax as XS owns immovable property in Cyprus	0.5	
Market value estimated by tax dept	1	
Indexation on costs/land value 1 January 1980 and indexation from then/construction cost from month of payment/not on transfer fees	2	
Evi pay 20% CGT on 80% of capital gain	1	
	<u>5</u>	4
<b>(b)</b> Group for loss relief purposes – one is 75% subsidiary of the other – or both are 75% subsidiaries of a third company	1	
Resident and non-resident companies OK – non-resident company must own at least 75% of a resident company	2	
Non-resident may surrender losses to XS but after all possibilities of set-off or transfer in France exhausted	1	
Only current year losses can be surrendered and group for the whole year	1	
SDC on rental income, interest or foreign dividends not affected	0.5	
19% SDC on deemed dividends only on Evi's share – non-resident's share exempt from SDC	1	
	<u>6.5</u>	5
<b>(c)</b> Capital gain at market value as related parties, less indexation as normal	1	
VAT not chargeable, with reason	1	
Land transfer fees payable, at half the rate	1	
Accounting profit on disposal high – will form part of after-tax accounting profits for deemed dividend	1	
Excess of market value over price deemed dividend	1	
Rental income less 20% taxable income for Evi – may take her to the 35% band	1.5	
No capital allowances, with reason	0.5	
Also SDC on rent 3% of 75% on gross – deducted at source by XS	1	
Rent payable by XS deducted from taxable and accounting profits – saving in corporation tax – saving SDC on deemed dividends	1	
	<u>9</u>	7
<b>(d) Transfer of assets type</b>		
Assets must be given in exchange of shares – thus XS will continue to own indirectly – does not help	1.5	
<b>Partial division</b>		
Branches of activity retained and transferred, define branch of activity – 'own means function'	1.5	
Partial division type application to XS/Apre – cannot be separate branch of activity, with reason	1	
Partial division type application to XS/Apre – business reason to attract new investment – can be separate section of business, with reasons	1	
	<u>5</u>	<u>4</u>
		<u>20</u>

	<i>Available</i>	<i>Maximum</i>
<b>5 (a)</b> If increase to €19,500 no income tax		
Dividend exempt	1	
Social insurance by George and Axonas – rates – computation of amount	0·5	
Increase in salary and employer contributions reduce corporation tax payable – computation of amount	2	
Reduction in deemed dividend SDC – computation of amount	2	
Personal social insurance contributions deductible from taxable income – no income tax, with proof	1·5	
Replacing payment of taxes with payment of social insurances may give pension and social insurance claim benefits in future	1·5	
	<u>10</u>	<b>10</b>
<b>(b)</b> Service thus supply where recipient is/Cyprus	1	
Reverse charge, with explanation	2	
Professional services but not physically in Cyprus therefore no Cyprus income tax implications	1	
	<u>4</u>	<b>4</b>
<b>(c)</b> Place of supply is Cyprus if ownership transferred in Cyprus/Cyprus VAT should be charged	2	
Irrelevant that they are going to take parts overseas	0·5	
Option for John to post/ship parts to outside EU, after they have seen and paid for goods – export – VAT zero rated	2·5	
For EU customers, no VAT charge for VAT registered business customers who provide VAT registration number	1	
Non-business customers within EU must pay VAT	0·5	
	<u>6·5</u>	<b>6</b>
		<u><b>20</b></u>