Answers

1 TK Holdings Ltd

Briefing notes for meeting with Mr Takis

To: Tax partner
From: Tax assistant
Date: 7 November 2016

(i) Capital gains tax and corporation tax payable by TK Holdings Ltd (TKH) for 2016 if the proposed sales of immovable property take place in December 2016 and are taxed under capital gains

In this case no corporation tax will be payable on the profit made on the sale of the immovable properties.

Detailed calculations of the estimated capital gains tax payable are shown in Schedules A and B. Regarding these calculations the following should be noted:

- No indexation is allowed on the land transfer fees, indexation is allowed only on the cost of the respective properties.
- In the case of the land, indexation on the cost of the fencing is calculated from the relevant month in which this expenditure was made.
- The capital gains calculation for the flat results in a loss and this can be deducted from the capital gain made on the sale of the land.

Detailed calculations of the corporation tax payable is shown in Schedule C. Regarding this schedule, the following should be noted:

- Dividends and interest are exempt from corporation tax and are therefore deducted from the taxable profits.
- No capital allowances can be claimed on the flat for 2016 as it is to be sold before the end of that year.
- Capital allowances claimed in the case of the flat are not deducted from purchase cost for capital gains tax purposes but they will result in a balancing addition for corporation tax purposes.
- As the building in question consists of a flat, it falls under the category of other buildings for capital allowances purposes. The legislation prescribes that the period of use of such a building is 33 years and the allowances are given on the original cost of construction of the building, excluding the cost of land. As the building was bought from a developer, the cost of construction includes his profit on the building and a proportion of any land transfer fees which the developer incurred. The capital allowances claimed on the flat are as calculated in Schedule D.

(ii) Corporation tax payable by TKH for 2016 if the proposed sales of immovable property take place in December 2016 and are taxed as trading income

Detailed calculations of the estimated corporation tax payable are shown in Schedule E. Regarding this schedule, the following should be noted:

- The profit on the sale of the flat equals the sale proceeds less the tax written down value of the building as computed in Schedule D (see above) and the original transfer fees.
- The profit on the sale of the land is simply the sale proceeds less the costs of acquisition and fencing and the land transfer fees. It has been assumed that no capital allowances have been claimed on the fencing.
- No indexation is allowed in the case of corporation tax.

(iii) Minimum dividend payable out of TKH's 2016 profits in order to avoid a deemed distribution

Detailed calculations of the minimum dividend and resulting special defence contribution (SDC) payable if the immovable property sale transactions are taxed under capital gains are shown in Schedule F. Regarding this schedule, the following should be noted:

- The accounting profits have been estimated by adjusting Mr Takis's budget.
- The accounting profit on the sale of the flat and the land must be included based on any accounting depreciation claimed and their relevant accounting written down value. The specific calculation for the flat is shown in Schedule G.

Detailed calculations of the minimum dividend and resulting SDC if the immovable property sale transactions are taxed as trading income are shown in Schedule H.

Note: Both schedules start from the same accounting profits – the only difference in the after-tax accounting profits is the corporation tax and capital gains tax payable.

(iv) Issues relevant to the Tax Department's decision on how to tax the immovable property sales

The question to be addressed is whether trading in immovable property was one of the business activities of TKH such that the profits from the sales should be taxed as trading income.

The name of the company includes the word 'holdings' which suggests that TKH holds investments for the long term and is not a trading or property development company.

TKH's memorandum and articles state that the objects of the company include investment in immovable property, giving an indication of long-term investments held for capital appreciation rather than for trading. The financial statements of the company also state this as one of the main businesses of TKH.

The fact that no other sale transaction has been made since TKH's incorporation, i.e. for 34 years, and that the two immovable properties have also been held for a lengthy period, i.e. 23 years and 15 years respectively, supports the view of holding and not trading in property investments.

Mr Takis, the sole director of the company, is an accountant, a profession unrelated to trading in immovable property.

There is no evidence of TKH actively trying to sell the property. The decision to sell was made because Mr Takis wishes to wind down the company.

The subject matter of the transaction being immovable property means that the Tax Department will be biased towards taxation as a capital gain due to the vast majority of cases and precedent.

The fact that the property was acquired by re-investment of company retained profits and no loans were taken is, again, an indication of long-term investment.

The fact that the land was fenced cannot be considered as an attempt to develop it.

Schedule A – Capital gains on the sale of the flat in Larnaca

	€
Sale proceeds	35,000
Less:	
Indexed purchase cost excluding land transfer fees (24,000 x 218·67/135·27)	(38,797)
Land transfer fees (no indexation)	(1,223)
Loss on disposal	(5,020)

Tutorial note: *The RPI for November 2016 is used as, in practice, the RPI for December 2016 is normally unavailable until the end of the month. It was equally acceptable for candidates to use the RPI for December 2016.*

Schedule B – Capital gains on the sale of land at Pera

	€
Sale proceeds	135,000
Less:	
Indexed purchase cost excluding land transfer fees (22,000 x 218·67/168·78)	(28,503)
Indexed cost of fencing (12,650 x 218·67/210·05)	(13,169)
Land transfer fees (no indexation)	(1,110)
Capital gain on disposal	92,218
Loss on sale of flat	(5,020)
Taxable gain	87,198
Capital gains tax at 20%	17,440

Schedule C – Corporation tax payable for 2016 if the transactions are taxed under capital gains

	€	€
Profit per budget		14,775
Less:		
Dividend (not taxable under corporation tax)	15,000	
Interest (not taxable under corporation tax)	210	
		(15,210)
Add:		
Immovable property tax	260	
Annual company registrar fees	350	
Accounting depreciation	440	
Balancing addition (capital allowances claimed on flat as per Schedule D)	12,420	
		13,470
Taxable profit for 2016		13,035
Corporation tax at 12·5%		1,629

Schedule D – Tax written down value of the flat as at 31 December 2016

	€ Land	€ Building	€ Total
Per developer's books	5,000	15,000	20,000
Appropriation of profit pro-rata costs	1,000	3,000	4,000
Total	6,000	18,000	24,000
Capital allowances claimed to 31 December 2015 (3% for 23 years)	0	(12,420)	(12,420)
Tax written down value of building excluding the cost of land	6,000	5,580	11,580

Schedule E – Corporation tax payable for 2016 if the transactions are taxed as trading income

	€	€
Profit per budget		14,775
Less:		
Dividend (not taxable under corporation tax)	15,000	
Interest (not taxable under corporation tax)	210	
		(15,210)
Add:		
Profit on sale of flat (35,000 – 11,580 (tax written down value as per Schedule D) – 1,223)	22,197	
Profit on sale of land (135,000 – 22,000 – 12,650 – 1,110)	99,240	
Immovable property tax	260	
Company registration fees	350	
Accounting depreciation	440	
		122,487
Taxable profit for 2016		122,052
Corporation tax at 12·5%		15,257

Schedule F – Minimum dividend and special defence contribution (SDC) if the transactions are taxed under capital gains

	€	€
Profit per budget		14,775
Add SDC on bank interest (210 x 30/70)		90
Accounting profit on sale of the flat (as per Schedule G)		19,897
Accounting profit on sale of the land (as per Schedule E)		99,240
Accounting profit before taxes		134,002
Less taxes:		
Capital gains tax payable (as per Schedule B)	17,440	
SDC on interest	90	
Corporation tax (as per Schedule C)	1,629	
		(19,159)
After-tax accounting profits for deemed distribution purposes		114,843
70% thereof		80,390
SDC payable at 17%		13,666

Schedule G – Accounting profit on the sale of the flat in Larnaca

	€	€
Sale proceeds		35,000
Less:		
Purchase cost	24,000	
Transfer fees	1,223	
	25,223	
Less accounting depreciation for 23 years (23 x 440)	(10,120)	
		(15,103)
Accounting profit on sale		19,897

Schedule H – Minimum dividend and SDC if the transactions are taxed as trading income

	€	€
Accounting profit as per Schedule F		134,002
Less taxes:		
SDC on interest	90	
Corporation tax (as per Schedule E)	15,257	
		(15,347)
After-tax accounting profits for deemed distribution purposes		118,655
70% thereof		83,059
SDC payable at 17%		14,120

2 Mr Tsai

(a) Cyprus tax status in 2018

Cyprus tax years are equivalent to calendar years. A physical person is considered a tax resident of Cyprus if he or she is physically present in Cyprus for more than 183 days in total in a specific year. If Mr Tsai moves to Cyprus in April 2018, then he will be physically present in Cyprus for more than 183 days in 2018.

In accordance with the terms of his contract Mr Tsai will travel to Europe. Calculations will need to be made to determine his actual days of physical presence in Cyprus after deducting travelling to Europe, using the special rules for counting days of arrival and departure in order to determine whether he will be over the 183 day threshold in 2018.

Even though Mr Tsai will be considered tax resident in Cyprus for income tax purposes in 2018, he will not be considered domiciled in Cyprus for the purpose of special defence contribution (SDC) as he is not domiciled in Cyprus in accordance with the provisions of the Wills and Succession Law nor has he been resident in Cyprus in accordance with the income tax legislation for at least 17 of the 20 years before 2018.

(b) Cyprus tax implications

(i) Income from contract of employment with SE Cyprus Ltd (SEC)

All income from Mr Tsai's contract with SEC will be considered as Cyprus source income and, as such, will be taxable in Cyprus irrespective of whether he is considered Cyprus tax resident or not.

Salary

Mr Tsai's salary will be subject to income tax in accordance with the normal rates. However, he will be allowed a deduction of 50% of his salary for ten years starting from the first year of his employment because:

- his employment will start after 1 January 2015;
- his annual salary will exceed €100,000 per year;
- he has not been Cyprus tax resident for three (or more) tax years out of the five tax years immediately prior to the tax year in which he commenced his employment nor in the preceding tax year.

Mr Tsai's visits to Cyprus to help set up SEC were too short at circa 35 days, to make him resident in any of the past three years.

Benefits

Benefits given to employees by reason of their employment are taxable. There is no comprehensive tax legislation on the taxation of benefits in kind but the Income Tax Law states that income includes benefits from any office or employment, including the estimated annual value of any quarters or board or residence or any other allowance granted in respect of an office or employment, whether in money or otherwise. Benefits provided to the spouse or children of the employee are treated as if they are provided to the employee.

The provision of the furnished house owned by SEC to Mr Tsai will be taxed at the amount which the house could be rented to a third party, or if there are similar houses rented in the area on the amount of these rents. The fact that the house is owned by SEC and it will not cost SEC anything as Mr Tsai will pay for all utilities is irrelevant.

Similarly, the payment of tuition fees for Mr Tsai's daughter will be a benefit in kind for him, the value of which will be the actual amount paid by SEC.

The lump sum payment of €20,000 is also taxable but Mr Tsai will be able to deduct the actual expenses incurred in relocating to Cyprus in order to start working for SEC.

Share option

The option granted to Mr Tsai will only be taxable if he actually exercises the option and benefits from it. In other words, if on completion of his contract Mr Tsai is entitled to the option and sells or exercises it to acquire SE Investments Group (SEIG) shares and, at the time he exercises the option, the value of the shares is more than €1, then he will be taxed on

the difference between the value of the shares obtained and what he has paid for them. If he simply sells the option, then he will be taxed on the amount obtained for the option.

It is irrelevant that he may exercise the option after the completion of his contract, when he may no longer be resident in Cyprus, as the benefit will be considered as Cyprus source income and so taxable in Cyprus.

Effect of business trips
The remuneration from the rendering outside the Republic of salaried services for a total aggregate period of more than 90 days in the year of assessment to an employer not resident in the Republic or to a permanent establishment outside the Republic of an employer resident in the Republic is exempt from income tax. However, as SEC is a Cyprus tax resident company, Mr Tsai is unlikely to qualify for this exemption unless he spends more than 90 days outside Cyprus rendering services for a permanent establishment of SEC abroad.

(ii) Income from other sources

Director's fees from SEIG in Farland
A Cyprus tax resident is taxable in Cyprus in respect of emoluments from an employment irrespective of where the duties are performed, i.e. on a worldwide basis. As Mr Tsai will be tax resident of Cyprus from 2018 onwards, his income from SEIG in Farland will be taxable in Cyprus even if his duties are performed outside Cyprus.

Interest/dividends/profit from sale of shares
Interest, dividends and profits from the sale of shares are specifically exempt from income tax.

Further, as Mr Tsai is non-domiciled in Cyprus for SDC purposes, he will be exempt from SDC on the interest and dividends he receives irrespective of their source.

Rental income
Mr Tsai's rental income will be taxable in Cyprus as he will be tax resident in Cyprus from 2018.

He will be entitled to the 20% deduction allowed for physical persons. He will also be able to claim capital allowances on the construction cost of the house provided that the property is not more than 33 years old as the life of a commercial or residential building such as a house is considered to be 33 years for capital allowances purposes and this period is not renewed or extended by subsequent sales or transfers.

As Mr Tsai is not domiciled in Cyprus for SDC purposes, he will be exempt from SDC on his rental income.

Double tax relief
Even though there is no double tax treaty between Cyprus and Farland, Cyprus will allow relief unilaterally on the tax payable in Farland in respect of Mr Tsai's director's fees from SEIG and his rental income. However, the relief will be restricted to the amount which would be ascertained if the amount of the income were computed in accordance with the provisions of the law and charged to tax at a rate ascertained by dividing the tax chargeable on the total income of the person entitled to the income by the amount of his or her total income. The foreign income is included at an amount inclusive of any foreign tax suffered.

Mr Tsai is therefore likely to incur some additional income tax on his rental income in Cyprus on top of the tax suffered in Farland as he is expected to pay tax in Cyprus at the highest rate provided in the legislation of 35% compared to the 20% stated chargeable in Farland. The position regarding his director's fees from SEIG will need to be determined.

(c) Risk of SEIG being considered as tax resident of Cyprus

The term 'resident in the Republic' when applied to a company means a company whose management and control is exercised in the Republic. There is no definition of management and control but in practice it can be taken to be:

- where the majority of the directors reside, and
- where board meetings are held, and
- where the general policy of the company is formulated.

The co-existence of all three criteria is essential.

The place where the meetings of the directors are held, although essential, may not always be conclusive. It is the place where real management and control of a company is exercised. This may sometimes, in fact, be exercised by one person, in which case their place of residency will be the company's place of residence. There are no clear cut rules – each case is decided on its own facts. Neither where the company's central office is located nor where the annual general meetings are held is a material deciding factor.

Mr Tsai will only participate in high level decisions and as such cannot be expected to exercise real management and control in Cyprus. Further, unless he is the only director of SEIG, then the majority of the company's directors will not be resident in Cyprus.

It is, therefore, highly unlikely that the Tax Department will claim the co-existence of all three criteria including formulation of company policy as being in Cyprus. The fact that SEIG has a wholly owned subsidiary, SEC, in Cyprus is irrelevant.

3 Maroulla

(a) Value added tax (VAT) on rental payment

Maroulla will not have to pay VAT on the rental payment as rent is exempt from VAT. It is irrelevant that KP Properties Ltd is registered for VAT.

As Maroulla will work as a self-employed person, she will not need to deduct special defence contribution (SDC) at source from the rental before payment to KP Properties Ltd. The requirement to deduct SDC does not apply to physical persons paying rents.

(b) VAT registration

Maroulla will be making taxable supplies in the course of furtherance of a business. In accordance with the VAT legislation, she will be liable to register and charge VAT on her invoices when:

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

The historic test will be the one relevant to Maroulla, therefore she will not be liable register for VAT before she starts business.

Maroulla has the option to register voluntarily at any time before she exceeds the threshold or even before she starts her business as an intending trader.

Postponing VAT registration until the threshold has been exceeded has the advantage of keeping administration of the finances of the business simple and avoids the need for de-registration if the business does not go well.

On the sales/output side, not registering removes the need to charge VAT on the sales of services and products to her customers. This is potentially a major advantage as Maroulla's customers will be end consumers who cannot recover VAT and so will find her services relatively cheaper than if she is registered.

However, on the purchases/input side, there is a disadvantage in that she will not be able to recover VAT immediately on the initial expenses to set up the shop. She will be able to recover this VAT when she does register, subject to the following restrictions:

- VAT on any services (e.g. the interior decorator's services) can be recovered provided the services were acquired six months before the date of registration.
- VAT on goods can be recovered provided the goods have been acquired in the three years before the date of registration and are still held at the time of registration.

Therefore, subject to the three-year time limit, the VAT on the furniture and equipment and on any unsold stock of cosmetic products will be recoverable as input VAT on registration.

(c) VAT on purchases of hair cosmetics and accessories from Italy and China, respectively

Hair cosmetics from Italy – within the EU
When Maroulla orders hair cosmetics from Italy, if she is registered for VAT in Cyprus and gives her VAT registration number to the Italian supplier, the supplier will not charge any VAT on the invoices. The Italian supplier can check her VAT registration number on the internet system available within the EU. Maroulla will account for VAT on these purchases in Cyprus using the reverse charge method.

If Maroulla is not registered for VAT at the time she purchases the goods from Italy, then the Italian supplier will have to charge VAT at the relevant Italian rate. Maroulla will not be able to recover this VAT.

Import of hair accessories from China – outside the EU
Maroulla will have to pay Cyprus VAT on the importation of the hair accessories before the goods are released from Customs control. The VAT will be payable on the total of the purchase cost, transport costs and import duty and this will not be affected by whether Maroulla is VAT registered or not at the time of the import. If Maroulla is registered, she will be able to recover the import VAT paid as part of her inputs. If she is not registered, she will only be able to recover the VAT as per the VAT rules for pre-registration purchases (as in (b) above).

(d) VAT on sales by mail order to Greece and the United States

Sale of goods by mail order to Greece – within the EU
The supply will be a business to consumer (B2C) sale and there will be no need to check for customers' VAT registration numbers.

As these will be sales to consumers in the EU, they will fall under the distance sales rules. Maroulla will have to charge VAT in Cyprus using the relevant rate even though the goods will be dispatched to Greece. She will need to monitor the level of her sales to Greece as, if she exceeds the threshold for distance sales in Greece, she will need to register for VAT in Greece, charge Greek VAT and account for this VAT to the Greek authorities.

Sale of goods by mail order to the United States – outside the EU
Sales of goods to the United States will be an export of goods and therefore zero rated for VAT irrespective of the nature of the recipient. Maroulla will need to keep evidence of these shipments as, in case of a VAT audit, she will have to prove that the goods were exported.

(e) VAT implications of free of charge or 50% discounted promotions

The value on which VAT is imposed is the consideration given in exchange for the supply provided that the transaction is between third parties and the amount of the consideration is not affected by any other commercial, financial or other relationship between the purchaser and the seller.

The VAT Commissioner has power to issue an order, not later than three years from the date of a supply, that the tax value is the open market value, where

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

Such an order is unlikely to be made in the case of a normal level of promotions/discounts. However, if Maroulla offers her services free of charge or at a significant discount to end-consumers for a long period of time, such that the business was consistently loss-making, this would bring into question whether she is carrying on a business (with a view to making a profit) at all and this, in turn, would affect her VAT registration and the recoverability of input VAT.

4 Mrs A

(a) Special defence contribution (SDC) on dividend payments

Payment of dividends by each company

AH Holdings Ltd (AH)
Under both options, as Mrs A is tax resident and domiciled in Cyprus, AH will have to withhold SDC at the current rate of 17% on any dividend payments made to her. The SDC deducted has to be paid to the Tax Department by the paying company by the end of the month following the month of the dividend payment.

Sub 1 Ltd (S1) and Sub 2 Ltd (S2)
Under option 1, S1 and S2 will not need to deduct SDC at source before payment of the dividend to AH.

Under option 2, S1 and S2 will have to deduct SDC on the dividend payments made to Mrs A and pay it over to the Tax Department.

Sub 3 Ltd (S3)
Under option 1, the shares of S3 are held by AH. Dividend payments made to a resident company by a non-resident company are only subject to SDC where the company paying the dividend engages directly or indirectly, to the extent of more than 50%, in activities which lead to investment income **and** the foreign tax burden is substantially lower than the Cyprus tax burden. As the foreign tax burden in Triland is substantially higher (not lower) than in Cyprus, dividends paid by S3 will be exempt from SDC in the hands of AH, irrespective of the types of activity engaged in by S3.

Under option 2, dividends will be received by Mrs A directly from S3, a non-resident company. Mrs A will have to make a separate declaration and pay the SDC herself on a six-monthly basis, on 30 June and 31 December annually.

Deemed distribution provisions
In accordance with the deemed distribution provisions of the SDC legislation, companies are deemed to have distributed to their resident shareholders 70% of their after-tax accounting profits, by the end of two years from the end of the year to which the profits relate, and account for SDC at the rate in force to the Tax Department. This deemed distribution is reduced by actual distributions made within the two years.

In the case of S1 and S2, option 1 would have an advantage if the dividends paid just covered the minimum required by the deemed distribution provisions. In such a case, S1/S2 will not have to deduct any SDC at source and AH will receive the dividend gross. However, any such dividend will increase AH's after-tax accounting profits and so affect the amount potentially payable by AH under the deemed distribution provisions in two years' time to Mrs A. The payment of SDC will, however, be delayed and the dividend which needs to be paid to avoid a deemed distribution charge will be only 49% (70% of 70%) of the original profits of S1/S2. Under option 2, this possibility does not exist as Mrs A, who is a physical person, will hold the shares directly.

In the case of S3 paying dividends, option 1 will also be preferable to option 2. In the case of option 1, the dividend paid by S3 is not subject to SDC and, although it will form part of AH's after-tax accounting profits for deemed distribution purposes, SDC will be suffered on only 70% of the dividend two years after the year of receipt by AH, unless distributed on to Mrs A within this period. Compared with option 2, the whole of the dividend will be received directly by Mrs A and she will suffer SDC at 17% immediately.

No dividend paid for three years
If S1 or S2 does not pay an actual dividend sufficient to cover the amount required by the SDC deemed dividend provisions, then, irrespective of whether the shareholder is AH or Mrs A, SDC will be payable on 70% of the company's after-tax

accounting profits as if the dividend had been distributed to a physical person. Therefore, in such a case neither option presents an advantage over the other.

As S3 is not a Cyprus tax resident company, it is not caught by the deemed distribution provisions. Therefore the non-payment of a dividend by S3 will not have any SDC implications.

(b) Group loss relief for corporation tax

Losses may be surrendered by a company resident in the Republic (the 'surrendering company') and, on the making of a claim by another company resident in the Republic (the 'claimant company'), may be allowed to the claimant company by way of relief from corporation tax, where both have been members of the same group for the whole of the year of assessment.

Two companies are deemed to be members of a group if one is a 75% subsidiary of the other or both (each one separately) are 75% subsidiaries of a third company.

A set-off of losses may also be made in the case of a member of the group which is a new company incorporated by its holding company during the current year, even though it has not been a member of the group for the whole year.

The losses surrendered have to be losses of the same (current) year. Losses brought forward by one group company cannot be used by another group company in a future year.

S3 is not a company resident in the Republic so it cannot form part of the group for the surrender of losses under either option.

Under option 1, AH, S1 and S2 will be considered part of a group so will be able to surrender current year losses between them. Even if S1 and S2 are incorporated by AH during 2018, they can still form part of the group for loss relief purposes in that year.

Under option 2, AH, S1 and S2 will not be considered as part of a group and will not be able to surrender any losses between them as they are each directly controlled by a physical person (Mrs A) and not by a company.

Tutorial note: *For future companies in the group, a surrendering company may be a company which is resident in another EU member state, provided it has exhausted all the possibilities of set-off or transfer of its losses in the state of its residence or in another member state where an intermediate holding company may be based, as such losses are computed according to the provisions of the Cyprus law.*

(c) Group registration for value added tax (VAT)

Two or more companies belonging to the same group of companies may apply for a VAT group registration. A group exists where one company controls the others or one person controls them all, however, a group VAT registration is restricted to companies incorporated in Cyprus and who have a place of establishment in Cyprus. As a result, under both options AH, S1 and S2 can become members of the same VAT group but S3 cannot.

The effects of group registration are:

- goods and services supplied by one group company to another group company are outside the scope of VAT;
- supplies made to or by group companies are treated as made to or by a nominated group company known as the representative member;
- only the representative member is registered and it is responsible for submitting VAT returns and paying the VAT.

Tutorial note: *It is not necessary to include all the companies of a group in the group registration. For example, a group company in a net repayment position for VAT could stay outside the group registration in order to accelerate its VAT repayments by submitting monthly returns instead of quarterly ones.*

5 ABC Ltd

(a) (i) Corporation tax payable for 2017

	2017 €
Expected taxable profit	100,000
Loss relief available:	
2013 taxable loss	(45,000)
2014 taxable loss	(15,000)
Taxable profit after loss relief	40,000
Corporation tax at 12·5%	5,000

Tax losses cannot be carried forward for more than five years. The 2011 loss of €190,000 would have been used against the 2012, 2015 and 2016 profits but the balance remaining of €115,000 would be lost due to the five-year rule.

The 2013 and 2014 losses will not have been used so are available to deduct from the 2017 taxable profits. The expected corporation tax payable for 2017 is therefore €5,000.

(ii) Payment of tax for 2017

The estimated tax due for 2017 has to be declared and paid by temporary return during 2017 in two equal instalments. The latest payment for the first instalment will be 31 July 2017 and for the second, 31 December 2017.

Given that no additional tax surcharges or penalties arise if 75% of the overall tax due for a tax year as finally determined has been paid by temporary return, then the minimum tax payable by ABC Ltd during 2017 would be €3,750 split equally between the two instalments.

The remaining balance of any taxes for 2017 as finally determined can be paid by 1 August 2018 at the latest without incurring any penalties or interest.

(b) Effect of increased expected taxable profits in 2017

ABC Ltd can revise the second instalment of temporary tax for 2017 payable by 31 December 2017. In fact, on the temporary assessment form there is provision for such a possibility and the taxpayer is allowed to revise the taxable profit declared with the first instalment, upwards or downwards.

If the revision is upwards, as in the case of ABC Ltd, then interest but no penalty is payable on the tax portion assumed to have been paid late, being half the additional tax paid in December as this tax should have been paid on 31 July 2017.

Additional corporation tax payable ((140,000 – 100,000) x 12·5%)	€5,000
75% thereof paid on 31 December 2017	€3,750
Interest payable for paying five months late (3,750/2 x 4% p.a.)	€31

(c) Filing of personal tax returns

Under the provisions of the Income Tax legislation, only individuals having gross income which exceeds the tax free amount (the amount which is subject to tax at a rate of 0%) in a year of assessment are required to submit an income tax return.

For the year 2016, the tax free amount is €19,500, therefore Andreas has to file a personal tax return but Maria does not. It is irrelevant that Andreas does not owe any tax for the year due to the operation of PAYE by ABC Ltd.

The deadline for filing the 2016 return is 30 April 2017. An extension of three months is given to this deadline if the return is filed electronically through the taxisnet system.

(d) Correction of error in value added tax (VAT) return

A voluntary correction of an error or misdeclaration may be made by a trader where an erroneous VAT return has been submitted in which a higher or lower amount of VAT payable or repayable has been declared.

The mechanism for correcting an error depends on its size and whether it relates to a return within or extending beyond a period of three years.

– If the net value of the error or misdeclaration made (underpayments of VAT less overpayments of VAT) does not exceed €1,708, the correction may be made by simply correcting them on the VAT account and in the company's next VAT return.

– If the net value of the error or misdeclaration exceeds €1,708, then the Tax Department will have to be notified of the intention of making corrections. Corrections may be made only on directions or requirements of the Tax Department.

As far as the invoice dated 24 March 2012 is concerned, the error cannot be corrected voluntarily as more than three years have elapsed. ABC Ltd must write to the Tax Department explaining the error and follow their guidance on how it must be corrected.

For the invoice dated 12 March 2016, the error can be corrected voluntarily as it is within the three-year limit.

ABC Ltd will need to assess the amount of the error and its net effect on the amount of VAT paid for the quarter ended 31 March 2016.

The supply of marketing services from the Swedish company is a B2B (business to business) supply of a service, so the service is deemed to be supplied where the recipient is located which, in this case, is in Cyprus.

The Swedish supplier must have verified that the supply was made to ABC Ltd for business purposes and must not have charged Swedish VAT on the invoice.

ABC Ltd must account for this invoice in accordance with the reverse charge provisions of the VAT legislation. It should have treated the invoice as a sale to itself. On the one hand it should have included €1,900 (€10,000 at 19%) as output VAT and, on the other, because the service was received for business purposes, it should also have included the same amount as input VAT. The net effect on VAT payable would therefore be zero.

As the net effect of the error is below €1,708, ABC Ltd can voluntarily correct the mistake by making the relevant entries in its output and input VAT of the current quarter's VAT return.

Tutorial note: *By voluntarily correcting errors, it is possible to avoid potential assessments of tax by the Tax Department, and additional tax and interest which may be charged where errors or misdeclarations are discovered during a VAT inspection*.

Professional Level – Options Module, Paper P6 (CYP)
Advanced Taxation (Cyprus) **December 2017 Marking Scheme**

			Available	*Maximum*
1	**(i)**	CGT flat – Use of original cost/indexation/deduction of transfer fees without indexation	3	
		CGT land – Use of original cost/indexation/deduction of transfer fees without indexation/correct indexation of fencing	3	
		Deduction of loss from flat	1	
		Application of CGT rate of 20%	0·5	
		Corporation tax calculation (0·5 for each line of adjustment)	3	
		No CAs for 2016, with explanation	1	
		Application of corporation tax rate of 12·5%	0·5	
		Explanation/computation of balancing addition for flat	3	
			15	13
	(ii)	Adjustment for dividend/interest (as in (i))	0·5	
		Trading profit for sale of flat/use of tax written down value	1·5	
		Trading profit on sale of land	1·5	
		Explanation/assumption re CAs on fencing	1	
		Adjustment for immovable property tax/registrar fees/accounting depreciation (as in (i))	1	
		Comment re no indexation	0·5	
			6	5
	(iii)	Case of capital gain:		
		Accounting profit on sale of flat	2	
		Accounting profit on sale of land	1	
		Explanations	1	
		SDC on interest adjustment	0·5	
		Deduction of CGT/SDC/CT (0·5 each)	1·5	
		Correct application of 70%/17% rates	0·5	
		Case of trading income:		
		Start with correct accounting profit figure	0·5	
		Deduction of SDC and CT (0·5 each)	1	
		Correct application of 70%/17% rates	0·5	
			8·5	7
	(iv)	Identification of issue as to whether trading or not in immovable properties	1	
		Name of company 'holdings'/objects include investments in immovable property in memorandum and accounts	2	
		No other transactions for 34 years/length of holding period	1	
		Sole director is an accountant – unrelated to property trading	1	
		No evidence of actively trying to sell	0·5	
		Bias by Tax Department as immovable property	1	
		No loans but re-investment of retained profits	1	
		Fence not considered development	0·5	
			8	6
		Format and presentation of the briefing notes	1	
		Clarity and effectiveness of communication	2	
		Logical flow of calculations	1	
			4	4
				35

				Available	*Maximum*
2	**(a)**		Income tax: 183 day rule for physical person residency/conclusion for Mr Tsai	1·5	
			Possibility not resident in 2018 if a lot of travel/special rules on days of arrival and departure	1	
			SDC: Non-domiciled/not resident for 17 of last 20 years/exempt	2	
				4·5	4
	(b)	**(i)**	SEC contract will be Cyprus source of income thus taxable in Cyprus irrespective	1	
			50% exemption and explanation of conditions	2·5	
			Benefits in kind taxable, including those relating to spouse and children	1	
			House taxable based on its rental equivalent	1	
			Tuition fees taxable based on amount paid by employer	0·5	
			Lump sum relocation expenses taxable but can deduct actual expenses	1	
			Share option taxable only if/when exercised or sold	1	
			Explanation of calculation of benefit/taxable amount	1·5	
			As by reason of employment taxable in Cyprus irrespective if exercised later	1·5	
			90 days rule explanation/only if for a permanent establishment of SEC	1·5	
				12·5	11
		(ii)	Farland salary taxable in Cyprus irrespective of where duties performed	1	
			Interest, dividends and profit on sale of shares specifically exempt from income tax	1	
			Interest and dividends SDC exempt	1	
			Rental income taxable/20% deduction/wear and tear based on 33 years	1·5	
			No SDC on rental income	0·5	
			Explanation of unilateral relief even though no DTT	2	
				7	6
	(c)		Management and control in Cyprus/criteria/co-existence/depends on facts	3	
			High level decisions only not real management and control	0·5	
			Mr Tsai not single director	0·5	
			Highly unlikely all three criteria co-exist/SEIG considered tax resident	0·5	
			Wholly owned subsidiary irrelevant	0·5	
				5	4
					25

			Available	*Maximum*
3	**(a)**	Rent is exempt from VAT	1	
		Physical person – no SDC at source	1	
			2	**2**
	(b)	Taxable supplies in the course of furtherance of a business	1	
		Historic test/future prospects test/explanation	2	
		Historic relevant to Maroulla, so no need to register	1	
		Possible to register voluntarily	0·5	
		Delaying simplifies finances	0·5	
		If business closes no need to de-register	0·5	
		For sales – serious advantage as customers are end consumers	1	
		No recoverability of input VAT	0·5	
		Can be recovered on subsequent registration/subject to conditions re services and goods – explain	2·5	
			9·5	**8**
	(c)	Italian cosmetics no VAT if registered – not registered then Italian VAT	2	
		If import from China then VAT at customs – no difference if registered or not	2	
			4	**4**
	(d)	If to Greece then intra EU distance sales/Cyprus VAT	1	
		But may have to register in Greece if Greek threshold exceeded	1	
		If to United states then exports – zero rated	1	
		Irrelevant who is the US customer	0·5	
		Evidence of export required	0·5	
			4	**3**
	(e)	Explanation of value of supply rules	1·5	
		Powers of commissioner	2	
		Potential effects on registration/recoverability position	0·5	
			4	**3**
				20

			Available	*Maximum*
4	**(a)**	AH to Mrs A deduct SDC under both options	1	
		SDC deducted at source/pay over at end of the following month	1	
		Option 1: S1 or S2 to AH no deduction of SDC	1	
		Option 2: S1 or S2 to Mrs A deduct SDC	1	
		Option 1: S3 to AH exempt/state reason	2	
		Option 2: S3 to Mrs A taxable/must declare separately/when	1·5	
		S1 or S2 option 1 has advantage if distribute minimum dividend as 70% of 70% – explain	2	
		S3 – option 1 preferable with explanation of deemed distribution effect in AH	1·5	
		If no payment of dividends by S1 or S2 deemed distribution effect the same under both options	1·5	
		If no payment of dividends S3 no SDC effect as not caught by deemed distribution provisions	1	
			13·5	12
	(b)	Definition of group company: resident/75% holding/whole year/newly incorporated	2	
		Losses of current year only	1	
		S3 not part of group under option 1 or option 2	0·5	
		S1, S2 and AH group under option 1	0·5	
		Not a group under option 2, with reason	1	
			5	4
	(c)	Control by another company or person	1	
		Incorporated or place of establishment in Cyprus	1	
		AH, S1 and S2 but not S3 under both options	1	
		Effects of registration	1·5	
			4·5	4
				20

				Available	*Maximum*
5	**(a)**	**(i)**	Losses restricted to five-year carry forward	0·5	
			Explanation of treatment of 2011 loss	1	
			Explanation of treatment of 2013 and 2014 losses	1	
			Computation	1·5	
				4	**4**
		(ii)	Two instalments/dates of payment	1·5	
			Can pay 75% of final tax due without penalties	1	
			Pay balance by 1 August 2018 – no interest or penalties	1	
				3·5	**3**
	(b)		Possible to revise second instalment	1	
			Provided for on temporary return	0·5	
			No penalty but interest in such a case	1	
			Calculation of interest payable	1·5	
				4	**3**
	(c)		Explain effect of tax free amount	1	
			Conclude Andreas needs to file but not Maria	1	
			Irrelevant that no tax is due	0·5	
			Relevant filing dates (0·5 each)	1	
				3·5	**3**
	(d)		Invoice dated 24 March 2012 error cannot be corrected voluntarily as more than three years elapsed – correction only by guidance from Tax Department – size irrelevant	1·5	
			Invoice 12 March 2016 within three years but can be corrected voluntarily if net amount is less than €1,708	1	
			B2B supply of a service – place of supply is where the recipient is located	1	
			Swedish supplier verified for business and did not charge Swedish VAT	1	
			ABC Ltd account using reverse charge – both sale and purchase to itself – increase input and output VAT by €1,900 – input for business and therefore recoverable	2	
			Net effect zero – possible to correct voluntarily – increase output and input VAT of current quarter	1	
				7·5	**7**
					20