Suggested solution

Section A

Question 1

MEMORANDUM

To: Tax manager

From: Tax assistant

Subject: Katerina

Date: 3 June 2026

Following the email from Katerina, the following should be brought to your attention regarding the matters raised:

(a) Sale of Upsell

Income tax implications

Katerina is Cyprus tax resident and therefore the proceeds from the disposal of her self-employment business, Upsell, will be assessed in Cyprus as part of her taxable income. The disposal should be analysed by reference to the separate assets transferred under the agreed contract terms, namely trading goodwill and inventory.

The trading goodwill is treated as a taxable trading receipt for Cyprus income tax purposes. As Katerina incurred an identifiable cost of €100,000 when she acquired the goodwill on setting up Upsell in 2021, only the excess realised on disposal is brought into charge. Accordingly, the amount taxable in her trading income in respect of goodwill is €80,000 (€180,000 proceeds less €100,000 cost). This gain is also within the scope of general healthcare system (GHS) contributions as it forms part of her trading income base.

The inventory disposal is treated as a trading transaction rather than a capital disposal. The inventory is included in the statement of financial position at cost of €150,000 and is sold for €220,000, giving rise to a trading profit of €70,000 which is taxable as part of Katerina's self-employment profits for the year. This profit is likewise included in the GHS base applicable to trading income.

Therefore, for the purposes of the disposal, Katerina's taxable trading income is increased by €80,000 in respect of goodwill and €70,000 in respect of inventory.

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Value added tax (VAT) implications

The sale contract indicates that Sophia will acquire the business comprising trading goodwill (€180,000) and inventory (€220,000) for total consideration of €400,000, with VAT "if applicable". As Upsell was VAT registered on commencement and Sophia will be VAT registered upon acquisition, the default position is that the transfer of the business assets would be within the scope of VAT and VAT would normally be chargeable unless the disposal qualifies for the Cyprus VAT going concern treatment.

The transaction should be structured as a transfer of a going concern (TOGC), so that the transfer is treated outside the scope of VAT and Katerina does not charge output VAT on the €400,000 consideration. This treatment is only supportable if the facts demonstrate that what is transferred is a functioning business (or an identifiable part of a business) capable of being operated by the purchaser, rather than a mere sale of separate assets.

Accordingly, the key conditions which must be satisfied in practice are that the transfer includes the assets necessary to operate Upsell as a business, and that Sophia intends to continue the same trading activity immediately following completion. On the scenario facts, the assets being transferred (goodwill together with inventory) represent the core components of the Upsell trading operation and, provided that Sophia continues the business of selling Upsell clothing rather than acquiring the assets for disposal or private use, the continuity condition should be satisfied.

VAT status is also relevant. Katerina is already VAT registered and Sophia is expected to be VAT registered at the point she acquires the business. This supports TOGC treatment because the purchaser is stepping into the seller's VAT position and will continue making taxable supplies as a VAT-registered trader.

From a compliance perspective, both parties should retain clear documentation that the disposal is of the business as a going concern, including the sale agreement wording, evidence of Sophia's VAT registration, and written notification to the Tax Department where required. In addition, the transaction should not be fragmented in a way which undermines TOGC treatment; the sale should be treated as a single transfer of the operating business rather than separate, standalone disposals of goodwill and inventory.

Finally, given Katerina's intention that Upsell will cease operating as soon as possible, it will be important that any cessation aligns with a transfer to Sophia rather than a period where the business has already stopped and only assets are being sold. If TOGC treatment applies and Katerina ceases trading, she should proceed with the VAT deregistration process within the required timeframe after cessation. If, as a result of the transfer, Katerina ceases trading, she must notify the Commissioner of Taxation accordingly within 60 days of cessation of trading by submitting an application for cancellation of VAT registration using form VAT 204.

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(b) Future plans for Happy Happenings Ltd (Happy)

Option 1: Branch/permanent establishment

Katerina's proposal is that a Cyprus tax resident company reactivates operations and organises most events in Danceland, potentially through opening a branch there and employing local staff. On these facts, the Danceland presence is intended to be a fixed place of business through which Happy will carry on its event-organising activity, which is consistent with a permanent establishment (PE) in Danceland.

As Happy is Cyprus tax resident, the default position is that its worldwide taxable profits are within Cyprus corporation tax, and shareholder taxation follows through special defence contribution (SDC)/general healthcare system (GHS) on distributions. However, profits attributable to a foreign PE are generally exempt from Cyprus corporation tax, so a Danceland branch would ordinarily allow Happy's Danceland trading profits to fall outside the Cyprus corporation tax charge.

Given that Danceland applies a 5% corporate tax rate, the key issue is whether the Cyprus PE exemption could be denied under the statutory anti-avoidance condition for low-taxed PEs. Under this rule, the PE exemption is not available only where both conditions are met, namely the PE derives more than 50% investment income (or is predominantly investment-asset based) and the foreign tax burden is substantially lower than Cyprus (i.e. 5% is below the "50% of Cyprus" benchmark). On the scenario facts, the branch is described as organising events using employees and local operations, which indicates active trading income rather than investment income. In those circumstances the "investment income" limb would not be satisfied, and therefore the low tax rate in Danceland should not, by itself, disapply the exemption.

The fact that Danceland has no double tax treaty with Cyprus does not prevent Cyprus from granting the PE exemption where the conditions are met, because the exemption is provided by domestic Cyprus law. The absence of a treaty becomes more relevant only if the PE exemption were denied (for example, if the branch later generated mainly passive/investment income), because then the profits would be taxable in Cyprus and relief would need to be considered by reference to Cyprus's unilateral credit mechanisms rather than treaty relief.

Even where the PE profits are exempt from Cyprus corporation tax, the branch would still have practical consequences at group/shareholder level. In particular, the accounting profits of the overseas branch would form part of the overall accounting profits of Happy and would be relevant when considering the company's distributable profits and any deemed distribution considerations under SDC/GHS rules. Therefore, while the branch may remove Cyprus corporation tax on the Danceland trading profits, it does not automatically eliminate all Cyprus tax consequences connected with profit extraction or distributions.

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Accordingly, establishing a Danceland branch can achieve the outcome Katerina anticipates (i.e. taxation of active Danceland trading profits at 5% in Danceland with no Cyprus corporation tax on those profits), provided the branch is operated as a genuine trading PE and does not become predominantly investment-income generating. The key ongoing risk is that the exemption position depends on the nature of the branch income and activities, so Happy should monitor the income mix and maintain evidence that the branch represents substantive event-organising operations in Danceland rather than a passive profit-shifting arrangement.

Tutorial note:

The overseas PE will not fall under the provisions of the Controlled Foreign Companies (CFC) rules, as although it is a low-taxed foreign PE accounting profits are below €750,000 (there is no non-trading income).

Option 2: Setting up Joyous Ltd (Joyous) and charging for marketing services

Katerina's other alternative is to incorporate Joyous in Danceland (taxed at 5%) and have it charge Happy for "marketing services" once Happy becomes profitable again, with the intention that profit is shifted and taxed in Danceland rather than in Cyprus. On the facts given, Joyous is expected to have profits in excess of €800,000 with no non-trading income. This indicates a deliberate pricing and profit allocation model rather than a routine support function, and it creates a clear risk of challenge under Cyprus anti-avoidance rules aimed at low-taxed controlled entities.

From a Cyprus perspective, Happy remains a Cyprus tax resident company and is taxed in Cyprus on its taxable profits. If Happy pays material "marketing fees" to Joyous, the immediate Cyprus risk is that the deduction could be challenged if the charges are not arm's length or are not supported by genuine services actually performed in Danceland. This is particularly relevant because the stated commercial rationale is to "pay overall less taxes", which raises scepticism over whether the agreement reflects real value creation. The practical implication is that, if the fees are excessive or unsupported, Cyprus could deny or restrict the deduction in Happy, thereby increasing its Cyprus taxable profits. In addition, the Tax Department may expect contemporaneous documentation of the scope of services, pricing basis and evidence of performance.

Separately, the proposal also creates a potential CFC exposure. A CFC arises where a Cyprus resident company controls a low-taxed foreign company, and Cyprus can impose a charge by bringing undistributed profits into the Cyprus tax base where conditions are met. Danceland's 5% rate is substantially lower than Cyprus' effective corporate tax burden, meaning the "low-taxed" condition is likely to be met. On the scenario expectations, accounting profits of Joyous are anticipated to exceed €750,000 with no non-trading income, which is consistent with the conditions which trigger a Cyprus CFC charge. Consequently, if Joyous is controlled by Happy and the arrangement lacks genuine economic substance, Cyprus could attribute all or part of the subsidiary's undistributed profits to Happy and tax them in Cyprus as an additional CFC charge.

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If a Cyprus CFC charge arises, relief should be considered for foreign tax suffered by Joyous in Danceland (5%) to mitigate double taxation.

Given the limited facts, further information is required before concluding whether the charges are commercially supportable and whether the arrangement would be regarded as non-genuine. In particular, the draft service agreement should be reviewed to confirm the precise services, deliverables, pricing mechanism and termination rights; the level of people, functions and decision-making in Danceland should be established to determine whether Joyous has substance consistent with the profit allocated to it; and it should be clarified whether Happy could realistically procure the same services from independent providers at comparable cost. Without this evidence, the proposal remains high-risk as it appears designed primarily to divert profits to a low-tax jurisdiction.

Tutorial note:

The kind of agreement which is mentioned, between Happy and Joyous, would be classified as a non-genuine agreement between the parties, and it is apparent that it is in place to gain a tax advantage.

(c) Liquidation of Happy

The tax cost of "closing the company" is determined by the final distributable position on liquidation rather than by the current-year result in isolation.

Happy's year-end position changes materially once the final event and the office disposal are brought into the 2026 results, because neither has been reflected in the draft profit or loss account. The November event would generate a net profit of €16,262 and the office disposal would produce an accounting profit of €75,000 (sale proceeds €160,000 less carrying value €85,000). When these items are incorporated, the revised accounting profit for 2026 becomes €86,262.

Revised accounting profit:	**€**
Net accounting loss	(5,000)
Final event profit	16,262
Profit on disposal of office (€160,000 - €85,000)	75,000
Revised accounting profit	**86,262**

For capital gains tax, the office disposal would give rise to a chargeable gain because Happy is disposing of Cyprus immovable property. The office was acquired in March 2022 via an exchange with a plot and, applying the roll-over relief mechanism in the exchange, the office's readjusted cost for CGT purposes is €60,000. Indexation is applied to that readjusted cost using the indexation factor provided, giving indexation of €5,443 and therefore a chargeable gain of €94,557. Capital gains tax at 20% is €18,991 and is payable by the company on the disposal.

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Capital gains tax – disposal of the office:	**€**
Selling price	160,000
Less:	
Base cost (€100,000 - €40,000)	(60,000)
Indexation [(259.24/237.68) x €60,000] - €60,000	(5,443)
Capital gain	**94,557**
Capital gains x 20%	18,911

Exchange of office with plot:	**Plot**
	€
Market value	90,000
Less: Indexed costs (given)	(50,000)
Capital gain	**40,000**
Less: Roll-over-relief	(40,000)
Chargeable gain	**0**
Readjusted value of office (€100,000 - €40,000)	60,000

The corporation tax computation removes the €75,000 accounting disposal profit and replaces it with the capital allowances balancing adjustment so that relief is given only for allowances actually claimed. On the office, allowances of 3% for three years amount to €9,000 on a cost of €100,000, giving a tax written down value of €91,000. As the proceeds exceed the written down value, the balancing charge is restricted to allowances claimed, so €9,000 is brought into taxable income. The taxable income for 2026 is therefore €20,262 and corporation tax at 12.5% is €2,533 and considering also the additional 10% corporation tax surcharge, a further €253, total corporation tax payable is €2,786.

Tax computation – Happy Happenings Ltd	**€**
Revised accounting profit:	86,262
Add: disallowed expenses:	
Depreciation	0
Less:	
Profit on disposal – (€160,000 - €85,000)	(75,000)
Add:	
Balancing charge (see below)	9,000
Taxable income	**20,262**
Corporation tax – 12.5%	2,533
Add: 10% additional tax – Corporation Tax at 10%	253
Total corporation tax payable	**2,786**

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Balancing statement:	**€**
Cost of office	100,000
Capital allowances (CA) – 3 yrs x 3%	(9,000)
TWDV	**91,000**
Sale proceeds	160,000
Balancing charge – restricted to CA claimed	9,000

Liquidation is not confined to distributing the "current year" profit; it releases the company's distributable reserves, including retained distributable profits from prior years. The distributable profits for 2026 are calculated from the revised accounting profit of €86,262, after deducting corporation tax of €2,786 and capital gains tax of €18,911, leaving €64,565. In addition, Happy has accumulated distributable profits brought forward from prior years of €89,000. Accordingly, total distributable profits available on liquidation are €153,565**.**

(d) Katerina's personal tax position

For 2026, Upsell's accounting profit for the period to 31 May 2026 is €50,000 and must be adjusted to reflect the disposal of the business assets. As per (a) above, an amount of €80,000 must also be included for goodwill and €70,000 for inventory.

Revised accounting profit:	**€**
Net accounting profit	50,000
Add: Profit on goodwill disposal	80,000
Add: Profit on disposal of inventory	70,000
Revised accounting profit	**200,000**

In arriving at taxable trading profit, non-deductible/private items must be adjusted. Katerina's "salary" is drawings and is added back. Entertainment is restricted to the lower of 1% of turnover and €17,086. Using the turnover implied in the financial information, 1% is €2,889 ([€130,000/0.45]*1%), therefore €7,111 is disallowed from the €10,000 entertainment expense. The goods taken out by Katerina are not a deductible business expense for tax, so the cost of €12,500 is added back through the adjustment process in order to arrive at the correct taxable trading profit. On the scenario figures, this results in a taxable trading profit of €259,611 for 2026.

Taxable trading profit:	**€**	**€**
Revised accounting profit		200,000
Add: disallowed expenses		
Depreciation	0	
Katerina salary	40,000	

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Entertaining customers – Lower of €288,889 x 1% = €2,889 and €17,086, therefore adjustment = €10,000 - €2,889 = €7,111	7,111	
Cost of items taken by Katerina	12,500	
		59,611
Taxable trading profit		**259,611**

Her other income for 2026 comprises dividend income arising from the extraction of value from Happy Happenings Ltd on liquidation, an overseas pension of €20,000, a Cyprus pension of €12,000 and fixed deposit interest of €4,500 (being €200,000 at 4.5% for six months from July to December 2026).

For income tax purposes, dividend income and bank deposit interest are exempt from income tax, so they are removed from the income tax base even though they remain relevant for SDC and/or GHS. Accordingly, total income of €449,676 is reduced by exempt dividend income of €153,565 and exempt interest income of €4,500, giving net income for income tax purposes of €291,611 before allowances.

GHS contributions for 2026 arise on each relevant income category and must be reflected in the overall personal tax position. On the scenario basis, GHS on employment/trading-type income is capped, giving €7,200 (4% on the €180,000 ceiling), GHS on dividends is €4,069 (2.65% on €153,565), GHS on pensions is €848 (2.65% on €32,000) and GHS on interest is €119 (2.65% on €4,500), giving total GHS of €12,236. These amounts are then reflected in the computation as allowable deductions/adjustments in arriving at taxable income of €279,375.

Income tax is then computed by taxing the overseas pension under the special pension basis and taxing the remainder under the normal personal income tax bands. On the scenario computation this results in income tax payable of €88,495.

SDC is then considered separately, because dividends and interest are not subject to income tax but can still attract SDC. The liquidation distribution/dividend amount of €153,565 gives rise to SDC of €26,106 at 17%, and the fixed deposit interest of €4,500 gives rise to SDC of €765 at 17%, giving total SDC payable of €26,871.

Income tax – Katerina	**€**	**€**
Income:		
Taxable trading profit	259,611	
Dividend income	153,565	
Overseas pension	20,000	
Pension from Cyprus	12,000	
Interest income (€200,000 x 4.5% x ½)	4,500	
Income before deductions and allowances		**449,676**
Less: Dividend income (exempt)	(153,565)	

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Less: Interest income (exempt)	(4,500)	(158,065)
Net Income after deductions		**291,611**
Less: Allowances		
GHS contributions on taxable income (€180,000 x 4%)	(7,200)	
GHS contributions on dividend income (€153,565 x 2.65%)	(4,069)	
GHS contributions on pensions (€32,000 x 2.65%)	(848)	
GHS contributions on interest income (€4,500 x 2.65%)	(119)	(12,236)
No restriction as total allowances below 1/5 of Net Income		-
Taxable income		**279,375**
Income tax payable	**€**	**€**
Overseas pension tax		
Up to €3,420	0	
€3,420 - €20,000 x 5%	829	829
Remainder of income		
0 – 19,500 x 0%	0	
19,500 – 28,000 x 20%	1,700	
28,000 – 36,300 x 25%	2,075	
36,300 – 60,000 x 30%	7,110	
60,000 – 279,375 x 35%	76,781	87,666
Tax payable by Katerina		**88,495**

Tutorial note:
No adjustment has been made to the income tax computation for the GHS ceiling, since excess GHS above €180,000 is refundable separately under the GHS rules. An alternative presentation would be to cap GHS within the computation workings, which is also acceptable if clearly shown.

SDC payable:		**€**
SDC on dividends (€153,565 x 17%)		26,106
SDC on interest income (€4,500 x 17%)		765
		26,871

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Section B

Question 2

(a) Zoe

Cyprus tax residency

Zoe will not satisfy the Cyprus 183-day residence test in 2026 under either commencement scenario because she will only relocate to Cyprus during June or July 2026 and will also spend October, November and December working in Farland. The relevant issue is therefore whether she can qualify as a Cyprus tax resident under the 60-day rule instead. For the 60-day rule to apply, Zoe must be present in Cyprus for at least 60 days in 2026, must not be present in any other single country for more than 183 days in the same year, must not be tax resident in any other country in 2026, must carry on employment, business or hold an office in Cyprus during the year, and must maintain a permanent residence in Cyprus. In Zoe's case, several of these conditions are already met because she has rented an apartment in Limassol and will be employed by Fortuitous Ltd (Fortuitous) in Cyprus.

If Zoe relocates to Cyprus around 10 June 2026 and commences employment on 15 June 2026, she can qualify as a Cyprus tax resident under the 60-day rule. Zoe was outside Farland from 1 January 2026 to 20 March 2026 and has remained there only since returning on 21 March 2026. As a result, if she departs on 10 June 2026 and then returns to Farland for October, November and December, her total presence in Farland for 2026 will not exceed 183 days, it will only be 173 days. Since she will also have a permanent residence in Cyprus, Cyprus employment, and more than 60 days' presence in Cyprus by the end of the year, she will satisfy the Cyprus 60-day rule and will therefore be treated as Cyprus tax resident for 2026.

If, instead, Zoe relocates to Cyprus around 10 July 2026 and commences employment on 15 July 2026, the conclusion changes. On those facts, her period of presence in Farland before departure is longer and, once the October to December assignment is added, her total presence in Farland during 2026 will exceed 183 days, it will be 203 days. She would therefore be tax resident in Farland for 2026 and would fail the Cyprus 60-day rule condition that she must not be tax resident in another country during the same tax year. Accordingly, under the later commencement scenario, Zoe would not be Cyprus tax resident in 2026.

Therefore, the earlier commencement date of 15 June 2026 allows Zoe to qualify as Cyprus tax resident under the 60-day rule, whereas the later commencement date of 15 July 2026 does not.

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Income tax exemptions

Assuming Zoe is Cyprus tax resident for 2026, the starting point is that her employment income is within the Cyprus income tax net unless a specific statutory exemption applies. In this scenario, the two exemptions which are potentially relevant are the employment income exemption under article 8(23A) for high-remuneration first employment in Cyprus, and the 90-day overseas employment exemption for qualifying employment exercised outside Cyprus.

In relation to the duties performed in Cyprus for Fortuitous, the most commercially significant relief is article 8(23A). Zoe's employment contract provides for monthly remuneration of €7,500 while working in Cyprus. Although the contract anticipates that she will only work in Cyprus for a maximum of nine months per calendar year, the exemption focuses on the remuneration level of the qualifying employment and whether the remuneration exceeds the €55,000 threshold in the first 12 months from commencement. On the facts, her contractual remuneration exceeds €55,000, and she will be commencing employment in Cyprus for the first time, having not previously been Cyprus tax resident nor previously worked in Cyprus. Therefore, the Cyprus employment is capable of meeting the conditions of article 8(23A) and, if claimed, would provide a substantial exemption on the qualifying Cyprus employment income for up to 17 years, subject to the continuing remuneration condition in each relevant year.

For the overseas duties performed in Farland, the 90-day exemption is potentially relevant because Zoe will be working outside Cyprus for at least 90 days during the calendar year. However, the exemption does not depend only on the day-count condition. It also requires that the overseas duties are exercised for a non-Cyprus resident employer or for a foreign permanent establishment of a Cyprus-resident employer. Here, the scenario states that the duties will be performed at Fortuitous' branch in Farland and describes that branch as a fully-fledged trading branch carrying out exclusively trading activities. This supports the view that the Farland branch constitutes a foreign permanent establishment of Fortuitous Ltd, so the employer condition for the exemption can be satisfied. Provided the employment duties exercised outside Cyprus genuinely exceed 90 days in 2026, the Farland branch remuneration would therefore be exempt from Cyprus income tax.

Tutorial note:

Although the exemption as per the article 8(21) is available for Zoe this is not considered the most beneficial option, as it grants a lower amount of exemption to her employment income, and is only available for the year following 2026 (i.e. for the year 2027).

(b) Fortuitous Ltd's corporation tax - adjustments to accounting profit

Fortuitous Ltd's projected accounting profit for 2026 of €590,000 must be adjusted to reflect the incremental cost of employing and deploying Zoe under the terms described.

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A time apportionment assumption is required because she is assumed to commence on 15 June 2026, therefore her Cyprus employment period is for three and a half months.

Accordingly, the Cyprus salary cost recognised in 2026 is €26,250 (3.5 × €7,500). Employer social insurance and GHS contributions arising on this Cyprus payroll cost are also reflected as an additional employment cost of €3,429. The motor vehicle benefit creates a personal tax charge for Zoe, but the company must still recognise the running costs of providing the vehicle; based on the scenario assumption of 15% of cost and the same time basis, the 2026 cost is €1,313.

The Farland assignment is carried out through a branch of the same Cyprus tax resident company, so the branch profit included in the projection must be reduced for the incremental Farland remuneration. The scenario basis is €9,000 per month for three months (October–December), giving a reduction of €27,000.

	€	€
Projected accounting profit for the year:		590,000
Private motor vehicle expenses (€30,000 x 15% x 3 .5/12 months)	(1,313)	
Salary of Zoe in Cyprus (3 ½ x €7,500)	(26,250)	
Employer contributions for Zoe {€3,750 x (8.8% + 2.9% + 2% + 1.2% + 0.5%)} + (€5,551 x 10.5% x 3) + (€7,500 x 4.9% x 3)	(3,429)	
Overseas branch result effect (€9,000 x 3 months)	(27,000)	(57,992)
Revised accounting profit for Fortuitous		**532,008**

(b) Impact of employing Zoe on Fortuitous' corporation tax position

The starting point for Fortuitous' corporation tax computation is the revised accounting profit from part (a) of €532,008. From this figure, only the tax adjustments arising from Zoe's package are required, because the scenario states that the remaining depreciation charge equals the capital allowances for the year and therefore does not create a net adjustment.

The private motor vehicle provided to Zoe creates two corporation tax adjustments. Firstly, accounting depreciation on a private motor vehicle is not deductible for corporation tax purposes, therefore the depreciation on the car (20% × €30,000 = €6,000) is added back. Secondly, the interest restriction on private motor vehicles applies, so the finance cost is restricted to €750 (2.5% × €30,000), which is also added back as disallowed. These adjustments increase taxable profits because they represent statutory limits on tax relief for private motor vehicles even where the costs are commercially incurred.

The benefit in kind arising on the private motor vehicle (PMV) is taxed on Zoe personally, but the corresponding amount is allowed as a deduction in the company's corporation

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tax computation so that the package is not taxed twice in economic terms. The benefit in kind is calculated at €3,900 for a full year and is time-apportioned for the period the car is made available in 2026; the resulting deductible amount is €1,138. After these adjustments, Fortuitous' taxable income for 2026 is €537,620 and corporation tax at 12.5% is €67,203.

Because the scenario states that Fortuitous distributes all available distributable profits each year, the shareholder consequences must then be determined from the post-corporation-tax distributable profits. Distributable profits are €464,805. On distribution, SDC at 17% is €79,017. GHS on dividends is charged at 2.65% but is subject to a contribution cap; applying the cap produces GHS of €4,770.

Fortuitous – tax computation for the year 2026	**€**	**€**
Revised accounting profit per (b):		532,008
Add: disallowed expenses:		
Depreciation for private motor vehicle (20% x 30,000)	6,000	
Restriction of interest on PMV (30,000 x 2.5%)	750	6,750
Deduct:		
Effect of benefit in kind (BIK) taxed on Zoe (working below)	(1,138)	(1,138)
Taxable income		**537,620**
Corporation tax – 12.5%		**67,203**

BIK calculation relating to PMV to Zoe:	**€**	**€**
Cost of PMV	30,000	
Value of car use	17%	5,100
Repairs and maintenance	4%	1,200
Fuel	5%	1,500
Total of above		**7,800**
BIK calculation according to value of PMV	50%	3,900
Time apportioned	3.5/12	1,138

Dividend taxes relating to year 2026:	**€**	**€**
Revised accounting profit		532,008
Less:		
Corporation tax		(67,203)
Distributable profits		464,805
SDC – 17%		**79,017**
GHS – 2.65% capped at €180,000		**4,770**

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Question 3

(a) VAT group

In accordance with the legislation, group VAT registration is available where one company controls the others in the group or one person controls all of them. 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. The group registration, however, is restricted to companies incorporated in Cyprus and/or which have a place of establishment in Cyprus.

The proposed structure places the exempt tuition fee activity in Teachright Edu Ltd (Edu) and the taxable cafeteria activity in Teachright Café Ltd (Café), with Edu owning Café. This ownership structure permits the companies to consider VAT group registration, which would allow the group to submit a single VAT return through a nominated representative member and treat supplies between group members as outside the scope of VAT for VAT accounting purposes.

The principal advantage of VAT grouping in this scenario is administrative and cashflow efficiency. A single VAT return is prepared for the group and only the net VAT position is paid or refunded. This is particularly relevant here because the group's operations include significant taxable inputs (printing/courier and cafeteria purchases at 19%) alongside exempt education income, so offsetting input VAT across the group in one return may reduce timing mismatches which could arise if the companies reported separately. VAT grouping also removes the need to account for VAT on intra-group charges, which can simplify internal recharges (for example, if functions were later centralised).

However, VAT grouping creates a material disadvantage for the group because it aggregates the activities of both companies for partial exemption purposes. Edu generates largely exempt income (tuition fees), while Café generates taxable turnover (cafeteria at 9%). If the newsletter is operated by Edu (as assumed in part (c)), Edu will also have taxable turnover, but this remains small relative to exempt tuition fees. When the entities are grouped, any residual/non-attributable input VAT on overheads must be apportioned across the VAT group's total supplies and the partial exemption/de minimis tests are applied at group level rather than entity level. This can reduce recoverability of VAT on overhead costs compared to a structure where the taxable entity is insulated from exempt turnover.

A further drawback is that (under VAT grouping) group members are typically jointly responsible for the VAT obligations of the group, and the representative member bears the compliance burden of compiling data across both entities. Given that the group

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operates in two cities and expects each location and department to be capable of operating independently, the practical administration of a single VAT return may become more complex and create a control risk if information flows are not robust.

Accordingly, VAT group reporting is available and may be attractive for simplification and netting, but it must be evaluated against the likely partial exemption impact, given the dominance of exempt tuition fees within the combined turnover. The decision therefore turns on whether the compliance benefits and any netting advantages outweigh the potential loss of input VAT recovery on overheads when the group is treated as a single partially exempt taxable person.

(b) Tax compliance obligations

Both companies will lease premises in Cyprus, and, as tenants, their obligations are not limited to the accounting recognition of rental expense. The tax treatment depends on whether the landlord is an individual or a company, whether the lease is treated as a VAT-able lease, and whether a written lease agreement exists, which triggers stamp duty.

Where the landlord is a Cyprus tax resident individual (or a non-resident individual receiving Cyprus-sourced rent), the tenant has a statutory obligation to operate withholding on the rental payments. Specifically, special defence contribution (SDC) is withheld at 3% on 75% of the gross rent, and general healthcare system (GHS) contributions are also withheld at 2.65% on the gross rent, with the tenant remitting the withheld amounts to the Tax Department on the prescribed semi-annual payment dates. The practical effect is that the landlord receives the net rent, and the tenant must ensure its systems track rent paid per contract period and apply the correct withholding basis.

If, however, the landlord is a company, the withholding profile changes: the tenant's obligation is limited to withholding SDC on rents where applicable, and GHS withholding is not operated in the same way as for individual landlords. The tenant must therefore identify the landlord type at the outset and retain supporting evidence (e.g., landlord legal form and tax status) because this directly determines whether GHS withholding is required.

VAT on rent is also dependent on the VAT status and the nature of the tenant's activities. The scenario assumes both companies are VAT registered, but the VAT treatment of rental expense differs in substance because Edu supplies largely VAT-exempt education services, whereas Café makes taxable supplies (cafeteria sales at 9%). This distinction is important in light of the 90/10 rule or equivalent recovery restriction concept applied in practice to the VAT treatment of commercial rent. In broad terms, VAT on commercial rent is generally relevant only where the tenant carries out predominantly taxable activities. As a result, rent charged with VAT is commercially more "neutral" for Café because any VAT charged at 19% is generally recoverable as input VAT to the extent it relates to taxable supplies. By contrast, Edu would not normally satisfy the 90/10

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threshold because its activities are mainly exempt. Therefore, VAT would generally not be chargeable on Edu's rent and, even if VAT were charged, it would tend to represent a real cost because input VAT recovery is constrained by the exempt nature of its outputs.

The position is further affected by the decision on where the newsletter activity sits. If the newsletter activity (taxable at 3%) is housed in Edu, the company will have a mix of exempt tuition fee income and taxable newsletter supplies. This raises partial exemption considerations and can allow some input VAT recovery only to the extent permitted under the partial exemption and de-minimis framework, rather than full recovery. However, the existence of some taxable supplies from the newsletter would not in itself mean that Edu meets the 90/10 threshold for taxable use, so VAT on rent may still remain outside the recoverable input VAT base or become a real cost in practice. In contrast, if the newsletter activity is placed within Café, the taxable entity's VAT recovery position is typically stronger and VAT on rent would be more likely to be fully recoverable, which can be important given rent is expected to be a recurring and material cost in each location. Accordingly, the group's internal allocation decision on the newsletter is not only operational; it directly affects whether VAT on rent becomes a cost for the education entity.

Finally, stamp duty is relevant because Cyprus stamp duty is imposed on written documents relating to matters taking place in Cyprus, which includes lease agreements for Cypriot premises. Therefore, each written rental contract entered into by Edu and Café should be assessed for stamp duty at the applicable rates by reference to the contract value, subject to the statutory cap.

(c) Projected VAT payable/receivable for the first quarter

The VAT group's quarterly position is determined by aggregating taxable outputs and recoverable inputs across both companies, while recognising that the VAT group is partially exempt because the dominant supply is VAT-exempt tuition fees from Edu, alongside taxable cafeteria sales (9%) and taxable newsletter sales (3%). Consequently, input VAT must be separated into directly attributable input VAT (fully recoverable if attributable to taxable supplies) and non-attributable overhead input VAT, which is recoverable only to the extent permitted under the de-minimis/partial exemption rules.

On the output side, tuition fees of €250,000 are exempt and therefore generate no output VAT. Cafeteria sales of €150,000 at 9% produce output VAT of €12,385 and the Cyprus newsletter sales of €20,000 at 3% produce output VAT of €583. Total VAT output for the quarter is therefore €12,968.

On the input side, the group incurs standard-rated VAT on the Café-related costs and the newsletter costs, which are directly attributable to taxable supplies and therefore recoverable. This includes input VAT on purchases of food and drinks (€11,176), cafeteria rent where VAT is charged (€2,395), cafeteria utilities (€958) and newsletter costs

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(€3,193). In addition, Edu's overhead VAT of €798 is treated as non-attributable because it cannot be directly allocated between exempt tuition fees and taxable newsletter income and therefore falls within the partial exemption computation.

Additionally, regarding VAT on rental expense for Edu, under the Cyprus VAT treatment of commercial rent, VAT is generally relevant only where the tenant carries out predominantly taxable activities, often expressed through the 90/10 rule or an equivalent VAT recovery restriction concept. Since Edu derives mainly exempt tuition income, it would not satisfy that threshold. As a result, VAT would generally not be charged on its rent.

The partial exemption ratio is calculated by comparing taxable supplies of €170,000 with total supplies of €420,000, giving a recovery percentage of 40% when rounded. Applying this percentage to the non-attributable overhead VAT of €798 gives an initially recoverable amount of €319 and an initially irrecoverable amount of €479. However, this amount is less than 50% of the total input VAT of the group and is also less than €171 per month on average, which is €513 for the three-month quarter. Accordingly, the de-minimis condition is satisfied for the quarter and the effect is that the whole amount of the non-attributable VAT of €798 becomes recoverable, rather than only €319.

Therefore, the total recoverable input VAT for the quarter is €18,520, being directly attributable recoverable VAT of €17,722 plus non-attributable overhead VAT of €798. After offsetting this against total output VAT of €12,968, the VAT group is in a net refundable position of €5,552 for the first quarter.

A further practical implication is that the de-minimis test is not purely a quarterly compliance exercise. The final position must still be reviewed at the end of the partial exemption year using the annual adjustment, so the quarterly recovery remains provisional and may be revisited if the annual de-minimis limits are not ultimately met.

Income	**Gross amount**	**Rate**	**VAT output**
	€		**€**
Tuition fees	250,000	Exempt	-
Cafeteria sales	150,000	9%	12,385
Newsletter	20,000	3%	583
Total VAT output			**12,968**
Expenses	**Gross amount**	**Rate**	**VAT input**
	€		**€**
Rental expense – Edu	15,000	Exempt/no VAT charged	-
Rental expense – Café	15,000	19%	2,395
Newsletter costs	20,000	19%	3,193

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Purchases of food and drinks	70,000	19%	11,176
General overheads - Edu	5,000	See notes	798
General overheads - Café	6,000	19%	958
Total VAT input			**18,520**
VAT recoverable			**(5,552)**

Calculation of ratio	**Supplies**	**Attributable**
	€	**€**
Reduced rate supplies	170,000	17,722
Exempt supplies	250,000	-
	420,000	**17,722**
Ratio of reduced rate/total supplies	40%	
Allocation to not attributable		**Recoverable**
	€	**€**
Overheads not attributable	5,000	
VAT on overheads not attributable (€5,000/1.19 x 0.19 = €798, and applying the ratio per above)	479	319

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Mark scheme

Question 1

(a) Sale of Upsell

Income tax treatment	5
VAT implications	5

Maximum 8 marks

(b) Future plans for Happy Happenings Ltd (Happy)

Branch/permanent establishment (PE)	6
Set up Joyous Ltd	5

Maximum 10 marks

(c) Liquidation of Happy

Consequences	1
Capital gains tax calculations	5
Corporation tax computation	4

Maximum 10 marks

(d) Katerina's personal tax position

Trading profit calculations	3
Tax calculations	6
Supporting advice	3

Maximum 12 marks

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Professional skills marks:

Communication

General report format and structure (use of headings, sub-headings and an introduction)

Style, language and clarity (tone of report response, presentation of calculations, appropriate use of the tools, easy to follow and substantive amount of content)

Analysis and evaluation

Logical and structured approach taken in relation to the sale of Upsell

Comprehensive assessment of Katerina's personal tax position including appropriate numerical analysis

Commercial Acumen

Future plans for Happy Happenings Ltd considers relevant and valid commercial matters

Scepticism

Evaluation of the liquidation of Happy Happenings Ltd clearly justifies, with evidence, Katerina's decision and its impact

Maximum 10 marks

Total 50 marks

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Question 2

(a) Zoe

Residency	4
Income tax exemptions	4

Maximum 7 marks

(b) Accounting profit for the year ended 31 December 2026

Adjustments	4

Maximum 4 marks

(c) Corporation tax for the 2026 year of assessment

Approach	2
Calculations	4
Private motor vehicles treatment	3

Maximum 9 marks

Professional skills marks:

Analysis and evaluation

Structured and logical approach taken to Zoe's residence status and its impact

Clear, logical and systematic approach to the evaluation of Zoe's employment on the company's corporate tax position with appropriate numerical analysis

Commercial acumen

Assessment of Fortuitous Ltd's adjustments to projected accounting profit clearly addresses the impact to the company

Maximum 5 marks

Total 25 marks

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Question 3

(a) VAT group

Conditions and restrictions	3
Advantages/disadvantages	4

Maximum 7 marks

(b) Compliance obligations

Company landlord v individual landlord	4
Relevance of VAT status of tenant	1
Effect of newsletter activity	2
Stamp duty	1

Maximum 7 marks

(c) VAT payable/receivable

Calculations	6

Maximum 6 marks

Professional skills marks:

Analysis and evaluation

Structured and logical approach taken to the evaluation of group VAT registration

Evaluation of Teachright group's projected VAT payable/receivable is comprehensive and includes supporting calculations

Commercial acumen

Advice supplied in relation to Cyprus tax compliance obligations addresses relevant and valid commercial points.

Maximum 5 marks

Total 25 marks

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