
Answers

1 MEMORANDUM

To: Tax partner
From: Tax assistant
Date: 2 December 2019

Re: Mr Andreas (Mr A) – Investment in immovable property earning rental income
Comparison of annual taxes payable on rental income

(i) Taxes payable if Mr Andreas (Mr A) buys the building personally

	€
Income tax (Schedule A)	2,466
Special defence contribution on gross rents (12 x (2 x (€1,000 + €600))) x 75% x 3%	864
Total	3,330

Income tax payable

The detailed computation of the annual income tax payable by Mr A is shown in Schedule A. The combination of his pension and rental income take him into the 25% band of taxation.

Any interest on Mr A's remaining personal savings is exempt from income tax and is therefore ignored in the computation.

The computations show capital allowances of €17,857 reducing the taxable income from the property. These capital allowances can be claimed for another 19 years. As the purchase price is less than the original total cost of construction of the building, detailed capital allowance computations have been provided in Schedule B to demonstrate that the purchase price which Mr A will pay is not lower than the tax written down value inherited from the previous owners. If the purchase price paid by Mr A had been lower than the tax written down value, the capital allowances would be restricted to the lower amount over the remaining 19 years.

Individuals, but not companies, are allowed a deduction of 20% on gross rental income as an expense and actual expenses are not allowed (irrespective of the amount). Accordingly, actual estimated expenses have been ignored in Schedule A.

Mr A will have to file a provisional tax return by 31 July every year declaring an estimate of the tax due for that year. The tax due is payable in two equal instalments by 31 July and 31 December of that year. If the estimated tax paid by instalments is less than 75% of the actual income tax liability for that year, then a 10% penalty applies (on the balance of tax payable).

Mr A will be required to file a tax return electronically by 31 July of the following year, he is not allowed to file a paper return. Any remaining tax, which was not paid by the two instalments during the year, is payable by 30 June of the following year. The deadline for filing the tax return is 31 July. It is therefore advisable to prepare and file the tax return before 30 June of the following year so that any tax due can be computed and paid on time.

Special defence contribution (SDC)

In addition to income tax, SDC of 3% on 75% of the gross rents received in a year is payable.

Payment of SDC depends on the type of tenant liable for the rent. If the tenant is a company, which may be the case for the shops, then any SDC due will be deducted at source from the rental payment and the net amount paid to Mr A. In the case of a shop rented to a company, SDC of €22.50 (€1,000 x 75% x 3%) will be deducted from the monthly rental and €977.50 will be paid to Mr A. The company will then give two certificates to Mr A per tax year showing that the SDC due has been deducted at source, and paid to the tax department, one for the six months to 30 June, and one for the six months to 31 December each year.

In the case where the tenant is an individual, the rental income will be received gross and Mr A will have to pay the SDC due by self-assessment in two periods: one for the six months to 30 June, and one for the six months to 31 December each year. The deadline for payment is before the end of each six-month period respectively (for example, the payment for the period from 1 January to 30 June is payable before 30 June). Payment can only be made electronically.

(ii) Taxes payable if Mr A buys the building using his newly registered company

	€
Corporation tax (Schedule D)	1,774
Special defence contribution on gross rents (12 x (2 x (€1,000 + €600))) x 75% x 3%	864
Special defence contribution on minimum dividends (Schedule E)	1,673
Total	4,311

Corporation tax payable

A computation of the expected annual accounting profit for the company is shown in Schedule C. The accounting profit is then adjusted in Schedule D to arrive at the taxable profit and corporation tax due.

If a company is used, the deduction of 20% of gross rents received is not available, instead the actual expenses are deductible. Some of the company expenses are not allowable for tax purposes as can be seen from the computation in Schedule D.

The same capital allowances are available as in the case of Mr A purchasing the building personally.

The company will be a separate taxable person from Mr A even though all the shares will belong to Mr A, and upon registration, the company should apply to be registered as a taxable person and receive a separate tax identification number from Mr A.

As a separate taxable person, the company will have to file a provisional tax return with the same filing and instalment payment deadlines as in the case of owning the property personally. As for individuals, if the tax paid by instalments is less than 75% of the total tax liability of the year, then an additional tax of 10% of the balance is imposed.

Any remaining tax not paid by these instalments during the year has to be settled by 1 August of the following year.

The company will have to prepare audited accounts and file a tax return electronically based on these accounts within 15 months from the end of the tax year.

The payment of any outstanding tax is therefore before the deadline for filing the tax return of the company. It would therefore be advisable to seek to prepare and file the tax return before 1 August of the following year so that any underpayment of tax is accurately computed and paid on time.

(iii) Special defence contribution (SDC)

There is no difference on the amount due or on the method of declaring and paying the SDC due between the option of Mr A owning the property personally or through a company.

SDC on dividends

Unlike the situation of owning the building personally (where the balance of any profit after the payment of tax is available to Mr A to spend), if a company is used, Mr A will only receive the rental income if the after-tax accounting profits of the company are distributed as dividends to him as the sole shareholder.

As Mr A is tax resident and domiciled in Cyprus, 17% SDC will be deducted at source by the company and paid to the tax department by the end of the month following the month of payment of the dividend.

Furthermore, 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 this deemed dividend is payable by the company.

The computation of SDC payable is shown in Schedule E. The computation assumes that the minimum of 70% required by the legislation would be distributed. If, instead, 100% of the distributable profits of the company were paid to Mr A as a dividend, 17% of that would be payable as tax but our conclusion would not change.

Conclusion

It is clear from the above analysis that the option of owning the property personally will result in lower annual taxes payable on the rental income.

(iv) Tax on sale of the building assuming Mr A purchases the building personally

In accordance with Cyprus legislation, the profit on disposal of immovable property situated in Cyprus is taxable under capital gains tax unless the profit is of a trading nature in which case it will be taxed under income tax. The tax liability on a disposal can be substantially different depending on whether it is deemed to be capital or trading in nature.

If the transaction is considered to be of a trading nature, the profit will be added to Mr A's other income in the year of the sale and taxed according to normal rules. Given the level of his current income, a significant part of the anticipated profit will be taxed at 35%.

If the transaction is deemed to be of a capital nature, the profit will be reduced by indexation on the cost and then will be taxed at 20%.

The following will be considered by the tax department in deciding if the profit on the sale in three years' time is trading or not:

Frequency of similar transactions

If there were similar transactions in the past, it could indicate trading, however, Mr A's only other disposal is the sale of a property which he inherited from his parents ten years ago. That transaction was clearly different to this current situation.

Length of ownership

The fact that Mr A will be selling after only three years of ownership would indicate that the purpose of the purchase was not for a long-term investment. This will be an indicator that the sale is of a trading nature rather than capital.

Profit motive/reason for sale

The fact that Mr A is making the purchase with a view to selling at a good profit (assuming that he sells for €800,000), then this will be an indicator that the transaction is of a trading nature. However, if the eventual reason for sale was not for profit but, for example, was due to hardship (such as health reasons or a difficult economic situation) this would not indicate trading.

Method of acquisition and financing

Mr A will be investing his personal savings and he will acquire the property by outright purchase. While borrowing to purchase would be more indicative of trading, an outright purchase with a view to sell may indicate trading, unlike the case of inheriting the property.

Knowledge of owner

Mr A was a business consultant advising on how a business can increase its profits. If his client list included immovable property investment businesses, this may be taken as Mr A having knowledge of the matter and an indicator that the transaction is of a trading nature.

It is important to note that no one factor is conclusive in its own right, all factors are considered together and each case is decided on its own facts.

Schedule A

Income tax payable by Mr Andreas personally

	€
Pension	18,200
Rental income (12 x (2 x (€1,000 + €600)))	38,400
Total gross income	<u>56,600</u>
Less deductions:	
20% of gross rental income as expenses – actual expenses not allowable	(7,680)
Capital allowances (Schedule B)	<u>(17,857)</u>
Taxable income	<u>31,063</u>
Tax due:	
0–€19,500 at nil	–
€8,500 at 20%	1,700
€3,063 at 25%	766
Total income tax payable	<u>2,466</u>

Schedule B

Building capital allowances for both Mr Andreas as a person or his company

	€
Purchase price by previous owners	750,000
Less: cost of construction	<u>(630,000)</u>
Total developer's profit	<u>120,000</u>
Total construction cost	630,000
Less: cost of land	<u>(130,000)</u>
Building cost	500,000
Add: <i>pro-rata</i> profit on building excluding the land (120,000 x 500,000/630,000)	<u>95,238</u>
Building cost eligible for capital allowances claimed	595,238
Annual capital allowances at 3% = 17,857	
Claimed from 2005 to 2018 (assuming sale will be done in 2019) 14 years x 17,857	<u>(249,998)</u>
Tax written down value of building at time of purchase	<u>345,240</u>

Schedule C

Estimated annual company profit and loss account

	€	€
Rental income (12 x (2 x (€1,000 + €600)))		38,400
Less expenses:		
Building management fees	1,900	
Insurance	950	
Maintenance costs	2,500	
Annual registrar fees	350	
Audit fees	1,000	
Depreciation	<u>15,000</u>	
Total expenses		<u>(21,700)</u>
Accounting profit before tax		<u>16,700</u>

Schedule D

Estimated annual corporation tax computation

	€	€
Accounting profit before tax		16,700
<i>Add</i> expenses not allowable:		
Annual registrar fees	350	
Depreciation	<u>15,000</u>	
		15,350
Less: capital allowances (Schedule B)		<u>(17,857)</u>
Taxable profit		<u>14,193</u>
Corporation tax at 12.5%		<u>1,774</u>

Schedule E

SDC on minimum dividends

	€
Accounting profit before tax	16,700
Less: corporation tax (Schedule C)	<u>(1,774)</u>
Less: SDC on rental income (38,400 x 75% x 3%)	<u>(864)</u>
Accounting profit after tax	<u>14,062</u>
Minimum dividend at 70%	<u>9,843</u>
SDC thereon at 17%	<u>1,673</u>

2 (a) (i) Permanent establishment

'Permanent establishment' is specifically defined in the legislation. It means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term 'permanent establishment' (PE) includes especially:

- (1) a place of management;
- (2) a branch;
- (3) an office;
- (4) a factory;
- (5) a workshop;
- (6) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

Short-term construction projects may be excluded. A building site or construction or installation project or supervisory activities constitute a PE only if they last more than three months.

Based on the above interpretation, there is no doubt that the distribution centre of Xepo will constitute a PE in Cyprus.

(ii) Taxation of the distribution centre

In accordance with Cyprus legislation, the profits attributable to the business of the distribution centre in Cyprus will be taxable in Cyprus under corporation tax. The distribution centre will be treated as a separate entity from Xepo and will be eligible for all deductions and exemptions applicable to any tax resident company.

The computation of the profits will be made as if the distribution centre constitutes a separate and independent business from Xepo, just as if it is a separate company from Xepo. There will be an obligation for Xepo to register the PE in Cyprus as a branch under Cyprus company law and appoint a branch representative. The branch would have to register with the tax department as a taxpayer and obtain a tax identification number and it will have to file tax returns and pay taxes according to the deadlines applicable to a limited liability company.

(iii) Operating as a PE or subsidiary

For tax purposes, a PE will be treated as if it is a limited liability company so in general there is no difference.

Xepo will have the right to request to be treated as a tax resident company in Cyprus as a whole. This will help reduce its tax liability in Cyprus if it is loss making in Farland and the distribution business in Cyprus – the branch – is profit making. If Xepo asks to be treated as a tax resident of Cyprus, then the loss can be deducted from the profits of the branch and this will reduce the tax liability in Cyprus. It must be noted that in such a case there is a claw back provision in case Xepo returns to profits in the future. In the case where the distribution business is operated through a wholly owned subsidiary, then the losses of Xepo in Farland cannot be utilised against the Cyprus subsidiary profits as Xepo is not a tax resident of Cyprus and Farland is not a member of the European Union (EU).

Both a PE and a wholly owned subsidiary can benefit from the notional interest deduction provisions of the legislation on new capital invested in Cyprus.

(b) Risk to Xepo of becoming tax resident of Cyprus

Irrespective of its place of registration, a company can be considered 'resident in the Republic' for tax purposes and therefore liable to tax in Cyprus on its worldwide income if its management and control is exercised in the Republic.

There is no definition of management and control in the legislation 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 of 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.

The existence of a PE (Xepo's distribution centre) in Cyprus does not, of itself, create a risk of Xepo becoming a tax resident of Cyprus.

The occasional visits by Xepo's directors to Cyprus does not mean that Xepo will become tax resident in Cyprus.

Additionally, the distribution centre represents only a small part (5%) of the overall Xepo business, indicating that 95% of Xepo's business is managed and controlled outside Cyprus.

The risk of Xepo being treated as a tax resident of Cyprus is extremely low.

(c) Sale prices from Xepo to subsidiary in Cyprus

The price at which Xepo will sell the goods to its subsidiary in Cyprus will determine the cost of sales of the subsidiary and therefore the profit taxable in Cyprus.

Section 33 of the Cyprus legislation provides that where:

- (a) a business in the Republic participates directly or indirectly in the management, control or capital of a business of another person; or
- (b) the same persons participate directly or indirectly in the management, control or capital of two or more businesses;

and in either case conditions are made or imposed between the two businesses in their commercial or financial relations which differ from those which would be made between independent businesses, then any profits, which would, but for those conditions, have accrued to one of the businesses, but, by reason of those conditions, have not so accrued, may be included in the profits of that business and taxed accordingly.

Based on the above, the tax department may adjust the profits for income tax purposes of a tax resident company where it is of the opinion that, because of the special relationship between the Cyprus resident company and the other party to a transaction, the Cyprus profits are understated.

There is no exact guidance in Cyprus legislation on how the prices should be determined – there is no prescribed percentage profit or some formula, for example. The legislation adopts the arm's length principles prescribed in the OECD international standard used for determining transfer prices for tax purposes. The approach is to treat members of an international group as operating as separate entities rather than as separate parts of a unified business. The prices should then be the prices which would have been determined by independent businesses given the same terms and conditions of sale.

As Farland is not a member of the EU, value added tax (VAT) will have to be paid on importation of the goods to Cyprus before the goods are custom cleared for free circulation in Cyprus. The tax value of imported goods for VAT purposes includes the purchase cost (the price charged by Xepo) and all other duties, taxes and other charges and all incidental costs, by way of commission, packing, transportation and insurance up to the port or place of importation. The purchase price will likely be a large percentage of this value.

In accordance with VAT legislation, the open market value should be used which is the money value which would have been payable by a customer for the supply and it should not be affected by any commercial, financial or other relationship between the purchaser and the seller.

The tax department has power to issue an order adjusting the value on which VAT is paid, not later than three years from the date of a supply, where

- the consideration is lower than the market value; and
- the purchaser and seller are connected persons; and
- the purchaser is not eligible to be credited with all the input tax on the supply.

(d) Taxation of income from Farland sources in Cyprus on the key employees

Once the employees spend more than 183 days in a calendar year in Cyprus, they will be considered as Cyprus tax residents and as a result their worldwide income will be taxable in Cyprus including income from Farland sources.

Xepo's employees may not be considered Cyprus tax residents in the year of relocation if they arrive in Cyprus after July and in such a case, they will only be subject to income tax on Cyprus source income.

However, any profit on the disposal of shares is specifically exempt from tax except where that company has immovable property in Cyprus unless the company's shares are traded on a recognised stock exchange in any place in the world, then the profit is, again, exempt.

Interest and dividends are also exempt from income tax, but are taxable under SDC in the hands of tax resident and domiciled individuals. In the case of these Farland employees, even though they are going to be considered tax resident, they will not be considered domiciled until 17 years after their arrival and therefore there will not be any tax on their interest and dividend income from either Farland or Cyprus sources.

Any other income will create a tax liability in Cyprus, but in the absence of any double tax treaty, Cyprus gives unilateral tax credit relief under certain conditions for the tax suffered abroad.

3 (a) Value added tax (VAT) on transactions between group companies

A taxable supply is any supply of goods or services made for a consideration which is not an exempt supply. VAT should be charged on supplies of goods or services between companies of the VM group because:

- each company is registered for VAT and therefore all are taxable persons,
- each company provides goods and/or services in the course or furtherance of a business, and
- supplies between companies of the same group are not specifically exempt from VAT.

There is no single rate applicable to supplies between group companies. The rate which should be applied is the rate applicable on such transactions to third parties. The current rate which applies on all taxable transactions is 19% unless there is provision in the legislation for a lower rate. Lower rates currently in Cyprus are 9%, 5% and 0%.

(b) Group VAT registration

In accordance with the legislation, group VAT registration is available where one company controls the others in the group or one person controls them all. A legal person is considered to control another legal person if legally it has the right to control its activities or it is a 'parent company' of that legal person in accordance with Cyprus company law. In accordance with Cyprus company law, this means owning directly or indirectly more than 50% of the value of its ordinary share capital and/or it is a shareholder of the company and has the legal right to control the composition of the board of directors. In order to determine the group, foreign companies can be included with no permanent establishment in Cyprus.

The group registration, however, is restricted to companies incorporated in Cyprus and/or which have a place of establishment in Cyprus. As a result, the foreign companies of the VM group with no permanent establishment in Cyprus cannot be included and neither can the companies which Variousmix Holdings Ltd does not control.

Not all group companies have to be included in the group VAT registration, therefore the VM group can select to include only the companies which will help reduce or simplify its VAT administration.

The advantages of a group VAT registration are as follows:

- Only one VAT return will be filed for the whole group.
- Only the net VAT will be paid or refunded for the whole group.
- Only the representative member is registered and is responsible for submitting the VAT return and payment of tax.
- No VAT needs to be accounted for on supplies between members of the VAT group.
- Supplies to, or by, group companies are treated as made to, or by, a nominated group company known as the representative member.

The disadvantages of a group VAT registration are as follows:

- The administration of collecting all the information from members of the group and compiling the single VAT return can be onerous.

Accordingly, it may be advisable for the VM group to include in its group VAT registration the smaller companies in the group which are centrally administered from one accounts department, but exclude the larger companies with independent accounts departments (such as VM Hotels Ltd).

- Care should be taken in the case of companies which are partially exempt as the calculation of non-attributable input VAT will be made for the whole VAT group and the *de minimis* rule will apply to the group as a whole.
- All members of the group are jointly and severally liable for payment of the VAT due for the whole group.
- The limits for the correction of errors which can be voluntarily corrected apply for the VAT group as a whole. If errors exceed the limits, permission in writing by the Commissioner will be required which will increase administration costs.

The VAT Commissioner may refuse to register a group where the members of the group are ineligible or in order to protect VAT revenue. The Commissioner may terminate the inclusion of a company which becomes ineligible.

(c) Divisional VAT registration

VM Hotels Ltd has the option to register each hotel as a separate division, subject to the approval of the Tax Department Commissioner, given that each hotel is large, has a separate accounting system, and is autonomous to a large extent.

This could be helpful to VM Hotels Ltd as there will be no need for the accounting departments of each of the hotels to coordinate with each other to produce only one VAT return for all of the hotels. Instead, each hotel will prepare their own VAT return and make their own VAT payment.

The implications of divisional VAT registration would be as follows:

- Each division (i.e. each hotel in this case) will be responsible for filing its own VAT return and paying any VAT due.
- No VAT invoices should be issued between divisions of VM Hotels Ltd.
- The VAT periods may change, and will be prescribed by the VAT Commissioner.

(d) Correction of the invoice omission by VM Hotels Ltd

A VAT mistake can be corrected voluntarily by making adjustments in the VAT period in which it was discovered provided that:

- the corrections relate to erroneous VAT returns of not more than three years from the VAT period in which the correction will be made;
- the net amount of VAT (input less output) of all the mistakes to be corrected does not exceed €1,708.

The purchase of the cosmetics from the Greek supplier was an intra-EU community business to business transaction. This means that the Greek supplier requested the VAT registration number of VM Hotels Ltd and after he was satisfied that VM Hotels Ltd is properly VAT registered in Cyprus, no VAT was charged on his sale invoice to VM Hotels Ltd.

VM Hotels Ltd should have accounted for the transaction using the reverse charge method. The VAT on the purchase is €2,850 (15,000 x 19%) which exceeds the voluntary correction limit of €1,708.

However, the net VAT effect of the mistake is zero as VM Hotels Ltd should have treated the amount of €2,850 both as output VAT (box 2 of the VAT return) and as input VAT because it relates to taxable supplies (box 4 of the VAT return).

As the net effect is zero and it is within three years of the error, VM Hotels Ltd can make a voluntary correction in the current period's VAT return.

4 (a) XLS Ltd

Corporation tax due for 2018

	Notes	€	€
Accounting profits			536,000
Adjustments			
Depreciation	1	123,000	
Capital allowances	1	(123,000)	
Dividend from Newco SA not taxable under corporation tax	3	(15,000)	
Adjustment of Newco SA interest received to gross amount	4	2,000	
Loss on Polco share disposal not allowable for tax purposes	5	50,000	
		<u>37,000</u>	
Taxable profit before losses brought forward			573,000
2013 own loss brought forward	6		(150,000)
2014 own loss brought forward	6		(10,000)
Taxable profit before group loss relief			413,000
Current year loss of Cysub1 Ltd	7		(19,500)
Current year loss of Cysubnew Ltd	8		(12,300)
Taxable profit for year			<u>381,200</u>
Corporation tax at 12.5%			47,650
Less: tax paid by provisional assessment			(30,000)
Less: tax suffered on Newland interest restricted to attributable amount	4		(1,750)
Tax payable			15,900
10% penalty for low provisional tax – less than 75% of the tax due for the year	10		1,590
Total corporation tax payable by 1 August 2019			<u>17,490</u>

Explanatory notes:

1. Accounting depreciation is not tax deductible but capital allowances are deductible for the year.
2. No notional interest should be added to accounting profits for the interest free loan to the director of XLS Ltd. Instead, an amount on interest of 9% per annum should be added on a monthly basis to the director's other earnings as a benefit in kind and tax should be deducted through PAYE by the company on a monthly basis from the director's income.
3. Dividends from Newco SA are exempt from corporation tax. The tax deducted at source from the dividend is not available as a deduction against the corporation tax due as the income is not taxable under corporation tax.

4. It is specifically noted that the loan to Newco SA was made in the ordinary course of business of XLS Ltd. Therefore interest on the loan is taxable as business income and it is part of taxable profits for corporation tax purposes. The amount to be included in the computation, however, should be the gross amount received. Even though there is no double tax treaty between Cyprus and Newland, the tax suffered at source is allowed as a credit against tax due for the year by XLS Ltd as follows:

Taxable profit for 2018	€ 573,000
Corporation tax payable on profit at 12.5% before loss relief	<u>71,625</u>
Corporation tax attributable to interest income from Newland SA (14,000 x 71,625/573,000)	1,750
Tax deducted at source in Newland	<u>2,000</u>
Unilateral relief restricted to attributable tax on interest of	<u>1,750</u>

5. The realised loss on the disposal of Polco shares is not allowable as a deduction for corporation tax purposes. Profits of any nature (regular trading or a one-off capital gain) on the disposal of shares are specifically exempt from tax and as a result, any losses are not allowable deductions.
6. A company's own losses brought forward must be utilised before any group loss relief. Losses can only be carried forward for a period of five years and cannot be carried backwards. The loss of 2012 of €400,000 cannot be used against 2018 taxable profits but can be used against profits of 2015, 2016 and 2017, leaving all the 2013 and 2014 losses available to set against 2018 taxable profits.
7. For group loss relief purposes, only current year losses of Cyprus tax resident companies can be used provided 75% of the voting share capital was owned directly or indirectly for the whole tax year. As a result, Cysub1 Ltd losses for 2018 can be used but Cysub2 Ltd losses cannot be used as XLS Ltd's holding falls below 75% (91% x 78% = 71%).
8. Cysubnew Ltd's losses can be fully utilised against XLS Ltd taxable profits because the holding is over 75% and group relief is specifically allowed for the whole year in the year of incorporation.
9. Newco SA losses cannot be utilised in any way as it is not a Cyprus tax resident company or a company resident in the EU.
10. As the tax paid by provisional assessment is less than 75% of the tax due for the year, a penalty of 10% is payable on the balance of the tax due. There is no interest on the tax due if paid by 1 August 2019.

(b) Double tax treaty

A double tax treaty (DTT) is an agreement made by two sovereign countries (referred to as the contracting states) with the main object of avoiding or minimising territorial double taxation of passive income such as taxation of interest, dividends and rents, and active income such as salaries and profits from a business.

The DTT sets out rules on how and where income will be taxed in order to avoid the same income being taxed in both the country of source and the country of residence of the recipient.

Such agreements have the force of law and supersede any existing local legislation (i.e. if there is a conflict, the DTT provisions prevail).

XLS Ltd has suffered withholding tax on interest (of €2,000) and dividend income (of €5,000) at source in Newland. Part of the withholding tax on interest €250 (€2,000 – €1,750) and all the withholding tax on dividend income €5,000 was lost and no benefit was received in Cyprus.

A DTT between Cyprus and Newland could have provided for reduced or no withholding taxes on such payments between the two countries and therefore XLS Ltd could have suffered fewer overall taxes on this income.

	<i>Available</i>	<i>Maximum</i>
1 Income tax		
Income tax computation/comments		
– Pension	0.5	
– Do not include interest as exempt	0.5	
– Rental income – total for year	0.5	
– Deduction of 20% of gross rents with explanation	0.5	
– No deduction of actual expenses	0.5	
– Deduction of capital allowances	0.5	
– Correct application of personal income tax rates and computation tax due	1.0	
Capital allowances computation/comments		
– Use original cost of construction	0.5	
– Deduct land cost	0.5	
– Adjust building cost <i>pro rata</i> for developer profit	0.5	
– Correct rate of 3% – max 33 years	0.5	
– Compute tax written down value compare to purchase price	1.0	
– Comment on importance of capital allowances to reduce tax payable – available for another 19 years	1.0	
Provisional tax declaration with dates and minimum tax to pay during year	1.0	
Tax return filing deadline	0.5	
Payment of balance of tax deadline	0.5	
	<u>10</u>	9
Special defence contribution		
3% on 75% of gross rents	1.0	
If tenant is company deducted at source else pay by self-assessment twice a year with dates	1.5	
Explain that SDC on gross rental income is exactly the same with same payment and filing dates between person and company	1.0	
	<u>3.5</u>	3
Corporation tax		
Computation of accounting profit for company		
– Rental income for year	0.5	
– Deduct actual expenses	1.5	
– Deduct accounting depreciation	0.5	
Computation of corporation tax payable		
– Registrar fees adjustment	0.5	
– Depreciation adjustment	0.5	
– Explain that actual expenses are allowed and not 20% like in case of physical person	0.5	
– Capital allowances with comment they are the same as for person	1.0	
– Use of correct rate and compute corporation tax payable	0.5	
	<u>5.5</u>	5
Computation of SDC on minimum dividends		
– Start with accounting profit	0.5	
– Deduct corporation tax	0.5	
– Deduct SDC	0.5	
– Compute 70% of after-tax accounting profit	0.5	
– Apply correct SDC rate 17%	0.5	
	<u>2.5</u>	2

	<i>Available</i>	<i>Maximum</i>
Explain provision of legislation for deemed dividend distribution and that in addition to the corporation tax SDC on dividends will be paid as Mr A tax resident and domiciled	2·0	
Explain that minimum is 70% but 100% payment of dividend may be more comparable to owning the building personally option	0·5	
Company will be a separate taxpayer and a separate tax identification number will have to be obtained	1·0	
Provisional tax payments the same for person and company	0·5	
Balance of tax on 1 August just one month and one day later than person	0·5	
Tax return filing 15 months after end of tax year	0·5	
Present taxes under each case in summary table and conclude that personally taxes are lower	1·0	
	<u>6</u>	5
 Tax treatment of sale in three years		
Profit on sale of immovable property in Cyprus taxed under capital gains tax unless it is of a trading nature and taxed under income tax	1·0	
Frequency of past sales	1·0	
Length of ownership only three years – strong indication of trade	1·0	
Motive and reason	1·0	
Method of acquisition and financing	1·0	
Knowledge of owner	1·0	
Explanation that in case of trading nature – added to other income for the year and rate may reach 35% – capital gains highly unlikely but rate only 20% – thus tax liability can be substantially different	2·0	
	<u>8</u>	7
 Format and presentation of the memorandum		
Clarity and effectiveness of communication	1·0	
Logical flow of calculations	2·0	
	1·0	
	<u>4</u>	4
		<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).*

	<i>Available</i>	<i>Maximum</i>
2 (a) Permanent establishment (PE)		
– Specifically defined in the legislation	0.5	
– 'fixed place of business'	0.5	
– provide some examples (0.5 each)	1.5	
– Short construction projects are excluded	0.5	
Distribution centre of Xepo will be a PE and profits attributable to the distribution business will be taxable in Cyprus under corporation tax	1.0	
Will have to register as branch under Company law and with tax department and obtain separate tax identification number	1.0	
File and tax return and pay taxes according the deadlines of a limited liability company	1.0	
No tax advantage between operating as a branch or a wholly owned subsidiary	1.0	
Except in case branch is profitable and Xepo in Farland is loss making – explanation	1.0	
Both branch and subsidiary can benefit from notional interest deduction	1.0	
	<u>9</u>	9
(b) Risk of Xepo becoming tax resident in Cyprus		
Country of registration not important – have to determine where management and control is exercised	1.0	
Criteria and co-existence	1.5	
Explanation of real management and control may be exercised by one person – no clear-cut rules	1.0	
Distribution centre will be a separate taxable entity	0.5	
Visits of directors does not create a risk	1.0	
Distribution centre a small part of Xepo business	1.0	
	<u>6</u>	5
(c) Sale prices from Xepo to subsidiary in Cyprus		
Xepo and subsidiary in Cyprus are related parties	1.0	
If tax department thinks that the terms of trade between them are not arm's length, then may adjust profits	1.5	
No provision in legislation on how the price should be determined specifically	1.0	
Price should be as if they were independent parties given the terms and conditions of sale	1.0	
VAT payable on importation of the goods in Cyprus	1.0	
Value for VAT includes the purchase price plus all cost and duties to the port of entry	1.5	
Tax department may adjust price under certain conditions	1.0	
	<u>8</u>	7
(d) Taxation of employee income from Farland		
Become resident and therefore taxable in Cyprus on worldwide income if they spent more than 183 days in a calendar year	1.5	
Profit from disposal of shares specifically exempt – unless immovable property in Cyprus	1.0	
Interest and dividends exempt from income tax but taxed under SDC – only for tax resident and domiciled individuals – will not be so for 17 years	1.5	
Unilateral credit relied given for tax suffered abroad in case income is taxable in Cyprus	1.0	
	<u>5</u>	<u>4</u>
		<u>25</u>

	<i>Available</i>	<i>Maximum</i>
3 (a) Supply is any supply of goods or services made for a consideration	1·0	
Group companies are taxable persons as they are registered – made for business purposes	1·0	
Not specifically exempt thus VAT at 19% unless the legislation provides for a lower rate	1·0	
Rate depends on nature of transaction – no single rate for group companies	1·0	
	<u>4</u>	4
(b) VAT group when one company controls the other or one person controls them all – non-controlled excluded	1·0	
Cyprus incorporated with Cyprus place of establishment – non-Cyprus companies excluded	1·0	
Not necessary to include all companies in group, can select the ones which can benefit	1·0	
One return filed – one payment by representative member	1·0	
Supplies between members are outside scope	1·0	
Care when including partially exempt – <i>de minimis</i> limit and calculations made for whole group	1·0	
All members of the group are jointly and severally liable for payment of VAT	1·0	
Limits for voluntary correction of errors apply to the group as a whole	1·0	
Commissioner may refuse to register group under certain conditions	0·5	
	<u>8·5</u>	8
(c) Possible for VM Hotels Ltd to register each hotel as a division for VAT as large with own accounts system	2·0	
Each division will file its own VAT return independently no need for one VAT to be compiled	1·0	
No invoices between divisions	1·0	
VAT periods as prescribed by Commissioner	1·0	
	<u>5</u>	4
(d) Voluntary correction possible limits €1,708 and three years	1·5	
B to B intra-community transaction – no VAT charged by Greek supplier	1·5	
Net amount zero and within three years thus voluntary correction possible	1·0	
	<u>4</u>	4
		<u>20</u>

	<i>Available</i>	<i>Maximum</i>
4 (a) Corporation tax due for 2018		
Start with accounting profits	0·5	
Depreciation/capital allowances no effect	1·0	
No notional interest on loan to director (BIK)	1·0	
Dividend from Newco SA exempt	1·0	
Interest from Newco SA taxed under corporation tax/explanation as in the ordinary course of business/add tax deducted at source	1·5	
Loss on Polco shares not allowable	1·0	
Own losses used before group relief	1·0	
2012 losses can only be used up to 2017	1·0	
2013 and 2014 all available against 2018	1·0	
75% direct and indirect requirement for group relief/losses of Cysub2 Ltd not available/Cysub1 losses available	2·0	
Non-resident company losses not available thus Newco SA not available	1·0	
Part of group for whole year but a subsidiary registered during the year allowed therefore Cysubnew losses can be used	1·5	
Use of correct corporation tax rate	0·5	
Deduct tax paid by provisional assessment	0·5	
Compute with explanations double tax relief on interest from Newco allowable unilaterally	1·5	
Apply 10% penalty on balance of tax due with explanation	1·5	
State deadline for payment of balance of tax with no interest	0·5	
	<u>18</u>	16
(b) Double tax treaty (DTT)		
Agreement between two contracting states	1·0	
Main object to set rules to ensure that income from investments or business is not taxed twice	1·0	
Above local law	1·0	
XSL could benefit as withholding tax on interest and dividends is lost	1·5	
	<u>4·5</u>	<u>4</u>
		<u>20</u>