
Answers

1 Roulla and Fresko Ltd

MEMORANDUM

To: Tax partner
From: Tax assistant
Date: 8 April 2019

ROULLA AND FRESKO LTD

Total taxes payable comparison table

For the year ended 31 December 2018

	Schedule	Roulla and Fresko Ltd – current position	Roulla as sole trader
		€	€
Roulla – Personal income tax	A/E	647	6,043
Fresko Ltd – Corporation tax	B	3,117	
Special defence contribution (SDC) on deemed dividend of 70% of the 2018 after-tax accounting profits of Fresko Ltd	C	1,485	
SDC on Rockland rental income (24,000 x 75% x 3%)		540	540
Rockland tax recoverable against SDC on rental income		(540)	
Roulla's social insurance as employee of Fresko Ltd (12,000 x 7.8%)		936	
Fresko Ltd's employer social insurance and other contributions on Roulla's salary (12,000 x total 11.5%) (exempt from holiday fund)		1,380	
Roulla's social insurance as self-employed shopkeeper (18,946 x 14.6%)			2,766
		<u>7,565</u>	<u>9,349</u>

From the above table, it can be seen that if Roulla operated her shop as a self-employed sole trader, total taxes payable for 2018 would be higher.

Comparing taxes payable by Roulla to the taxes payable by her friend as mentioned in her email is most probably incorrect due to the fact that she has a significant amount of rental income from her house in Rockland.

(i) Personal income tax computations

A computation of the tax due for 2018 given her current status is made in Schedule A and the following is noted:

- Gross rental income from the house in Rockland is added to her salary to arrive at her gross taxable income in Cyprus. In accordance with Cyprus legislation, a physical person earning rental income is allowed a 20% deduction of gross rental income as an expense and actual expenses are not allowed. As the house is over 33 years old, no capital allowances have been claimed.
- Personal medical plan contributions are limited to 1.5% of gross income so Roulla does not get a full tax benefit on her contributions. Her life insurance contributions are less than 7% of the insured sum so they are all allowable. The total of the restricted amount of medical plan, life insurance and social insurance contributions are restricted to 1/6th of taxable income. In the case of Roulla, no restriction is necessary.
- Even though Cyprus does not have a double tax treaty with Rockland, it allows unilateral credit for the tax on the rental income suffered in Rockland. From the total amount paid in Rockland of €2,588, only €1,152 is allowed as a credit as explained in Schedule A and the balance is lost.

Her personal income tax position is re-computed in Schedule E assuming that she operated her shop as a sole trader and the following is noted in this respect:

- Salary from Fresko Ltd was replaced by the taxable profits of Fresko Ltd (Schedule D). To arrive at taxable profits as a sole trader, her salary and employer social insurance and other contributions were added back, and the assumption was made that all other expenses will remain the same.
- Due to higher gross income she benefits a little more from personal medical plan contributions. Social insurance contributions were replaced by the contributions she would be making as a self-employed shopkeeper. No restriction was necessary to 1/6th of taxable income.
- The average rate on which she pays tax escalates to 15% and therefore she gets a full benefit of the tax paid in Rockland.

(ii) Fresko Ltd – Corporation tax for 2018

The corporation tax computation of Fresko Ltd is shown in Schedule B and the following is noted:

1. Allowable entertainment expenses are restricted to 1% of turnover.
2. Depreciation as well as the expenses on the saloon car are disallowed.
3. The annual levy payable to the Registrar of Companies is disallowed.
4. Gross interest on the company current account was treated as interest earned in the normal course of business and no adjustment was made.

(iii) Special defence contribution (SDC)

Deemed dividend

In order to fully compare the current tax position of Roulla and Fresko Ltd with the alternative of operating as a sole trader, a computation of SDC on deemed dividends needs to be made. In accordance with Cyprus legislation, if a company does not distribute at least 70% of its after-tax accounting profits as dividend within two years of the year end, then it is deemed to have done so and any SDC due on such deemed dividend is payable by the company. The computation is shown in Schedule C and the following is noted:

1. Nothing in the following years will change the SDC liability for 2018. It is simply a delayed payment of tax for 2018.
2. The computation was made on the minimum of 70% required by the legislation although strictly speaking to make it comparable 100% with the sole trader position one could say that SDC on 100% of after-tax profits should be computed. This is, however, an option in the case of a limited liability company and can be considered as a benefit of operating as such.

Rental income

As Roulla is tax resident and domiciled in Cyprus, SDC is payable on her foreign rental income in Cyprus.

As an amount of €1,436 of tax paid in Rockland remains unrelieved given the current status of Roulla as an employee of Fresko Ltd, this unrelieved tax can be used against the SDC liability of €540 due for the year. Under the self-employed scenario, the full tax credit for the Rockland tax is obtained against income tax payable.

Schedule A

Roulla – Personal income tax computation for 2018 as employee of Fresko Ltd

	€	€
Salary from Fresko Ltd		12,000
Rental income from house in Rockland		<u>24,000</u>
Total gross income		36,000
Less deductions:		
20% of gross rental income as expenses – actual expenses not allowable		<u>(4,800)</u>
Taxable income before social insurance, provident fund, etc		31,200
Less:		
Personal medical plan contributions – (€1,440 but restricted to 1.5% of gross income)	540	
Social insurance contributions	936	
Life insurance contributions (no restriction as below 7% of insurance amount)	1,329	
Total (no restriction as below 1/6th of taxable income)		<u>(2,805)</u>
Taxable income		<u>28,395</u>
Tax due:		
€0 – €19,500 at 0%		0
€8,500 at 20%		1,700
€395 at 25%		<u>99</u>
		1,799
Less tax paid in Rockland for which credit is available (Average tax rate on gross income is: $1,799/31,200 = 6\%$, thus tax credit restricted to 6% of net rental income of €19,200 = €1,152 even though €2,588 was paid)		<u>(1,152)</u>
Net tax payable before PAYE		<u>647</u>

Tutorial note: The amount of PAYE suffered at source is not deducted, because to make a comparison with the self-employed scenario, the tax liability before amounts suffered at source should be considered.

Schedule B**Fresko Ltd – Corporation tax computation****For the year ended 31 December 2018**

	€	€
Accounting profit		15,600
<i>Add</i> expenses not allowed:		
Entertainment expenses (allowable amount restricted to 1% of turnover) (5,230 – (1% x 280,351))	2,426	
Depreciation of saloon car not allowable	5,000	
Saloon car expenses not allowable	1,560	
Annual registrar levy not allowable	350	
		<u>9,336</u>
Taxable profit		<u>24,936</u>
Corporation tax at 12·5%		<u>3,117</u>

Schedule C**Fresko Ltd – SDC on deemed dividend payable on 2018 profits**

	€
Accounting profit	15,600
Less corporation tax payable for 2018 per Schedule B	<u>(3,117)</u>
After-tax accounting profits	12,483
70% deemed dividend	8,738
SDC at 17% on deemed dividend	<u>1,485</u>

Schedule D**Roulla – Computation of taxable profit as self-employed shopkeeper****For the year ended 31 December 2018**

	€
Taxable profit of Fresko Ltd as per Schedule B	24,936
<i>Add</i> Roulla's salary	12,000
<i>Add</i> employer social insurance and other contributions (12,000 x 11·5%)	1,380
Taxable profit as self-employed	<u>38,316</u>

Schedule E**Roulla – Personal income tax computation for 2018 as self-employed shopkeeper**

	€	€
Taxable profit per Schedule D		38,316
Rental income from house in Rockland		<u>24,000</u>
Total gross income		62,316
<i>Less</i> deductions:		
20% of gross rental income as expenses – actual expenses not allowable		<u>(4,800)</u>
Taxable income before social insurance, provident fund, etc		57,516
<i>Less</i> :		
Personal medical plan contributions – (€1,440 but restricted to 1·5% of gross income)	935	
Social insurance contributions (18,946 x 14·6%)	2,766	
Life insurance contributions (no restriction as below 7% of insurance amount)	1,329	
Total (no restriction as below 1/6th of taxable income)		<u>(5,030)</u>
Taxable income		<u>52,486</u>

Tax due:	€
€0 – €19,500 at 0%	0
€8,500 at 20%	1,700
€8,300 at 25%	2,075
€16,186 at 30%	4,856
	<hr/>
	8,631
Less tax paid in Rockland for which credit is available (Average tax rate on gross income is: $8,631/57,516 = 15\%$, thus maximum tax credit restricted to 15% of net rental income of €19,200 = €2,880 so full credit for tax in Rockland obtained)	(2,588)
	<hr/>
Net tax payable	6,043

2 Eskafeas Ltd

(a) Wholly owned subsidiary v branch

(i) Dealership is profitable

Subsidiary

The profits of the Newland subsidiary will not be taxable in Cyprus as the subsidiary will not be a Cyprus tax resident.

Any dividends received by Eskafeas Ltd (Eskafeas) from the subsidiary will be exempt from corporation tax. Even though the foreign tax burden (0%) on the subsidiary's profits will be significantly less than that in Cyprus (12.5%), its activities will not result in more than 50% of its income arising from investments. Accordingly, the dividend income received by Eskafeas from the Newland subsidiary will also be exempt from special defence contribution (SDC).

However, any dividends received by Eskafeas will form part of its after-tax accounting profits for the purposes of the SDC deemed dividend calculation. According to the SDC deemed dividend distribution provisions, if a company does not distribute at least 70% of its after-tax accounting profits to its shareholders as dividends within two years from the end of the tax year, the dividends will be deemed to have been distributed. Any SDC due on these deemed dividends (depending on the tax residency and domicile status of its shareholders at the time) will have to be paid.

Branch

The branch would constitute an overseas permanent establishment of Eskafeas, therefore its profits would be exempt from corporation tax in Cyprus.

As with the subsidiary scenario, there is an SDC deemed dividend issue in the case of the branch. The branch profits will be automatically included in the after-tax accounting profits of Eskafeas, and therefore will automatically be included in the deemed dividend calculation.

Conclusion

In both cases, the profits will be exempt from any tax in Cyprus. In the case of the subsidiary, however, the payment of dividends can be timed to minimise any SDC deemed dividend effects. Also, the subsidiary may reinvest some of its profits and never pay them as dividends to Eskafeas. In the case of a branch, there is no such flexibility and all profits whether distributed or not will be included in the SDC deemed dividend calculation.

(ii) Dealership is initially loss-making then profitable

Subsidiary

If the business in Newland makes losses and is run through a non-resident subsidiary, corporation tax loss relief is not available. This is because the subsidiary does not form part of a loss group with Eskafeas, as it will not be Cyprus tax resident.

Branch

In the absence of a double tax treaty, however, Cyprus allows relief for losses from a permanent establishment abroad using the unilateral provisions.

Accordingly, if the business in Newland initially makes losses, there is a tax advantage in operating as a branch because Eskafeas will automatically receive loss relief. However, loss relief will be clawed back when profits are made in the future. This is because branch profits equal to the amount of branch losses relieved in the past must be included in the chargeable income of Eskafeas when the overseas operations become profitable.

The accounting losses of the branch will automatically be consolidated with the accounting profits (if any) of Eskafeas in the period they arise, thereby decreasing Eskafeas' after-tax accounting profits subject to the deemed distribution provisions for SDC of the same year. However, the losses of a subsidiary cannot reduce the accounting profits of Eskafeas, and higher SDC will be payable.

Conclusion

It would be preferable to set the dealership up as a branch in this situation as loss relief would be available and lower SDC would be paid.

The best solution would be to set up the dealership as a branch initially and obtain loss relief, then to incorporate into a subsidiary company when the business becomes profitable.

(iii) Dealership is closed down having made only losses

Subsidiary

As mentioned above, loss relief would not be available if set up as a subsidiary company.

In addition, when the dealership closes down, if it is operated through a wholly owned subsidiary company, the loss on the diminution in value of the shares of the Newland subsidiary (whether realised or unrealised) will not be allowable for corporation tax purposes.

Unrealised losses on the revaluation of shares are also not allowable for computing after-tax accounting profits for SDC deemed dividend distribution purposes and must be added back. On closing down/liquidating the Newland subsidiary, these losses will be considered as a realised loss on the shares and therefore will be allowable for the computation of after-tax accounting profits for SDC deemed dividend purposes.

There will therefore be an indirect benefit to the extent that Eskafeas has after-tax accounting profits in the year in which the loss on the shares is realised.

Branch

If the dealership makes only losses before closing, there is a tax advantage in operating as a branch because loss relief will be available (as explained above) but there will be no clawing back of the branch losses.

Conclusion

In these circumstances, it would be preferable to set up the business as a branch.

(b) Taxation of employees' salary whilst working with Newland dealership

For income tax purposes, for an individual to be considered tax resident in Cyprus they must be in Cyprus for more than 183 days in a calendar year.

If an individual is not Cyprus tax resident, they are only taxed in Cyprus on Cyprus source income. If they are considered tax resident, then they are taxed in Cyprus on their worldwide income.

However, despite the Cyprus tax residency rule, the 90-day rule states that remuneration:

- from salaried services outside the Republic,
- for a total aggregate period in the year of assessment of more than 90 days,
- to an employer not resident in the Republic, or
- to a permanent establishment outside the Republic of an employer resident in the Republic,

is exempt from tax.

Optimum stay in Newland

As the planned duration of stay in Newland by the Eskafeas employees is between three and eighteen months, to ensure that the salary received from the Newland dealership is not taxed in Cyprus, the employees should stay in Newland for at least 90 days in a tax year.

Note that if their stay straddles two tax years, they should stay at least 90 days in the year of departure from Cyprus, and 90 days in the year of return back to Cyprus.

Taxation of other sources of income

Any salary received from Eskafeas will always be taxable in Cyprus, irrespective of how long the employee is in Cyprus, as it is Cyprus source income.

For employees who do not have any other income other than their salary from Eskafeas and from the dealership in Newland, they need to make sure they comply with the 90-day rule to make sure that their salary from Newland will not be taxable in Cyprus.

As they will not receive a salary from Eskafeas during their employment in Newland, there is an indirect tax benefit for all employees in that their taxable income will be less. They are not going to receive a whole year's salary from Eskafeas and therefore their taxable income may drop to a lower band of taxation (for example from 30% to 25%).

Accordingly, to ensure that taxable income drops to the lowest possible level, it is advisable to go to Newland for a period which straddles two tax years and to divide the period equally between the two tax years. For example, if an employee plans to go to Newland for a total period of 16 months, it may be better to be away for eight months in the first year and eight in the second so that their income from Eskafeas will be for only four months each year. This could possibly drop their income level below the threshold of €19,500, such that no tax is payable.

From an income tax point of view:

- interest and dividends received by physical persons are exempt from income tax, but
- rental income is taxable.

Rental income from Cyprus sources is taxable in Cyprus, irrespective of the tax residency of an individual. It will remain taxable in Cyprus, irrespective of the duration of stay in Newland, and timing of departure from and arrival in Cyprus.

Special defence contribution (SDC) is payable by Cyprus tax resident and domiciled individuals on:

- interest at the rate of 30%,
- dividends at the rate of 17%, and
- rental income at the rate of 3% on 75% of the gross rental income.

If an individual is not tax resident in accordance with the income tax law definition, then automatically they are not liable to SDC.

If an employee becomes non-Cyprus tax resident as a result of their duration of stay in Newland, even though they are domiciled in Cyprus, they can avoid SDC. To achieve this, they must be away from Cyprus for more than 183 days (6 months). To avoid SDC, the minimum duration of stay in Newland therefore has to be just over 12 months, and departure should be sometime in June and arrival back in July of the following year.

If employees plan to return to Cyprus for holidays during their employment in Newland, they must include the holiday in their calculation of days in Cyprus. Note that there are detailed provisions in law regarding when the days of departure and days of arrival count in the calculations. Evidence should be kept on the dates of travel, as this may be requested by the department of taxation.

(c) Subsidiary in Newland

The subsidiary will be registered in Newland, but irrespective of the country of registration, a company is considered tax resident in Cyprus if its management and control is exercised in the Republic.

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.

Eskafeas should therefore ensure that all the above criteria are met in Newland, and evidence can be provided in case the tax department makes an enquiry.

There are no clear-cut rules, each case is decided on its own facts.

However, note that if the tax department believes that the real management and control of the dealership in Newland is in fact exercised from Cyprus (for example, by Eskafeas' Cyprus resident management and directors), even though those individuals may not be officers of the subsidiary company in Newland, the Newland company may still be considered tax resident in Cyprus.

3 Takis

(a) Net cash required

The total cash payment which Takis will need to make for the purchase of the new office is €952,000 (€800,000 plus value added tax (VAT) at 19%). As there is VAT payable on the transaction, there will be no land transfer fees payable.

(i) Sale of the shop to a third party for cash

The capital gains tax payable on the sale of the original shop is as follows:

	€	€
Sales proceeds		500,000
Indexed cost of purchase (excluding transfer fees) (40,000 x 223.00/82.94)	107,548	
Transfer fees	<u>1,200</u>	
Total indexed cost to August 2019		(108,748)
Add capital allowances claimed		<u>17,800</u>
Capital gain		409,052
Less life time exemption (no sales in the past)		<u>(17,086)</u>
Chargeable gain		<u>391,966</u>
Capital gains tax payable at 20%		<u>78,393</u>

The cash required to purchase the new office is as follows:

	€	€
Purchase price		800,000
VAT at 19%		152,000
Land transfer fees		<u>0</u>
Total		952,000
Sale proceeds from sale of shop	500,000	
Less capital gains tax payable on sale	<u>(78,393)</u>	
		(421,607)
Net cash requirement		<u>530,393</u>

Note that the value of the shop at 1 January 1980 on the registration certificate is irrelevant as the shop was acquired after this date in January 1982. Also, in the case of physical persons, capital allowances claimed over the life of the building are added to the chargeable gain.

(ii) Part-exchange of the shop to the developer of the new office

In the case of giving the original shop in exchange to the developer, as all the sales proceeds are re-invested (i.e. the market value of the office is greater than the market value of the shop), all of the capital gain will be deferred (rolled over) and therefore no capital gains tax will be payable.

The cash required to purchase the new office is as follows:

	€
Total purchase price (as above)	952,000
Exchange of shop	<u>(500,000)</u>
Net cash requirement	<u>452,000</u>

Therefore, in the case of exchange, €78,393 (530,393 – 452,000) less cash will be required by Takis to complete the transaction which is the equivalent of the capital gains tax he will have to pay if he sells to a third party.

It must be noted, however, that the rolled over gain will be deducted from the cost of the new office for computing capital gains in case of a future sale. The revised cost will be:

	€
Purchase price before VAT	800,000
Less gain rolled over (before lifetime exemption)	<u>(409,052)</u>
Cost of office for purposes of calculation of future capital gains	<u>390,948</u>

The capital gains tax payable on a future sale will therefore be correspondingly higher as the payment of capital gains tax is not avoided, it is merely postponed. Future indexation will be applied to the reduced cost of €390,948 (not on €800,000).

(b) VAT implications in respect of the office building

From 13 November 2017, rental income is not exempt from VAT unless it is in respect of a residential building. As the property which Takis is buying is an office, assuming his taxable turnover exceeds the VAT registration threshold, he will need to register for VAT personally and charge VAT at 19% on the rental income VAT invoices issued to the tenant. As a VAT registered business, Takis will need to prepare and file quarterly VAT returns and pay any VAT liability arising. The fact that he is an employee of a plastics manufacturing company is irrelevant.

The input VAT he will pay (€152,000) will be refundable if he registers for VAT and will therefore reduce the cost of purchasing the office.

In addition, any input VAT paid in respect of repairs, maintenance and any other expenses relating to his rental business will be recoverable if the business is registered for VAT.

However, Takis needs to consider the business of the tenant carefully as in accordance with the legislation (as amended on 13 November 2017), if the tenant's business is exempt from VAT (i.e. the transactions are not taxable transactions for VAT purposes, such as an insurance company, a doctor, an investment business company, etc), then Takis cannot charge VAT on the rental income. Accordingly, he will not be able to register for VAT nor recover the input VAT paid on the acquisition of the office.

Takis needs to ensure that he rents the office to a business providing taxable supplies for the first ten years of rental in order to recover the full amount of input VAT paid on the purchase price. If he rents the office to a business providing exempt supplies in the first ten years, then input VAT recoverable is reduced on a pro rata basis according to the periods of rental. If his first tenant is a business providing taxable supplies, then all the input VAT is recoverable and refundable from day one.

Takis has the option to ask for the office to be exempt from VAT for the duration of his ownership. This decision is irrevocable and can only change when the owner of the building changes. There is no reason for Takis to opt to exempt the building at this

stage as he will not be able to recover the €152,000 of VAT. Any VAT Takis charges on the rental will be recoverable by his tenants under normal circumstances, and therefore the fact that he will charge VAT will not affect the marketability of the office for rental purposes. The only advantage of opting to exempt the building is to avoid VAT administration.

If Takis sells the office in the future, it will be considered a used building and sales of used buildings are exempt from VAT. He will therefore not have to charge VAT on its disposal.

4 Pantex Ltd

(i) Tax implications of the purchase of shares in Ena Ltd

Interest applicable, or which is deemed to be applicable, to the cost of purchasing an asset which is not used in a business, is not an allowable deduction. This restriction applies during the first seven years from the date of purchase of the asset. Shares in a company (such as Ena Ltd) are not an asset used in the business, therefore interest would not be allowable on the purchase of Ena Ltd's share capital. In addition, because the profit from the sale of shares is not taxable, this interest would not be allowable.

From 1 January 2012, this restrictive provision does not apply with respect to interest on the acquisition (directly or indirectly) of shares exclusively in a subsidiary company, provided that the assets of the subsidiary are all used in the business. If the subsidiary possesses assets which are not used in the business, the allowable interest deduction to the holding company is restricted.

As the land is Ena Ltd's only asset and it is not used for any purpose, the investment of €500,000 will not fall under the subsidiary exemption. Accordingly, Pantex Ltd will have to disallow from its corporation tax computation a proportion of its interest expense using the average interest rate on its borrowings for a maximum of seven years from the date the shares are purchased.

A rough calculation of the additional corporation tax which will be payable because of the purchase is:

	€
Total interest expense	110,000
Divide by: total borrowings	<u>2,500,000</u>
Average interest rate	4.4%
Interest on investment in Ena Ltd shares at average interest rate (500,000 x 4.4%) – disallowed	22,000
Increased corporation tax liability per year (22,000 x 12.5%)	2,750

The fact that Pantex Ltd has cash available in the bank at the time of the purchase of Ena Ltd shares is irrelevant, the restriction will still apply. Similarly, it is not necessary for Pantex Ltd to take out a new loan for the restriction to apply.

Tax implications of subsequent sale of shares

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

As Ena Ltd owns immovable property, the sale by Pantex Ltd of shares in Ena Ltd will be taxable under capital gains tax irrespective of the period the shares are held and the circumstances under which the sale of shares occurs. The gain will be computed on the difference in market value of the land on the date of purchase and date of sale irrespective of the price at which the shares are sold and irrespective of any other assets or liabilities Ena Ltd will have at the time.

No value added tax (VAT) or land transfer fees will be payable on the sale of Ena Ltd shares on the basis it is an indirect transfer of land as in the case of capital gains tax.

The realised profit on the sale of shares, however, will be included in Pantex Ltd's after-tax accounting profit for the purposes of the deemed dividend distribution calculation in accordance with the special defence contribution (SDC) legislation. Under these provisions, if a company does not distribute at least 70% of its taxable profits in the following two years, it is deemed to have done so and SDC at the current rate of 17% will be payable in accordance with the tax residency and domiciliation status of its shareholders at the time of the deemed dividend. As all shareholders of Pantex Ltd are physical persons tax resident and domiciled in Cyprus, then the deemed dividend provisions will apply in full and SDC at the rate of 17% will be paid on the profit from selling the shares. Any capital gains tax payable on the sale will be deducted from the after-tax accounting profits for deemed dividend calculations.

(ii) Tax implications of the purchase of land

Pantex Ltd is not in the business of land development and it will not enter into such a business until city planning zones change. Accordingly, the same restriction on the interest expense will apply to the cost of purchase of the land as it and the annual effect on the corporation tax liability will be the same as in the case of a share purchase, as it is proposed that the land will be purchased for the same price.

The sale of land is no longer exempt from VAT. Even though Ena Ltd is not registered for VAT, the sale of land by Ena Ltd will be considered as a transaction in the course of a business for VAT purposes. As the amount of the sale of the land is €500,000 in accordance with the 'future prospects' test for VAT registration, a business must register for VAT at any time if there are grounds to believe that the value of taxable supplies (excluding VAT) will exceed the threshold of €15,600 in the next 30 days. Ena Ltd will therefore have to register for VAT and charge Pantex Ltd VAT at the current rate of 19% on the sale.

Pantex Ltd will be able to recover the input VAT it will pay on the purchase of the land as any future sale will be a taxable transaction for VAT purposes by Pantex Ltd. Even if it is converted into residential plots which will be sold again, the sale of residential plots will be a taxable transaction for VAT purposes.

The fact that VAT may be charged on the purchase of the land will mean a temporary cash flow disadvantage for Pantex Ltd. If VAT will be payable on the transaction, then there will be no land transfer fees.

In the case of Pantex Ltd buying the land, it is beneficial for VAT to apply and Ena Ltd should claim that the land is being sold for business purposes as in the case of no VAT being applicable, then land transfer fees will be payable on the sale by Pantex Ltd at 50% of the current rates. These transfer fees will not be recoverable by Pantex Ltd and will form part of the cost of buying the land.

Tax implications of subsequent sale of land

As the land was acquired with the intention of development or trade for a profit, the profit will be a trading profit and will be included in profits taxable under corporation tax with no indexation allowed.

In the unlikely case of the profit being considered a capital gain, then no corporation tax will be payable on the profit, but capital gains tax at the current rate of 20% will be payable. Indexation allowance on the cost of purchase excluding any transfer fees will be allowed in such a case.

In either case, the accounting profit on the sale of the land less any tax payable (corporation tax or capital gain tax) will be part of after-tax accounting profits for the purposes of the deemed dividend calculation as in the case of the sale of shares.

The sale will be taxable for VAT purposes.

	<i>Available</i>	<i>Maximum</i>
1 Roulla and Fresko Ltd		
(i) Roulla – Personal income tax as employee of Fresko Ltd (Schedule A)		
Personal income tax calculation:		
Salary	0.5	
Rental income (gross amount included)	0.5	
20% expense deduction	1.0	
Restriction on medical plan to 1.5%	0.5	
Social insurance of employee only	0.5	
Life insurance	0.5	
Correct tax bands and total tax due	1.0	
Correct computation of unilateral credit	1.0	
Explanations:		
Actual rental expenses not allowed, 20% instead	1.0	
Rockland house more than 33 years, thus no capital allowances	1.0	
Medical plan restricted to 1.5% of gross income	1.0	
Life insurance contributions less than 7% of insured sum so allowable	1.0	
Total deductions below 1/6th of taxable income so no restriction	1.0	
Unilateral credit available restricted to average tax rate on gross income	1.0	
Personal income tax as self-employed shopkeeper (Schedule E)		
Personal income tax calculation:		
Adjustment of taxable profits of Fresko Ltd for salary and social insurance – use in computation (Schedule D)	2.0	
Rental income and expenses the same as currently	1.0	
Use of self-employed contributions	1.0	
Re-adjust medical plan, life insurance and no restriction on total	1.5	
Correct tax bands and total tax due	0.5	
Re-adjust unilateral credit – now full amount deducted	1.0	
Explanations re self-employed scenario	1.5	
	<u>20</u>	17
(ii) Fresko Ltd – Corporation tax computation (Schedule B)		
Calculations:		
Commence with accounting profit	0.5	
Entertainment	1.0	
Saloon car depreciation and expenses	1.0	
Annual levy	0.5	
Application of correct rate	0.5	
Explanations:		
Allowable entertainment restricted to 1% of turnover	0.5	
Current account interest	1.0	
	<u>5</u>	5
(iii) Special defence contribution (SDC)		
Calculation of SDC on deemed dividend payable (Schedule C)	1.5	
Calculation of SDC on rental income	1.0	
Deduct unrelieved Rockland tax from SDC under employee scenario	0.5	
Explanations:		
Deemed dividend provisions	1.5	
Address 100% of dividend to make comparable to sole trader	1.0	
SDC on rental income explanation	1.0	
Unrelieved Rockland tax deducted from SDC under the employee scenario	1.0	
	<u>7.5</u>	6

	<i>Available</i>	<i>Maximum</i>
(iv) Social insurance and other contributions		
Correct calculation of employee and employer contributions in the case of Fresko Ltd	2·0	
Correct calculation of self-employed contributions	1·0	
	<u>3</u>	3
Format and presentation of the memorandum	1·0	
Clarity and effectiveness of communication	2·0	
Logical flow of calculations	1·0	
	<u>4</u>	<u>4</u>
		35

	<i>Available</i>	<i>Maximum</i>
2 Eskafeas Ltd		
(a) Wholly owned subsidiary v branch		
(i) Profitable		
Subsidiary's profits will not be taxable in Cyprus as non-resident	0.5	
Dividends received will be exempt from corporation tax in Cyprus and explanation	1.5	
Dividends received will form part of after-tax accounting profits of Eskafeas and thus be subject to special defence contribution (SDC) deemed dividend and explanation	1.5	
Branch overseas establishment – profits exempt from corporation tax in Cyprus	1.0	
Profit will automatically be part of after-tax accounting profits of Eskafeas for SDC deemed dividend purposes	1.0	
Conclusion: Subsidiary – dividend payment can be timed and not all profits may be paid as dividend as some may be reinvested – there is flexibility	1.5	
(ii) Initially loss-making then profitable		
If subsidiary, no corporation tax loss relief as not loss group if not Cyprus resident	1.0	
Cyprus allows unilateral loss relief for permanent establishment abroad	1.0	
Branch – automatic loss relief when accounting profits/losses are consolidated – loss relief clawed back when profits made	1.5	
Losses reduce after-tax accounting profits for SDC automatically in the case of a branch	0.5	
Conclusion: Set up branch initially and incorporate later	1.0	
(iii) Closed down having made only losses		
Loss on disposal of shares (realised or unrealised) not corporation tax allowable expense	1.0	
Unrealised losses on shares added back to profits for SDC deemed dividend – when realised allowed – thus indirect benefit – provided that Eskafeas has profits in the year of realisation	1.5	
Conclusion: Branch – no clawing back of loss relief	1.0	
	<u>15.5</u>	12
(b) Taxation of employees' salary whilst working with Newland dealership		
Income tax definition of tax residency for individuals – if not Cyprus resident then only taxed on Cyprus source income	1.5	
90-day rule definition	1.5	
Minimum stay in Newland 90 days each year irrespective of tax residency	1.0	
Salary from Eskafeas Cyprus source – taxable irrespective of tax residency	1.0	
Indirect benefit as lower taxable income – drop in bands – split period equally to maximise benefit	1.5	
Rental income also Cyprus source	1.0	
Dividends and interest exempt from income	1.0	
If tax resident and domiciled, then SDC – if not resident in accordance with income tax definition, then no SDC	1.0	
Avoid SDC by being away for more than 183 days – thus minimum duration little over 12 months – depart in June and arrive in July of the next year (0.5 each)	1.5	
Holidays and counting of days provisions	1.0	
	<u>12</u>	10
(c) Subsidiary in Newland		
Registration not important – Cyprus tax resident if management and control in Cyprus	1.0	
Criteria and co-existence	1.5	
But if Cyprus resident Eskafeas management involved may be tax resident even though not officers	1.0	
	<u>3.5</u>	<u>3</u>
		<u>25</u>

	<i>Available</i>	<i>Maximum</i>
3 Takis		
(a) Net cash required		
Value added tax (VAT) at 19% as new – no transfer fees	1·0	
Capital gains tax payable computation:		
Sale proceeds	0·5	
Indexation	1·0	
Transfer fees – no indexation	1·0	
Lifetime exemption	0·5	
Correct capital gains tax rate	0·5	
Value 1 January 1980 irrelevant	1·0	
Capital allowances adjustment for physical persons	1·0	
Computation of net cash – add VAT deduct capital gains tax	1·0	
All gain can be rolled over with explanation	1·5	
Net cash computation in case of exchange – conclude is lower – use €500,000	1·0	
But cost for future capital gains lower by gain rolled over	2·0	
	<u>12</u>	10
(b) VAT implications in respect of the office building		
From 13 November 2017, not exempt unless used as a residence – if rental exceeds threshold, Takis must register for VAT and charge VAT on the rent at 19%	1·5	
Takis to prepare and file VAT returns on a quarterly basis and pay any VAT due as a VAT registered business – the fact that he is also an employee of a plastics manufacturing company is irrelevant	1·5	
Input VAT on purchase can be claimed from day one if rental to a tenant making taxable supplies	1·0	
Input VAT on repairs and expenses related to the rental business can be claimed	1·0	
Takis to ensure that he selects a tenant which makes taxable sales so that he will charge VAT – legislation provides if tenant makes exempt supplies then rental is exempt – if exempt, input VAT is not recoverable	2·0	
Ten-year pro rata adjustment	1·0	
Option to exempt – irrevocable until change of ownership – but input VAT will be lost	1·5	
Only advantage of option to exempt in Takis' case is to avoid VAT administration	0·5	
VAT on the rental will be recoverable by the tenant	1·0	
No VAT on future sale as building will be used	1·0	
	<u>12</u>	<u>10</u>
		<u>20</u>

	<i>Available</i>	<i>Maximum</i>
4 Pantex		
(i) Purchase and subsequent sale of Ena Ltd shares		
Interest on asset not used in the business not allowed for seven years	1·0	
Subsidiary asset used in the business but from acquisitions from 1 January 2012 only applies to assets of the subsidiary not used in business	1·0	
Land of Ena Ltd is only asset – not used in business thus restriction applies	1·0	
Estimate of additional corporation tax per year	1·5	
Irrelevant if cash in hand available at the time of purchase	1·0	
Irrelevant if no new loan is taken	1·0	
Sale of shares exempt from corporation tax	1·0	
Capital gains tax payable on the difference in market values – holding period irrelevant and irrelevant if circumstances were trading in shares	2·0	
No value added tax (VAT) or land transfer fees on sale of shares even though indirect transfer of land	1·0	
Profit on sale of shares included in after-tax accounting profits for deemed dividend calculation and explanation	2·0	
As all shareholders of Pantex Ltd are physical persons tax resident and domiciled, then 17% special defence contribution (SDC)	1·0	
(ii) Purchase and subsequent sale of land		
If purchase of land, no difference to corporation tax effect	1·0	
VAT will apply as land no longer exempt	1·0	
Ena Ltd will have to register in accordance with future prospects test and explanation	2·0	
VAT paid by Pantex Ltd recoverable as sale of land in future or plots taxable	1·0	
If VAT, no land transfer fees but if no VAT, land transfer fees at 50% of the rates – land transfer fees not recoverable and form part of the cost	2·0	
Trading profit taxable under corporation tax	1·0	
If capital gains, no corporation tax but capital gains tax – indexation allowed	1·0	
Both cases accounting profit after taxes payable included in deemed dividend calculation	1·0	
Taxable for VAT purposes	0·5	
	<u>24</u>	<u>20</u>