Strategic Professional – Options

Advanced Taxation – Cyprus (ATX – CYP)

Tuesday 3 December 2019

ATX CYP ICPAC EN

ATX – CYP

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.

Think Ahead

ACCA

ΣΕΛΚ

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%

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. The same rate applies to overpayments of tax.)	3·5% p.a.[1]
Additional tax	5% of tax due
PAYE assessments	3·5%[2] 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%[1]
Employee	7·8%[1]
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%
Lifetime exemptions (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 today's date is 2 December 2019.

Your office has been preparing the personal tax returns of Mr Andreas for several years. Mr Andreas, who was working as a business consultant until he retired two years ago at the age of 65, is a Cyprus tax resident and is domiciled in Cyprus. His only income is a gross pension of €18,200 per year and bank interest of approximately €7,000. The bank interest arises on his personal savings and the €7,000 is credited to his bank account net of taxes.

For some time Mr Andreas has been thinking about using his savings to generate other sources of income and he has sent the following email in this respect:

Dear Sirs,

I have decided to invest part of my savings in the purchase of a used building consisting of two shops on the ground floor and two flats on the first floor. The building is on sale for €600,000 (including €190,000 for land). The shops are currently rented for €1,000 each per month and the flats for €600 each per month.

After I purchase the building, I will continue to rent out the flats and shops at the same rent per month.

The expected annual expenses for the whole building are as follows:

	€
Building management fees	*1,900*
Insurance	*950*
Maintenance costs	*2,500*
	5,350

I have received a valuation report which provides the following information:

– *The building was purchased by its current owners from a developer in 2005 for €750,000, and in the same year all parts of the building were rented. Capital allowances have been claimed for all years. According to the developer's records, the total cost of construction was €630,000 (including €130,000 for the land).*

– *The cost of constructing such a building today, excluding the cost of the land, would be €830,000.*

Accordingly, I feel that I am purchasing the building at a very good price and it is highly likely that I will, after a few years, sell the building for more than €800,000 (including the land). The only other capital sale I have made in the past was about ten years ago when I sold a plot of land which I inherited from my parents.

I was thinking of purchasing the building personally, but my lawyers have suggested that from a tax point of view it may be better to register a new company to buy the building. In this case, I will own 100% of the shares of the company and I will be the only director of the company.

Please provide me with your advice on how the rental income will be taxed, to help me make an informed decision on whether to buy the building personally, or use a limited liability company to purchase the building.

Yours sincerely

Mr Andreas

The accounting department of your firm has also informed you that if a limited liability company is used, the accounting depreciation of the building will be €15,000 per year, and the company will have to pay annual registrar fees of €350 and audit fees of €1,000.

Required:

Prepare a memorandum for your tax partner explaining the tax on the rental income if Mr Andreas purchases the building personally or through a limited company. You should include appropriate calculations to compare the options and advise which option will result in the lower total annual taxes payable on the rental income. Your memorandum should also include the various tax filing and payment requirements of each option.

Assuming the building is purchased personally by Mr Andreas, by making reference to the badges of trade but without performing any calculations, explain in your memorandum how a profit from the sale of the building in three years' time may be taxed.

The following marks are available:

(i) Personal income tax. (10 marks)

(ii) Corporation tax. (7 marks)

(iii) Special defence contribution (SDC). (7marks)

(iv) Tax treatment of the profit on sale. (7 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)

Note: You are not required to consider value added tax (VAT) issues, any general health scheme contributions or notional interest deductions.

(35 marks)

2 Your manager has received an email from Mr Chin, the financial controller of Xepo, a new client. Xepo is a large corporation registered and tax resident in Farland, a country in the Far East which does not have a double tax treaty with Cyprus.

Your manager has sent the following extract from the email:

Our company, Xepo, is a clothing manufacturer in Farland. We are considering setting up a distribution centre in Cyprus which will include a large warehouse and an administration office in Cyprus. The distribution centre will buy Xepo's goods (clothing) which will be imported in bulk, in containers, by sea-freight from Farland to Cyprus. The distribution centre will store the goods and then sell them in smaller batches to retailers in Cyprus and other European countries. The order administration and invoicing will be performed by the local administration office which will be set up adjacent to the warehouse.

Xepo employs 613 employees in total. Several key employees (we think it will be less than six), who have never visited Cyprus before, will move to Cyprus to manage the distribution business at least for the first three years. None of those employees will earn a salary of more than €40,000 a year. We need to know how these employees will be taxed in Cyprus on their income from Farland sources. In Farland, we have a very low tax rate on investment income and some of those employees have income from interest, dividends and profits on the disposal of shares on the Farland stock exchange.

Xepo also has five directors, all of whom are resident in Farland. We expect that they may occasionally visit Cyprus to inspect the distribution business and they are likely to combine the visit with some holiday. No director will stay in Cyprus for longer than 30 days in a year in total.

The warehouse in Cyprus will only handle 5% of Xepo's total sales. We are worried, however, that the business in Cyprus may cause the whole of Xepo to be considered a tax resident of Cyprus, and consequently will have to pay Cyprus tax on all of its income.

We are also not sure whether there are any tax benefits in setting up a wholly owned subsidiary in Cyprus to run the distribution centre. If a wholly owned subsidiary is used, it will have its own Cyprus resident directors and management. The subsidiary will only purchase goods from Xepo.

Your manager has asked you to help with the queries raised.

Required:

(a) (i) Define the term 'permanent establishment' and state whether Xepo's distribution centre will be considered a permanent establishment in Cyprus under Cyprus legislation.

(ii) Explain how the distribution centre will be taxed, how its income should be declared, and how the taxes should be paid.

(iii) Advise whether, for Cyprus tax purposes, operating the distribution centre through a permanent establishment would be preferable to operating through a wholly owned subsidiary of Xepo. (9 marks)

(b) Assuming Xepo's distribution centre is considered a permanent establishment in Cyprus, clarify whether Mr Chin is correct in believing that the whole of Xepo could be considered a tax resident of Cyprus. (5 marks)

(c) Assuming a wholly owned subsidiary of Xepo is incorporated in Cyprus to run the distribution centre, explain how the price of the goods which Xepo will sell to the subsidiary should be determined for the purposes of Cyprus taxation and value added tax (VAT). (7 marks)

(d) In relation to Xepo's key employees who will relocate to Cyprus to manage the distribution business, describe how their income from Farland sources will be taxed in Cyprus. (4 marks)

Note: Ignore general health scheme contributions in all parts of your answer.

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 Your firm has been approached by John, the newly appointed finance director of the Variousmix Group (VM), for advice on some value added tax (VAT) issues he is facing.

The VM group has been a client of the firm for many years, and has developed in a haphazard way. The group currently consists of 17 companies of various sizes and activities in Cyprus and abroad. VM Holdings Ltd, the parent company of the group, holds interests in the share capital of numerous companies ranging from 15% to 100%.

Each company in the group is individually registered for VAT and files its own VAT return. The administration and bookkeeping of the small companies in the group is centralised at the VM group headquarters in Limassol, Cyprus.

The Cyprus VAT registered companies in the group invoice goods and services they provide to each other at market values. This sometimes results in one company having to pay a large amount of VAT, and another having a large amount of VAT refundable, which is disadvantageous for cash flow purposes.

By far the biggest company in the group is VM Hotels Ltd which owns four large hotels in Cyprus. Each hotel operates independently and has its own administration and accounting department. All hotels are under the one VAT registration of VM Hotels Ltd and it has become very difficult and time consuming to collect the information and prepare the combined VAT return every quarter.

The internal audit department of VM Hotels Ltd has found that an invoice by a Greek (EU) supplier for €15,000 for the supply of cosmetics in small bottles for hotel rooms should have been, but was not, included in the VAT return for the quarter to 31 March 2019, which was filed on 10 May 2019.

Required:

(a) State, with reasons, why value added tax (VAT) should be charged on transactions between the group companies and the appropriate VAT rate. (4 marks)

(b) Advise whether group VAT registration could help the VM group simplify its VAT administration and state the advantages and disadvantages of group VAT registration. (8 marks)

(c) Advise whether divisional VAT registration could help VM Hotels Ltd and explain the implications of divisional VAT registration. (4 marks)

(d) Explain how the omission of an invoice by VM Hotels Ltd on its earlier VAT return should be corrected. (4 marks)

(20 marks)

4 Assume that today's date is 10 July 2019.

XLS Ltd is a Cyprus registered tax resident company which produces solar panels. Since 2013, XLS Ltd has owned 91% of the voting share capital of Cysub1 Ltd, a company providing installation services for solar panels.

The taxable profits/(losses) of the two companies in recent calendar years are as follows:

	2012	2013	2014	2015	2016	2017
	€	€	€	€	€	€
XLS Ltd	(400,000)	(150,000)	(10,000)	50,000	150,000	180,000
Cysub1 Ltd	(42,000)	(17,000)	(32,000)	12,500	5,000	1,780

Cysub1 Ltd's tax computation for the year 2018 shows a taxable loss of €19,500.

During 2017, Cysub1 Ltd acquired 78% of the voting share capital of Cysub2 Ltd, a Cyprus registered tax resident company, which has a taxable loss of €26,000 for the year 2018.

On 1 May 2018, XLS Ltd registered a new wholly owned Cyprus tax resident subsidiary company, Cysubnew Ltd, which made a taxable loss of €12,300 for the period from 1 May 2018 to 31 December 2018.

Since 2015 XLS Ltd has owned 85% of the share capital of Newco SA, a company registered and tax resident in Newland, a country which is not a member of the EU and has no double tax treaty with Cyprus. Newco SA manufactures solar panel components and has made a taxable loss of €62,000 for the year 2018. The corporation tax rate in Newland is 20%.

For the year 2018, XLS Ltd made an accounting profit before tax of €536,000 and the following information is available:

1. XLS Ltd had no borrowings during 2018 and as a result there is no interest expense charged against the accounting profit.
2. Depreciation deducted from the accounting profit is €123,000 and is equal to the capital allowances available for the year.
3. No interest was charged on a loan to one of the directors of the company of €120,000. The loan was outstanding all year and the director is tax resident and domiciled in Cyprus. The interest rate at an independent local bank which the director could have borrowed the money from is 3·5%.
4. The accounting profit includes €15,000 of dividends received from Newco SA. This is the net amount received after the deduction of €5,000 of tax at source in Newland.
5. After acquiring Newco SA in 2015, XLS Ltd made a loan to Newco SA in the ordinary course of its business where interest is charged at the market rate of interest. Net interest of €12,000 was received in 2018, after the deduction of €2,000 withholding tax in Newland. The net interest of €12,000 is included in the accounting profits of XLS Ltd for the year.
6. An investment in 25% of the share capital of Polco, a company which is tax resident in Poland (a member of the EU), was disposed in February 2018. The shares were purchased in November 2017 for €75,000 and were sold at a loss of €50,000. The loss is included in the accounting profit before tax of €536,000 above. Polco manufactures solar panel components and did not own any immovable property in Cyprus at the time of sale.
7. Provisional corporation tax of €30,000 was paid by XLS Ltd during 2018.

Required:

(a) Assuming XLS Ltd claims the maximum group loss relief available, calculate XLS Ltd's corporation tax payable for the year 2018 and penalties due, if any.

Note: For each of the notes (1) to (7) above, you should provide explanations of your treatment in your answer. (16 marks)

(b) Define the term 'double tax treaty' and explain how a double tax treaty between Cyprus and Newland could have benefitted XLS Ltd. (4 marks)

(20 marks)

End of Question Paper