

Strategic Professional – Options

Advanced Taxation – Cyprus (ATX – CYP)

Tuesday 2 June 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.

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%
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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 2% p.a.
(Interest is calculated on the basis of completed months.
The same rate applies to overpayments of tax.)
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

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

Stamp duty

€0.00 for amounts up to €5,000

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

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

Land transfer fees

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

Note:

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	222.35											

Section A – BOTH questions are compulsory and MUST be attempted

1 You should assume that today's date is 2 June 2020

Your firm has received an email from Andreas, the only shareholder and director of Pare Ltd, a long-standing client of your office. Pare Ltd is a Cyprus tax resident company which was registered in 2018. It is involved in cargo transportation in Cyprus and prepares accounts to 31 December each year. Andreas is also tax resident and domiciled in Cyprus.

Extract from Andreas' email:

Our business is expanding, and we plan to purchase a new lorry for our long-distance transportation needs between cities. We currently use a third-party transport company for this purpose and the new lorry will enable us to avoid this significant cost. Our in-house accounting department has prepared the attached cash flow projections for the new lorry. The lorry will be received and put to use on 1 January 2021, but we need to make a decision now so that we can place an order with the suppliers in Cyprus.

If the lorry is purchased, I will also be employing a driver for the lorry, to start work at the same time, on 1 January 2021. The driver will be paid a gross salary of €22,000 per annum. Our company is exempt from paying annual holiday contributions and the driver will be allowed 21 working days of paid holiday.

I further attach our actual results for the previous years and our budgeted results for future years before taking account of the lorry purchase. Included in the projections is my salary and related contributions of €18,000 per annum which will remain constant for the period.

Our policy for accounting purposes is to depreciate the lorry over eight years. Full depreciation will be made in the year of purchase and no depreciation in the year of disposal. We plan to sell this particular lorry at the end of the year, in four years' time before it requires major repairs. This is reflected in the cash flow forecast attached.

By incurring the cost of our own long-distance transport, we will increase our overall profits and the investment will lead to additional capital allowances and tax allowable costs. As part of the decision-making process, I would like to know the overall tax effect (increase or decrease) over the four years, 2021 to 2024, if we invest in the new lorry and employ the new driver. The company already has, in its current account, the available funds to buy the lorry.

From the attachment to Andreas' email, the following information is available.

Projected cash flow of lorry purchase (inclusive of VAT where applicable)

	€ 2021	€ 2022	€ 2023	€ 2024
Purchase of new lorry	95,200			
Fuel, lubricants and maintenance	13,400	15,000	18,500	16,500
Insurance	853	853	853	853
Road tax	700	700	700	700
Sale proceeds of used lorry				(30,000)
Total	<u>110,153</u>	<u>16,553</u>	<u>20,053</u>	<u>(11,947)</u>

Actual results of previous years

	€ 2018	€ 2019
Accounting loss before tax	(47,000)	(2,000)
Taxable (loss)/profit	(42,300)	3,540

Budgeted results of current and future years if lorry is NOT purchased

	€ 2020	€ 2021	€ 2022	€ 2023	€ 2024
Accounting profit before tax	3,000	25,000	43,000	83,000	96,000
Taxable profit	2,300	27,100	44,500	85,600	98,000

Budgeted saving from third-party transport services if lorry IS purchased

	€ 2021	€ 2022	€ 2023	€ 2024
Third-party transport expense all allowable for tax purposes	45,000	55,000	98,000	115,000

Your tax partner has asked you to prepare a memorandum of the tax effect ONLY of this investment. The information from your memorandum will be used as detail to be included in the wider advice to Andreas on this proposed investment.

Required:

Prepare a memorandum for your tax partner in which you compute the overall tax effect on Pare Ltd for the years 2021 to 2024.

Your memorandum should include a comparison of the tax effect if the lorry is purchased and the new driver employed; and if there is no purchase of the lorry or employment of the driver.

Your memorandum should also summarise and explain your calculations and, where necessary, state any assumptions you make.

Your calculations should include corporation tax, special defence contribution (SDC), social insurance and other employer contributions.

The following marks are available:

- (i) Corporation tax.** (15 marks)
- (ii) Special defence contribution (SDC).** (11 marks)
- (iii) Other taxes.** (5 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 letter was received from Helen requesting your advice:

I was born in Cyprus in 1963. I emigrated to Farland in 1983 where I still live today. Since I emigrated, I have only visited Cyprus for holidays and have never spent more than three weeks in Cyprus in any year.

I have recently inherited an office building, situated in Cyprus, from my father who was born in Cyprus and was tax resident in Cyprus all his life, until he passed away a few months ago. The office building was built in 1973 and was empty for many years. I have decided to rent it out for €44,000 per year, payable annually in January in advance. I have had a lot of interest from a number of businesses.

I retired two years ago and earn a pension of €1,500 per month from social services in Farland where tax is deducted at source. I earn rental income of €10,000 per year from an apartment I own in Farland, and I also earn interest on some deposits I have with Farland banks. Currently I do not have any income from Cyprus.

My tax advisers in Farland explained to me that my rental income from the office building in Cyprus will be taxable in Farland at the rate of 10% on the gross rent. Farland does not have a double tax treaty with Cyprus.

Required:

Explain all the various Cyprus tax implications for Helen of renting the office building whilst she remains tax resident in Farland. Include an estimate of the taxes she will need to pay on an annual basis, making reference to income declaration and tax payment deadlines, as well as any options available to her.

Without making any tax calculations, discuss how Helen's current tax position will change if she permanently moves to Cyprus, assuming that she continues to receive all her income from both Farland and Cyprus.

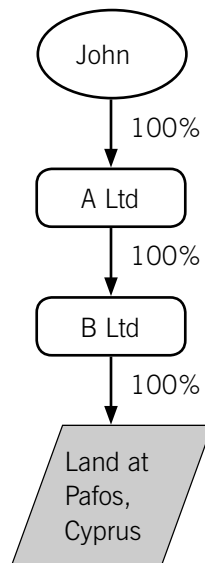
The following marks are available:

- (i) Personal income tax.** (14 marks)
- (ii) VAT.** (6 marks)
- (iii) Special defence contribution and other taxes.** (5 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

- 3 All the shares of A Ltd belong to John, a Cyprus tax resident and domiciled individual. A Ltd owns all the shares of B Ltd, and B Ltd owns a piece of land in Pafos, Cyprus. The following is a graphical representation of the ownership structure:



The following information was noted during a meeting with John:

1. B Ltd had been involved in the fabrication of aluminium profiles until recently. The land was used for the open storage of the raw materials of the business.
2. John is currently in negotiation with several interested parties to dispose of the land during the current year. The disposal will be taxed under capital gains tax.
3. John has no intention to liquidate A Ltd or B Ltd after the disposal of the land.
4. The current market value of the land is €500,000. It was purchased for €240,000 in December 2008 and land transfer fees of €11,200 were paid on the purchase. It is the only asset held in B Ltd and it appears in the statement of financial position at the total cost of €251,200. All liabilities of B Ltd have been paid in the past.
5. B Ltd had made losses in 2013 and 2014 but was profitable in the years prior to 2013. During 2020, it is expected to have an accounting loss of €5,500, all allowable for tax purposes. It also has €25,700 of tax losses from previous years carried forward to 2020.
6. B Ltd has not sold any other immovable property in the past other than the sale of its factory building last year (year ended 31 December 2019). No capital gains tax was paid on the sale of the factory building as it resulted in a capital loss of €35,000.
7. A Ltd has been a holding company since incorporation with no profit or loss. It was registered 25 years ago to hold the shares of B Ltd. The investment in the shares of B Ltd appears in its statement of financial position at €150,000.

Required:

- (a) **Assuming that the disposal of the land by B Ltd takes place in August 2020 at its market value, explain, with supporting calculations, the overall taxes payable in 2020 and in future years by A Ltd, B Ltd and John.**

Notes:

1. Ignore any VAT implications.
2. The retail price index for capital gains tax purposes in August 2020 will be 224.00. (15 marks)

- (b) **Explain the tax treatment if, alternatively, B Ltd continued to hold the land and A Ltd disposed of its shares in B Ltd for €500,000.** (5 marks)

(20 marks)

- 4 Hrima Ltd is a newly established bank which is tax resident in Cyprus. Since 1 September 2019, Hrima Ltd has provided banking services to local businesses and individuals from luxurious offices which it rents in the centre of Nicosia. Hrima Ltd is not registered for value added tax (VAT) as currently all its supplies are exempt from VAT.

Helen, the finance director of the bank, has sent an email, an extract of which is presented below, asking for advice from your firm.

Extract from Helen's email:

(a) Design services

The marketing department of our bank requested tenders for the supply of design services for our main advertising leaflet which will promote the services of the bank to new customers. After carefully considering all offers, the bank shortlisted three possible suppliers, all offering the service for the same price of €25,000 (twenty-five thousand euros) for the design service:

Cyprus design studio – a studio based in Cyprus

Greek design studio – a studio based in Greece

India design studio – a studio based in India

The Cyprus design studio has clarified, on its offer, that VAT at the rate of 19% is going to be charged on its invoice. The Indian studio, on the other hand, has clarified that no VAT or other extra taxes will be payable in India on its invoice.

All studios will issue their invoice in advance for the whole amount of €25,000 (plus VAT where applicable). A prepayment of 50% will be made on signing the contract for the work and the balance will be payable on completion about three months later.

(b) Import and sale of XPass security devices

As part of our online banking system we will order, from China in bulk, XPass security devices which will plug into the computers of our customers and allow them to access, in a very secure way, and transact on our online banking system. The first bulk order will be for 480 devices and we anticipate that it will take one year to sell all of them before we order a new batch. The cost of each device is €20 ex-works in China before shipment and custom clearing costs. Hrima Ltd will sell these to its customers at the sale price of €50 each. We have confirmed with the Cyprus Tax Department that the sale of these devices is not exempt from VAT, and VAT at 19% should be charged on their sale.

Some members of our board of directors insist that we must register for VAT immediately before we import the devices into Cyprus but I am keen, however, to delay registration for as long as possible. The sales of these devices will form less than 1% of our turnover.

Required:

- (a) Discuss the Cyprus VAT implications for Hrima Ltd on each of the three tenders for the purchase of the design service.** (10 marks)
- (b) Explain the VAT implications on the import and sale of the XPass devices if Hrima Ltd registers for VAT and whether such registration is compulsory.** (10 marks)

Note: Greece is a member of the European Union whereas India and China are not.

(20 marks)

End of Question Paper