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# Answers

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1 Memorandum

To: Tax partner  
From: Tax assistant  
Date: 2 June 2020

Re: Pare Ltd – New lorry purchase tax effect

Investment in new lorry and employment of a new driver

Tax savings summary

	€ No investment	€ Investment made
Corporation tax	27,343	39,659
Special defence contributions (SDC)	26,139	36,398
General health scheme contributions (GHS)	2,614	3,639
Totals	<u>56,096</u>	<u>79,696</u>
Overall tax increase		<u>23,600</u>

The above table summarises the tax increase if the future plans of Pare Ltd in investing in a new lorry and employing a new driver are implemented.

The computations of corporation tax due before and after the investment are shown in schedules A and B respectively. It is noted that the taxable loss of 2018 will be carried forward and relieved against taxable profits of the next five years – see schedule H.

The current shareholding structure of the company which is wholly owned by Andreas, a Cyprus tax resident and domiciled individual, means that the company is also caught by the deemed dividend provisions of the special defence contribution legislation (SDC). The provisions of the legislation are such that if Pare Ltd does not distribute at least 70% of its after-tax accounting profits, in the two years which follow the tax year in question, then the 70% is deemed to have been distributed and the SDC which would have been payable on such a distribution has to be paid. The deemed dividend is reduced by any actual dividend paid.

The provisions are such that they create an additional SDC liability for the year, delayed by two years, where an after-tax accounting profit has been realised. This liability is not affected by the results of any future or past years. It is affected, however, if the taxation status of the shareholders change.

The increased after-tax accounting profits result in additional SDC payable (schedules E and F).

In addition to SDC, the new GHS contributions payable on dividends or deemed dividends will also increase. The computations are shown at the bottom of schedules E and F and the overall effect has been included in the table above.

Schedule A

Corporation tax payable if lorry is not purchased

	€ 2021	€ 2022	€ 2023	€ 2024
Taxable profit	27,100	44,500	85,600	98,000
Loss relief from 2018 – see schedule H	<u>(27,100)</u>	<u>(9,360)</u>		
Taxable profit	–	<u>35,140</u>	<u>85,600</u>	<u>98,000</u>
Corporation tax at 12.5%	–	<u>4,393</u>	<u>10,700</u>	<u>12,250</u>
Total for all years				<u>27,343</u>

## Schedule B

### Corporation tax payable if lorry is purchased

	€ 2021	€ 2022	€ 2023	€ 2024
Taxable profit before purchase	27,100	44,500	85,600	98,000
<i>Add:</i> saving from third-party transport	45,000	55,000	98,000	115,000
Lorry capital allowances 20% x (95,200 x 100/119)	(16,000)	(16,000)	(16,000)	–
Lorry balancing allowance on disposal – schedule C	–	–	–	(6,790)
Fuel, lubricants and maintenance net of VAT	(11,261)	(12,605)	(15,546)	(13,866)
Insurance	(853)	(853)	(853)	(853)
Road tax	(700)	(700)	(700)	(700)
New driver total employment cost – schedule D	(25,047)	(25,047)	(25,047)	(25,047)
Taxable profit before utilisation of losses	18,239	44,295	125,454	165,744
Loss from 2018 – see schedule H	(18,239)	(18,221)	–	–
Taxable profit	–	26,074	125,454	165,744
Corporation tax at 12·5%	–	3,259	15,682	20,718
Total for all years				39,659

## Schedule C

### Lorry balancing allowance on disposal

	€
Purchase cost before VAT (95,200 x 100/119)	80,000
Allowances claimed for three years 2021, 2022 and 2023	(48,000)
Tax written down value in year of disposal	32,000
Sale proceeds before VAT (30,000 x 100/119)	(25,210)
Balancing allowance	6,790

## Schedule D

### New driver annual employment cost

	€ All years
Salary	22,000
<i>Add</i> employer contributions:	
Employer social insurance at 8·3%	1,826
Social cohesion fund at 2%	440
Redundancy fund at 1·2%	264
Industrial training fund at 0·5%	110
GHS at 1·85%	407
Total employment cost	25,047

## Schedule E

### Computation of SDC on dividends if lorry is not purchased

	€ 2021	€ 2022	€ 2023	€ 2024
Accounting profit before tax	25,000	43,000	83,000	96,000
<i>Less:</i> corporation tax – schedule A	–	(4,393)	(10,700)	(12,250)
Accounting profit after tax	25,000	38,607	72,300	83,750
Minimum dividend per deemed dividend provisions of the legislation – 70%	17,500	27,025	50,610	58,625
SDC payable at 17%	2,975	4,594	8,604	9,966
GHS payable at 1·7%	298	459	860	997
Total for SDC all years				26,139
Total for GHS all years				2,614

## Schedule F

### Computation of SDC on dividends if lorry is purchased

	€ 2021	€ 2022	€ 2023	€ 2024
Accounting profit before purchase	25,000	43,000	83,000	96,000
Add: saving from third-party transport	45,000	55,000	98,000	115,000
Lorry accounting depreciation (95,200 x 100/119)/8 years	(10,000)	(10,000)	(10,000)	–
Lorry accounting loss on disposal – schedule G	–	–	–	(24,790)
Fuel, lubricants and maintenance net of VAT	(11,261)	(12,605)	(15,546)	(13,866)
Insurance	(853)	(853)	(853)	(853)
Road tax	(700)	(700)	(700)	(700)
New driver total employment cost – schedule D	(25,047)	(25,047)	(25,047)	(25,047)
Accounting profit before tax	22,139	48,795	128,854	145,744
Less: corporation tax per schedule B	–	(3,259)	(15,682)	(20,718)
Accounting profit after tax	22,139	45,536	113,172	125,026
Minimum dividend per deemed dividend provisions of the legislation – 70%	15,497	31,875	79,220	87,518
SDC payable at 17%	2,634	5,419	13,467	14,878
GHS payable at 1·70%	263	542	1,347	1,488
Total SDC for all years				36,398
Total GHS for all years				3,639

## Schedule G

### Lorry accounting profit on disposal

	€
Purchase cost before VAT (95,200 x 100/119)	80,000
Depreciation over eight years for three years	(30,000)
Net book value on disposal	50,000
Sale proceeds before VAT (30,000 x 100/119)	(25,210)
Accounting loss on disposal	(24,790)

## Schedule H

### Loss relief available

	€
Taxable loss in 2018	42,300
Less: utilised against 2019 taxable profit	(3,540)
Less: utilised against 2020 expected taxable profit	(2,300)
Available against 2021 to 2023 profits (max five years)	36,460

## 2 Tax implications of renting the office building if Helen remains a resident of Farland

Currently, Helen is not tax resident or domiciled in Cyprus as she is not in Cyprus for more than 183 days in a calendar year. As a result, she does not have to declare any income or pay any tax in Cyprus other than her Cyprus source income. Her income from the office building will be taxable in Cyprus, as it is Cyprus source income, as follows:

### Income tax

The rental income will be taxable according to normal rules as shown in the computation below:

### Income tax payable by Helen on an annual basis

	€
Rental income	44,000
Less deductions:	
20% of gross rental income as expenses – actual expenses not allowable	(8,800)
General health scheme contributions (€44,000 x 1·70%) all allowable as below 1/6th of taxable income	(748)
Taxable income	34,452

	€
<b>Tax due:</b>	
0 – €19,500 at 0%	–
€8,500 at 20%	1,700
€6,452 at 25%	1,613
Total income tax payable	<u>3,313</u>

As she will not be tax resident in Cyprus, the tax she will have to pay in Farland is not deductible in Cyprus.

For income tax purposes Helen will have to register, with the tax authorities in Cyprus, as a taxpayer and obtain a tax identification number. On informing Helen of her tax identification number, the Tax Department will also notify her of a key number with which she will be able to obtain a username and password for the taxisnet system. This is necessary as personal tax returns in Cyprus can only be filed electronically.

To avoid any penalties, Helen will have to prepay at least 75% of the tax due for a tax year, which in Cyprus is the same as a calendar year, by filing a provisional tax self-assessment by 31 July. The provisional tax self-assessment is filed electronically at the same time as paying 50% of the tax due for the year. The balance of the tax is payable by 31 December; again electronically.

After the year end (of 31 December), she will have to pay the balance of any tax due, i.e. by 30 June of the following year. Payment, again, can only be made electronically.

Helen will have to file a tax return declaring only her Cyprus rental income and also declaring, on the first page of the tax return, that she is not tax resident in Cyprus. This tax return should be filed electronically through the taxisnet system by 31 July of the following year.

#### **Special defence contribution (SDC)**

SDC is payable on rental income at the rate of 3% on 75% of the gross income but non-domiciled individuals are exempted. For an individual to be domiciled, he or she must be tax resident first and as Helen will not be tax resident, she is exempt from SDC on the rental income.

#### **General health scheme contributions (GHS)**

The way the recent GHS legislation is drafted, it does not exclude non-residents from GHS contributions and therefore Helen will have to pay GHS contributions. As the rental is paid annually in advance in January, then GHS contributions will be payable at the rate of 1.70% on her gross rental income. On an annual basis she will have to pay €748 (€44,000 x 1.70%) of GHS.

As the office building will be leased to a business, if the business is a limited liability company, the GHS contributions will be deducted at source from gross rental payments. The tenant will need to provide Helen with a certificate of the GHS they have deducted from the rental income paid. The certificate should be given every six months – one for the first half of the year and one for the second half. It is noted here, however, that as the rent will be payable once a year in January in advance, then there will only be one deduction and only one certificate will be issued. Helen will not have to do anything else regarding the GHS due on her rental income other than saving the certificate.

If the tenant is an unincorporated business, then Helen will receive the rental payment in January every year without any deduction of GHS and she will have to declare and pay it electronically by 30 June of the same year.

#### **VAT**

Other than rental of residential buildings, the rental of a building is a taxable supply at the current standard rate of 19%, unless the tenant makes wholly, or substantially, exempt supplies. Helen's annual income will exceed the registration threshold of €15,600 and therefore she will need to register for VAT before she issues the first VAT invoice for the rent, on the basis of the 'future prospects' test subject to the options below.

Helen will have to file VAT returns on a quarterly basis and pay all the VAT she collects on her rental income to the Tax Department. She is able to deduct any VAT incurred on expenses relating to this income.

She has two options to avoid the requirement to register for VAT, as follows:

- She can select a tenant which makes only exempt (or substantially exempt) supplies like an insurance company, a bank, stockbrokers, etc. In such a case, her rental income will not be a taxable supply and she will not have to register.
- She can elect to exempt the building from VAT for the full period of ownership. This option is irrevocable and careful thought has to be made before it is selected, especially if there will be major repairs and renovation to the building in the future. In that case, any VAT incurred on those costs would not be recoverable.

#### **How Helen's tax position will change if she moves permanently to Cyprus**

If Helen moves permanently to Cyprus, she will become a tax resident in the calendar year in which she is in Cyprus for more than 183 days. As a result, she will be taxable in Cyprus on her worldwide income which means that she will need to declare, in Cyprus, her income from Farland. This income, where taxable, will be added to her Cyprus source income.

From an income tax point of view, her rental income from the apartment in Farland is taxable. She will be able to deduct the 20% on gross rents for physical persons and also capital allowances on the cost of construction (provided 33 years have not passed from completion of construction), as well as any interest on money borrowed to buy the property.

Even in the absence of a double tax treaty with Farland, Cyprus will unilaterally allow a tax credit for any tax paid on this income in Farland with some limitations.

As her Cyprus source income already takes her close to the limit of the 25% band of taxation, this means that much of her Farland rental income will be taxed at the 30% rate.

Helen can elect for her pension to be taxed separately at the rate of 5% and therefore it will not form part of the rest of her taxable income. The first €3,420 is tax free under this special mode of taxation.

Helen's interest income is exempt from income tax in Cyprus.

Helen will be liable for GHS at the rate of 1.70% on her gross total income which will consist of rental income from both Cyprus and Farland, her pension income and interest from Farland.

As Helen was not a tax resident of Cyprus for 17 out of the previous 20 consecutive years, she will not be considered domiciled in Cyprus on her return. The fact that her father was resident and domiciled in Cyprus is irrelevant. As the liability to SCD depends on being both domiciled and resident in Cyprus, Helen will only become liable when she has been resident in Cyprus for 17 years out of the previous 20 years.

### 3 (a) Overall taxes payable if B Ltd disposes of the land

#### B Ltd

The capital gains tax payable on the disposal of the land by B Ltd is as follows:

	€
Sales proceeds	500,000
Less: indexed cost of land (240,000 x 224.00/211.93)	(253,669)
Less: transfer fees on acquisition – no indexation allowed	(11,200)
Capital gain	235,131
Less: capital loss on sale of the factory building in 2019	(35,000)
Taxable capital gain	200,131
Capital gains tax at 20%	40,026

If the land is disposed of, B Ltd will have an after-tax accounting profit in 2020 as follows:

	€
Accounting loss before disposal of the land	(5,500)
Profit on disposal of the land (500,000 – (240,000 + 11,200))	248,800
Profit before tax	243,300
Less: capital gains tax payable	(40,026)
Accounting profit after tax	203,274

For corporation tax purposes, B Ltd will not have to pay corporation tax as the profit on disposal of the land is taxable under capital gain and is not taxable under corporation tax.

According to the special defence contribution (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.

If B Ltd does not distribute 70% of the €203,274 after-tax accounting profit made as a dividend by 31 December 2022, then it will be deemed to have done so and SDC will be payable on this deemed distribution at 17%. If a dividend was actually paid, SDC will be payable on the actual amount paid. It is better for B Ltd, therefore, to declare a dividend of at least €142,292 (70% of €203,274) by 31 December 2022. The dividend will be payable to A Ltd and will be exempt from corporation tax in A Ltd and, as it is not a deemed dividend, no SDC will be due. No future losses will affect this obligation.

#### A Ltd

Assuming that the dividend declaration by B Ltd is delayed until December 2022, this will then represent the accounting profit of A Ltd for 2022 (this is not taxable under corporation tax).

To avoid the deemed dividend provisions of the legislation explained above, A Ltd is required to distribute at least 70% (€99,604) of this after-tax accounting profit by December 2024. At that time 17% SDC will have to be deducted at source as John is tax resident and domiciled in Cyprus. The amount of SDC which will be paid by A Ltd on behalf of John will be €16,933 (17% x €99,604). The dividend has to be declared by 31 December 2024 and the SDC paid by the end of the following month to the Cyprus Tax Department.

Even if the dividend is not declared, the same amount of SDC will have to be paid by A Ltd.

The dividend or deemed dividend payable to John will also be subject to general health scheme (GHS) contributions at the rate of 1.70% on the gross dividend in addition to the €16,933 SDC which will be deducted at source from the dividend another €1,693 (1.70% x 70% x €142,292). The GHS will also be deducted at source by A Ltd and paid by the end of the following month to the Cyprus Tax Department.

## John

Other than suffering the SDC and GHS which A Ltd will deduct at source, John does not have any other tax to pay on this income.

The overall tax liability for this transaction (CGT, SDC and GHS) will be €58,652 (€40,026 + €16,933 + €1,693) and a net dividend of €80,978 (€99,604 – €16,933 SDC – €1,693 GHS) will be paid to John by the end of 2024 at the latest.

### (b) Taxes payable where A Ltd disposes of the shares in B Ltd

The same capital gains tax will be payable by A Ltd as was payable by B Ltd since the sale will be considered to be an indirect disposal of immovable property. Irrespective of the sale price of the shares, the market value of €500,000 for the land will be used for the capital gains tax calculation with the same costs and indexation.

If A Ltd disposes of the shares of B Ltd for €500,000, then it will realise an accounting profit of €350,000 (500,000 – 150,000). This profit made on the sale of the shares is exempt from corporation tax and any loss made is not allowable for tax purposes.

As A Ltd does not have any other income or expenses, the after-tax accounting profit will represent the accounting profit on the sale of the shares less the capital gains tax payable, i.e. €309,974 (€350,000 – €40,026). Due to the deemed dividend provisions, irrespective whether A Ltd distributes 70% of this profit (€216,982) as dividend by 31 December 2022 or not, as John is Cyprus tax resident and domiciled individual, SDC of €36,886 (17% x 70% x €309,974) will have to be paid by 31 January 2023.

Furthermore, the dividend or deemed dividend is subject to GHS contributions at 1.70%. As there is a maximum of €180,000 on which GHS contributions are payable, the amount of GHS on the deemed dividend will be €3,060 (1.70% x €180,000).

The same capital gains tax will be paid, €40,026, and SDC and GHS will be paid €39,946 (€36,886 + €3,060).

If A Ltd disposes the shares of B Ltd, the overall tax liability will be €79,972 (€40,026 CGT + €36,886 SDC + €3,060 GHS) and the net dividend for John will be €175,326 at the end of 2022.

**Tutorial note:** *In the scenario at (a), there is undistributed cash left in B Ltd and in A Ltd. There will be further tax implications when this is extracted.*

*In the scenario at (b), there will be a lesser amount of undistributed cash left in A Ltd, as a larger distribution has been paid to John. There will be further tax implications when this cash is extracted.*

## 4 (a) Value added tax (VAT) implication of the three options

As all supplies made by Hrima Ltd are exempt from VAT, then any VAT payable on the design service for the leaflet will not be recoverable, and therefore will be part of its cost irrespective of the supplier from which the service is purchased.

The supply of the design service is not exempt from VAT and it is taxable at the current standard rate of 19%.

### Cyprus design studio

In the case of the Cyprus based design studio, VAT of 19% will be added to the invoice and will be part of Hrima Ltd's total cost. The total cost of purchasing the service from the Cyprus supplier will therefore be €29,750 (€25,000 + €4,750).

The VAT of €4,750 will be a cost to Hrima Ltd as Hrima Ltd is not registered for VAT (since it makes only exempt supplies) and therefore cannot recover any input VAT.

### Indian design studio

The invoice from India, a non-EU country, will have no VAT applied to the cost. However, the general rule for services, as it applies from 1 January 2010, is that for business to business supplies (as is the case here), the place of supply of the service is the country where the recipient of the service is established.

A business which receives a service from abroad, which is not an exempt supply, is deemed to be supplying the service to itself, and must account for it using the reverse charge method. In other words, it is deemed to be the supplier of the service. Given that the supply of these design services is for €25,000, this exceeds the registration threshold of €15,600 and so, at the time of signing the contract for the design service with the Indian design studio, Hrima Ltd will be deemed to be making a supply of a service in Cyprus taxable at the standard rate of VAT.

The compulsory registration provisions of the VAT legislation state that a business has to register for VAT at any time, if there are reasonable grounds to believe that the value of taxable supplies (excluding VAT) in the next 30 days from that point in time will exceed €15,600 (future prospects test). As a result, Hrima Ltd would have to register for VAT before receiving the service and account for the sale to itself in a VAT return.

It will account for the output VAT of €4,750, and, as this service relates to exempt supplies, there will be no input VAT recovered. The end result will be that Hrima Ltd will have to pay €4,750 of VAT on the service it receives from the Indian design studio bringing the total cost to the same level as the cost from the Cyprus design studio, i.e. €29,750.

Hrima Ltd will have to deregister from VAT after this transaction if it does not plan to make any other taxable supplies in accordance with the deregistration provisions of the legislation. Penalties apply in case of late deregistration application.

### **Greek design studio**

The same principles apply in the case of purchasing from the design studio in Greece, even though Greece is a member of the EU. As in the case of the Indian design studio, Hrima Ltd will be deemed to be making a supply of this service to itself.

Hrima Ltd will have to register for VAT as above, and account for the VAT due using the reverse charge provisions of the legislation.

As for the Indian design studio, a VAT return will be required and output VAT of €4,750 must be paid to the Cyprus authorities. As the service relates to exempt supplies made by Hrima Ltd there is no recovery of the input VAT.

If Hrima Ltd does not plan to make any other taxable supplies, it must deregister from VAT as it would if the design services were purchased from the Indian studio.

### **Conclusion**

In summary, the cost of €29,750, including VAT, will be the same regardless of which design studio supplies the services.

A purchase from the Cyprus design studio means that Hrima Ltd is not making a supply to itself (under the reverse charge provisions). This means that there is no need to register, file a VAT return, pay the VAT due and then deregister on time to avoid penalties, which would be necessary if the design services were purchased from India or Greece. The costs associated with this process would be saved if the Cyprus design studio is selected.

## **(b) VAT implications for import and sale of XPass devices**

There is no requirement for Hrima Ltd to be registered for VAT to be able to import the XPass devices from China. As this is not an EU import, the goods will go through customs and VAT, at 19%, will be paid on the total of purchase cost and all shipping and insurance costs to bring the goods to Cyprus, before the goods are released for free circulation. If Hrima Ltd does not register for VAT, this will mean that the VAT paid on the importation of the devices will not be recoverable and will form part of their import cost.

In accordance with Cyprus VAT legislation, a trader must register for VAT if:

- at the end of any month, the value of taxable supplies (excluding VAT) for the 12 months then ended exceeds the current registration threshold of €15,600, such calculation being applied at the end of every month (historic test), or
- at any time, there are reasonable grounds to believe that the value of taxable supplies (excluding VAT) in the next 30 days from that point in time will exceed the current registration threshold of €15,600 (future prospects test).

Hrima Ltd anticipates that it will take about one year to sell the 480 devices of the first batch. If the devices are sold evenly throughout the year, on average this will be 40 devices per month which at €50 each will give taxable supplies of about €2,000 per month. This means that in seven to eight months' time Hrima Ltd will exceed the threshold of €15,600 and will have to register for VAT following the historic test explained above.

Even though, in accordance with its sales projections, Hrima Ltd will have to register at some point for VAT, there is no need to do so immediately. It can start selling the devices and once a month it should add up the sales of the previous 12 months and if these have exceeded the threshold of €15,600, then it will have to file an application for VAT registration. Hrima Ltd will have to start charging VAT on its XPass sales once it is notified by the Tax Department that it has been registered for VAT and has a VAT registration number, which should be shown on the XPass sale invoice.

Registering for VAT will have the following implications for Hrima Ltd:

### **(i) Additional administration cost – partially exempt computations**

Hrima Ltd will have to prepare and file a VAT return on a quarterly basis. Furthermore, the VAT return will have to be completed following the rules for partially exempt traders – traders who make taxable and exempt supplies – even though the taxable sales will be a very small amount of the total sales.

In accordance with these rules, input VAT which is wholly attributable to taxable supplies, i.e. the sale of the XPass devices, is fully recoverable and the input VAT which is wholly attributable to exempt supplies is not recoverable. Any input VAT which cannot be directly related to either taxable or exempt supplies, called non-attributable VAT, can also be recovered based on the following formula:

Non-attributable VAT x taxable supplies/total supplies

The above calculation has to be done on a quarterly basis for each VAT return and then an annual adjustment has to be done for the whole year.

Due to the fact that XPass sales will be less than 1% of Hrima Ltd sales, the amount of non-attributable VAT which can be recovered must be negligible.

If input tax wholly or partly attributed to exempt supplies is below a *de-minimis* limit, all such tax is allowed. However, given that the vast majority of supplies made by Hrima Ltd will be exempt supplies, these *de-minimus* limits will almost certainly always be exceeded.

### **(ii) Input VAT on XPass devices still in stock can be recovered**

As import VAT on the purchase and import of the XPass devices can be wholly attributed to taxable supplies, then the VAT on any devices still in stock at the time of VAT registration can be recovered by including it in input VAT on the first VAT return to be filed. There is a time limit of three years for the recoverability of input VAT on goods acquired before registration.



**(iii) More profit on the sale for Hrima – increase in cost for some customers**

After VAT registration, although output VAT will be charged, input VAT on the XPass devices still in stock will be recovered. This means the cost of each device will be less (by the VAT amount recovered) and, if Hrima Ltd continues to sell them at the same price, this will mean it will make more profit.

As Hrima Ltd will have to charge VAT on the selling price of €50, its business customers which are registered for VAT will be able to recover this VAT. However, private non-business customers or business customers which make only exempt supplies (such as doctors, insurance companies, etc) will not be able to recover this VAT. As a result, the XPass device will be more expensive to them (by the amount of VAT).

**(iv) VAT on office rent**

Hrima Ltd is renting luxurious offices in the centre of Nicosia. A landlord cannot charge VAT if the tenant is only making exempt supplies but will charge VAT if the tenant is registered for VAT. However, in accordance with guidance issued by the Tax Department, if 90% of sales are exempt from VAT, then the tenant is assumed to be an exempt trader for VAT on rent purposes and Hrima Ltd will continue to be charged rent without VAT.

	<i>Available</i>	<i>Maximum</i>
<b>1 Corporation tax</b>		
Computation of corporation tax if no investment made:		
– Use taxable profit	0·5	
– Apply correct corporation tax rate	0·5	
– Compute total tax for the four years	1·0	
Computation of corporation tax if investment made:		
Use taxable profit before investment	1·0	
Deduct capital allowance for three years at 20% on cost after deduction of VAT	2·0	
Compute balancing charge and deduct from 2024	2·0	
Deduct expenses net of VAT	1·5	
Deduct insurance – no VAT deduction	1·0	
Deduct road tax – no VAT deduction	1·0	
Deduct gross employment cost for employer and include GHS	1·0	
Loss carry forward with explanation	2·0	
Apply corporation tax rate and compute total corporation tax for the four years – comparison to before investment explanation	2·0	
	<u>15·5</u>	<b>15</b>
<b>Special defence contribution</b>		
Explain provisions of SDC for deemed dividends and why should be considered – explain that future accounting results do not affect SDC on deemed dividends	2·0	
Computation of SDC before investment – 17% of 70% of after-tax accounting profit – use corporation tax if no investment computed	3·0	
Computation of SDC if investment made:		
Use accounting profit before investment	1·0	
Deduct depreciation for three years on cost after deduction of VAT	1·0	
Compute and deduct accounting loss on disposal	1·5	
Deduct expenses net of VAT	0·5	
Deduct insurance – no VAT deduction	0·5	
Deduct road tax – no VAT deduction	0·5	
Deduct gross employment cost for employer and include GHS	0·5	
Deduct corporation tax under scenario of investment made	1·0	
Apply correct percentage (70%) and SDC rate (17%) on after-tax accounting profits – compare totals	1·5	
	<u>13</u>	<b>11</b>
<b>Social insurance and GHS</b>		
Computation of new driver employer cost by adding social insurance and other employer contributions	2·0	
Employer GHS contributions	1·0	
GSH on dividends	2·0	
	<u>5</u>	<b>5</b>
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>
		<b>35</b>

**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>
<b>2 Helen as non-resident</b>		
Helen not resident of Cyprus – 183 days rule – only taxed in Cyprus on Cyprus source income therefore rent taxable in Cyprus	2·0	
Annual income tax payable computation:		
– Rental income	0·5	
– 20% deduction for physical persons	1·0	
– Correct application of personal tax bands	1·0	
Tax payable in Farland on Cyprus income not deductible in Cyprus	1·0	
Registration for tax – file a tax return electronically on an annual basis by 31 July of following year	1·5	
At least 75% of tax must be paid by provisional assessment during a tax year – in two instalments 31 July and 31 December	2·5	
Balance of tax payable by 30 June of following years	0·5	
Not domiciled as not resident – no SDC payable	2·0	
GHS payable – rate – if lessee is limited company will deduct at source and supply certificate two times a year	2·0	
Explanation of how Helen will pay if tenant is unincorporated and deadline	1·0	
Rent for non-residential use thus taxable supply at standard rate – file quarterly VAT returns	2·0	
Helen must register in accordance with future prospects rule before issuing first rental invoice	2·0	
If tenant makes exempt transactions – not taxable	1·0	
Helen can elect to exempt the building for VAT – but irrevocable until ownership change	1·0	
	<u>21</u>	19
 <b>Helen as resident</b>		
Once she spent 183 days in a calendar year, Helen will taxable in Cyprus on her worldwide income	0·5	
Farland rent taxable – deduction of 20%/capital allowances if 33 years not elapsed on construction cost/interest	1·5	
Foreign pension option to be taxed separately at 5% – will not form part of taxable income	1·0	
Interest income is exempt from income tax	0·5	
Unilateral credit on foreign tax available subject to restrictions	1·0	
No SDC as not resident for 17 consecutive years – SDC due after 17 years residency in Cyprus	1·5	
GHS at 1·70% on all her income rental from both sources and pension from Farland – not on interest income	1·0	
	<u>7</u>	<u>6</u>
		<u>25</u>

	<i>Available</i>	<i>Maximum</i>
<b>3 (a) Overall taxes payable</b>		
<b>B Ltd</b>		
Capital gains tax payable:		
– Sale proceeds	0.5	
– Indexation	1.0	
– Transfer fees – no indexation	1.0	
– Capital loss deducted	1.0	
– Correct application of capital gains tax rate	0.5	
Clarify that no corporation tax payable as profit on disposal taxed under capital gains	1.0	
Compute after-tax accounting profits:		
– Accounting loss before disposal	0.5	
– Accounting profit on land disposal	1.5	
– Deduct capital gain tax	0.5	
Explain deemed dividend provisions of the legislation	1.0	
Explain that if B Ltd does not pay dividend then it will have to pay SDC on deemed dividend irrespective that the shareholder is a limited liability company	1.0	
Advice for B Ltd to pay at least 70% of its 2020 after-tax profits to A Ltd in two years' time		
– no SDC deducted at source by A Ltd	1.0	
No future losses will affect this obligation	0.5	
<b>A Ltd</b>		
The dividend from B Ltd will be the after-tax accounting profit of A Ltd for deemed dividend purposes for 2022	1.5	
SDC at 17% payable as John is tax resident and domiciled – compute amount	1.5	
Time limit of 31 December 2024	0.5	
GHS contributions will apply – correct rate of 1.70%	1.5	
No other tax to pay other than the SDC and GHS on the dividend deducted at source by A Ltd	0.5	
	<u>16.5</u>	<b>15</b>
<b>(b) A Ltd disposing the shares of B Ltd</b>		
The realised profit on the disposal of the shares is exempt from corporation tax	1.0	
The same capital gains tax will be payable as it will be considered an indirect disposal of land – irrespective of shares sale price, the market value of the land will be used	1.5	
Deemed dividend provisions apply on realised profit	1.0	
Compute amount of SDC payable	0.5	
Conclude that more SDC will be paid under this option and earlier	0.5	
GHS contributions at the correct rate and maximum of €180,000	1.5	
	<u>6</u>	<u>5</u>
		<u><b>20</b></u>

	<i>Available</i>	<i>Maximum</i>
<b>4 (a) VAT implications</b>		
Design service is not exempt	1·0	
Hrima Ltd is not registered and therefore all VAT paid is part of its costs	1·0	
Cyprus case – Cyprus VAT will be charged on the invoice	1·0	
Place of supply of B2B services is where the recipient is established – thus Hrima Ltd will be deemed to be supplying a non-exempt service to itself if from India or Greece	2·0	
As the self-supply will exceed the registration threshold of €15,600, Hrima Ltd will have to register on the future prospects test – explanation	2·0	
Explanation of accounting for reverse charge – output VAT payable but not recoverable as relating to exempt supplies	1·5	
Will have to deregister on time to avoid penalties	0·5	
Case of Greek and India suppliers, the same VAT will have to be paid by Hrima Ltd in Cyprus making the total cost of all three options the same	1·0	
But Cyprus option has less administration costs	1·0	
	<u>11</u>	<b>10</b>
<b>(b) VAT implications for import and sale of XPass devices</b>		
No requirement to register before import – VAT paid at customs	1·0	
Compulsory registration – historic test last 12 months not exceeding threshold – once a month compute taxable supplies of previous 12 months and apply for registration if threshold exceeded	2·0	
Compulsory registration – future prospects test – expect to exceed threshold in next 30 days	0·5	
Use of information to estimate timing of compulsory registration	1·0	
Can start selling devices with no VAT registration	0·5	
Additional administration cost for filing returns/partial exemption computation/annual adjustment. <i>De-minimus</i> unlikely to be applicable	3·5	
At time of registration input VAT on devices still in stock can be recovered – time limit of three years	1·0	
If registered, more profit on the sale for Hrima Ltd – increase in cost for some customers – explanation	1·0	
VAT on rent payable when registered but if exempt supplies more than 90%, still considered exempt	1·5	
	<u>12</u>	<u>10</u>
		<u><b>20</b></u>