

Strategic Professional – Options

# Advanced Taxation – Cyprus (ATX – CYP)

Tuesday 8 December 2020



**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.**

**Please note that you are not expected to make any reference to Covid 19 or the global economic crisis as a result of this pandemic in your exams. None of the temporary financial or legislative measures implemented as a result of Covid are examinable.**

ATX – CYP

Think Ahead

**ACCA**

**IFAC**

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 2019 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 2019 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, transcravators, 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) under €1,709	100%
(b) €1,709 and above	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.)	2% p.a.
Additional tax	5% of tax due
PAYE assessments	2% interest p.a. plus a surcharge of 1% per month

### **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	15.6%
Employer	8.3%
Employee	8.3%
Maximum annual insurable income for employees	€54,648

### **Other contributions by employers**

Social cohesion fund	2%
Redundancy fund	1.2%
Industrial training fund	0.5%
Central holiday fund (if not exempt)	8%

### **General health scheme contributions (with effect from 1 March 2019)**

Employer's	1.85%
Employee's/pensioners/income earners	1.70%
Self-employed individual	2.55%

Maximum income on which contributions are payable €180,000.

### Capital gains tax

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

### Stamp duty

€0.00 for amounts up to €5,000

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

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

### Land transfer fees

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

**Note:**

No transfer fees will be payable when the immovable property to be transferred is subject to value added tax (VAT).

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
2019	219.99	220.06	221.89	222.81	223.12	223.36	220.56	221.23	222.48	223.36	224.05	223.67
2020												

**This is a blank page.  
Question 1 begins on page 7.**

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

**1 You should assume that today's date is 18 November 2020**

Your manager has had a meeting with Nicos, a client of your firm. Extracts from a memorandum prepared by your manager together with information provided by Nicos are set out below:

**Extract from the memorandum prepared by your manager – dated 16 November 2020**

*Nicos owns 100% of the share capital of ABC Ltd and is the sole director of the company. Nicos is tax resident and domiciled in Cyprus and will continue to be so in the foreseeable future. ABC Ltd imports and sells specialised water pumps in Cyprus. Nicos has provided the attached projected statement of profit or loss for the year ending 31 December 2020 prepared by the accounts department of ABC Ltd. Salaries include Nico's salary of €40,000 per year.*

*The company has operated from its own warehouse since 2017. The warehouse was built by an independent construction company on land purchased by ABC Ltd in 2015. A schedule of non-current asset purchases is also attached.*

*Last week, ABC Ltd sold an overseas flat in Farland, which was an investment made for long term capital gain using surplus cash of the company, many years ago. The tax paid on the disposal was computed and paid by the Farland based accountants of ABC Ltd who were employed to handle the company's tax obligations relating to this property. The Farland accountants have informed ABC Ltd that there is no double tax treaty between Farland and Cyprus.*

*Up to 31 October 2020 the flat was earning rental income, after a deduction of 10% withholding tax in Farland. The flat was located in the historic part of Farland and was constructed in 1915. There were no expenses associated with the rental in this period.*

*ABC Ltd owns 35% of the shares in Zeta Ltd; a Cyprus resident company which provides plumbing services in Cyprus.*

*In July 2020, ABC Ltd paid €5,000 of provisional tax. However, Nicos is worried that the projected tax liability of ABC Ltd for the current year will mean that this may have been too low. Nicos wishes to keep the second installment of provisional tax as low as possible to preserve cash flow.*

*No Special Defence Contribution (SDC) has been paid. Nicos understands that there will be a significant SDC liability in future years based on the results for 2020 because of the deemed dividend provisions of the legislation, but he would like to know if there is anything he can do to minimise and/or delay any liability as much as possible without changing the corporate structure.*

ABC Ltd – Projected Statement of profit or loss and Schedule of non-current asset purchases

ABC Ltd – Projected Statement of profit or loss for the year ending 31 December 2020		
	€	€
Revenue		1,174,865
Cost of sales		(818,032)
Gross profit		<u>356,833</u>
<i>Add:</i>		
Rental income received from Farland flat (net of withholding tax)	18,000	
Net gain (after tax) on sale of flat in Farland – see below	143,357	
Dividends received from Zeta Ltd	167,000	
Interest on bank deposit account (amount received)	<u>1,247</u>	329,604
<b>Expenses</b>		
Salaries	115,200	
Employer social insurance and other contributions	17,510	
Repairs and maintenance	2,600	
Telephone and communications expenses	1,800	
Business entertainment	7,580	
Audit and accountancy expenses	5,600	
Annual company levy	350	
Bank charges	563	
Provision for diminution in value of investment in Zeta Ltd	155,000	
Depreciation	<u>52,040</u>	<u>(358,243)</u>
Net profit before taxation		<u>328,194</u>

ABC Ltd		
Schedule of non-current assets	Year of acquisition	€ Cost
Warehouse land	2015	350,000
Warehouse building construction cost	2017	762,000
Warehouse equipment	2017	35,000
Office furniture and equipment	2017	15,000
Computer hardware	2019	5,500
Accounting software	2019	6,700

Net income from sale of flat in Farland	€
	<b>2020</b>
Sale proceeds 9 November 2020	567,000
Less: Cost of purchase 3 May 2007	(362,000)
Less: Incidental costs of sale	(14,712)
Less: Capital gains tax (paid in Farland)	<u>(46,931)</u>
Net gain (after tax) (per statement of profit or loss)	<u>143,357</u>



**Required:**

Prepare a memorandum for your tax manager in which you compute all of the taxes payable by ABC Ltd for the year ending 31 December 2020, including the special defence contribution on deemed dividends relating to the profit for the year.

Present your results in a table showing the amount of each tax payment due and the deadline for each payment. Include in your memorandum, a statement of where penalties and/or interest may apply, but do not compute the amounts.

You should explain your calculations where necessary, and provide any other relevant information, stating any assumptions made.

The following marks are available:

- (i) Corporation tax. (15 marks)
- (ii) Special defence contribution (SDC). (12 marks)
- (iii) Other taxes. (4 marks)

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

**(35 marks)**

- 2 The following are notes from a meeting of the tax partner of your firm with Andreas, a young entrepreneur, which were forwarded to you, requesting your assistance:

*Andreas is 28 years old and has always been resident in Cyprus. Having worked in cafeterias in Nicosia since he was 21, he has decided to start his own cafeteria. For this purpose, he registered a new company Kafe Ltd. He holds all the share capital of Kafe Ltd and he is the only director and secretary.*

*Kafe Ltd has taken out a loan of €50,000 from a local bank to finance the business start-up.*

*As location is everything in the cafeteria business, Andreas has identified a suitable shop in the centre of Nicosia currently operating as a butcher shop. The butcher shop is currently occupied by John, a sole trader, who is registered for VAT. John has been renting the shop for over 20 years and has an agreement to occupy it for a further 5 years. Andreas has agreed that Kafe Ltd will pay €20,000 to John to ensure that he vacates the premises so that Kafe Ltd can rent it.*

*The shop is owned by two sisters, Anna and Maria, who inherited the property some time ago from their father. Anna is resident in Cyprus, but Maria is currently resident in London, England, as she is a full-time university student there. Maria only visits Cyprus for a few weeks a year, in August, for holidays and will continue to do so in the foreseeable future. Anna and Maria charge rent for the shop of €1,500 plus VAT per month. This is payable in advance every month, and is split equally between Anna and Maria. Andreas will set up a bank standing order for the separate payments to each sister.*

*Kafe Ltd plans to purchase 50% of its coffee beans from Colombia (non-EU) and 50% from Italy (EU). The purchase cost from each country being about the same. Each shipment will be of a value of €3,000. The current VAT rate applicable on coffee beans is 5%. The first shipment will be received before the cafeteria opens for business.*

*Most of Kafe Ltd sales will be taxable for VAT purposes at 9% but there will be supplies at 5% and 19%. Andreas is not sure how much the business will turnover each month but he has heard that he can voluntarily register for VAT and he would like our advice on this matter.*

**Required:**

- (a) **In respect of the of the €20,000 payment, explain the various tax implications for both John and Kafe Ltd.**  
(6 marks)
- (b) **Explain Kafe Ltd's tax obligations when making the rental payments to Anna and Maria. Compute, to the nearest cent, the amount of standing order payments that Kafe Ltd will need to set up to Anna and Maria.**  
(8 marks)
- (c) **State when Kafe Ltd will be required to compulsorily register for VAT, and analyse the advantages and disadvantages of not voluntarily registering for VAT. Make specific reference to the €20,000 payment to John, the payment of rent and the purchase of coffee beans.**  
(11 marks)

**(25 marks)**

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

**3** Maro, aged 40, lived in Cyprus with her Cypriot parents until ten years ago when she moved overseas to Newland. She is employed by a Newland fashion design company and is a successful businesswoman with shares in this Newland company. As Cyprus has double tax treaties with many countries, Maro wants to set up a Cyprus company ('Maro Designs') through which she wishes to sell her own designs internationally. She is planning to return to Cyprus in the next two to three years and she was advised to appoint a Cyprus resident 'nominee' director of Maro Designs until then. She will be managing all operations of the Maro Designs company, including the bank account, which will be maintained with a Cyprus local bank. The Maro Designs company will rent a small office in Cyprus and purchase some office furniture and equipment.

Maro wishes to set up a trust for her sister, Eleni. Eleni is 35 years old and has always been resident in Cyprus. She works as a pharmacist and earns a salary of €65,000 a year. The trust will earn interest, dividends and rental income from investments in Cyprus and abroad.

On her return to Cyprus, in two to three years, Maro will continue to earn a salary and dividends from the company in Newland. No tax will be payable in Newland on this income. Maro will have to occasionally visit Newland to attend board meetings and conferences. In future she plans to dispose of the shares in the Newland company.

**Required:**

- (a) Advise whether the Maro Designs company will be considered Cyprus tax resident with a Cyprus resident 'nominee' director. Assess what difference it would make if Maro is appointed sole director of the company from the beginning and continues to be so when she returns to Cyprus.** (7 marks)
- (b) Describe what a 'trust' is and how any income received by the trust, which Maro wishes to set up for Eleni, will be taxed in Cyprus.** (7 marks)
- (c) Explain how Maro will be taxed in Cyprus on her permanent return, on the dividends and salary she will continue to receive from the Newland company and from any future profit on disposal of her shares in that Newland company.** (6 marks)

**(20 marks)**

**4 Assume that today's date is 9 November 2020.**

Anna, a client of your firm, works as a secretary for a law firm with a salary of €28,000 per year. She is 52 years old and is tax resident and domiciled in Cyprus. She has sent the following email:

Dear Sirs,

I have invested part of my savings in a shop in Larnaca, Cyprus, in the hope of getting a better return than the current interest on my savings, but the whole matter is turning into a nightmare.

I purchased the second-hand shop in January 2010. Since then the shop has been rented to one tenant for €1,800 per month but unfortunately they vacated the shop in February this year. The shop has remained empty since then. Interest from potential new tenants has been low as the shop needs major repairs.

I am thinking about my options as follows:

Option 1

Selling the shop before the end of the year for its current market value. I have, for this purpose, commissioned an independent valuation report which I attach. I have never sold immovable property in Cyprus before.

Option 2

Another option I have is to rent it to a new third-party tenant who has offered to make the necessary repairs to the shop (estimated cost of repairs €18,000) and then rent the shop to him for five years, for €1,500 per month. He will use the shop as a kiosk. I do not expect to have any benefit from the repairs as I anticipate that the shop after five years will be in the same state as it is today.

On top of my other problems I have received an assessment for 2017 issued by the tax department last month showing income tax payable of €560. I cannot understand why – I have always filed my tax returns on time and paid all taxes due.

**Extract from the valuation report on the shop in Larnaca**

Property description	Used shop in Larnaca currently empty.  The shop was built in 2000. In accordance with the developer's records, construction cost was €155,000 of which €55,000 was for the cost of the land including land transfer fees. The shop was sold new in 2000 for €200,000.  Anna purchased the shop in January 2010 for €230,000. In addition, Anna paid land transfer fees of €12,400 at the time of purchase.
Estimated market value today	€270,000
Estimated rental value	€1,800 per month

**Required:**

- (a) Compute the capital gains tax payable by Anna if she takes Option 1, explaining your calculations where necessary. For purposes of your calculations assume that the retail price index applicable on the date of disposal of will be 224·0** (7 marks)
- (b) If Anna takes Option 2, explain the Cyprus income tax implications and the VAT implications and options available to her.** (10 marks)
- (c) Explain why the tax department may have issued an assessment, the time limits for so doing, and how Anna may challenge this assessment.** (3 marks)

**(20 marks)**

**End of Question Paper**