Fundamentals Level – Skills Module

Taxation (Malta)

Monday 7 December 2009

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.
Tax rates and allowances are printed on pages 2–4.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Paper F6 (MLA)

The Association of Chartered Certified Accountants

The Malta Institute of Accountants

SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings need only be made to the nearest €.
2. All apportionments should be made to the nearest month.
3. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates for the year of assessment 2009 are to be used in answering the questions.

Individual income tax

Married couples – joint computation

€		€	Rate %
0	to	11,400	0
11,401	to	20,500	15
20,501	to	28,000	25
28,001	and over		35

Other individuals

€		€	Rate %
0	to	8,150	0
8,151	to	14,000	15
14,001	to	19,000	25
19,001	and over		35

Non-resident individuals

€		€	Rate %
0	to	700	0
701	to	3,100	20
3,101	to	7,800	30
7,801	and over		35

Corporate income tax

Rate	35%

Value added tax (VAT)

Standard rate	18%
Reduced rate	5%

Capital allowances

Industrial buildings and structures	
Initial allowance	10%
Wear and tear allowance	2%

Plant and machinery

Minimum number of years over which items of plant and machinery are to be depreciated:	
Computers and electronic equipment	4
Computer software	4
Motor vehicles	5
Furniture, fixtures, fittings and soft furnishings	10
Equipment used for the construction of buildings and excavation	6
Catering equipment	6
Aircraft	12
Ships and vessels	10
Electrical and plumbing installations and sanitary fittings	15
Cable infrastructure	20
Pipeline infrastructure	20
Communication and broadcasting equipment	6
Medical equipment	6
Lifts and escalators	10
Air conditioners	6
Equipment mainly designed or used for the production of water or electricity	6
Other machinery	5
Other plant	10

Capital gains

Capital gains index of inflation

1983	428·06	1996	549·95
1984	426·18	1997	567·95
1985	425·17	1998	580·61
1986	433·67	1999	593·00
1987	435·47	2000	607·07
1988	439·62	2001	624·85
1989	443·39	2002	638·54
1990	456·61	2003	646·84
1991	468·21	2004	664·88
1992	475·89	2005	684·88
1993	495·60	2006	703·88
1994	516·06	2007	712·68
1995	536·61	2008	743·05

Fringe benefit rates on company cars

	Percentage of vehicle value
Vehicle use	
Vehicle not more than six years old	17%
Vehicle more than six years old	10%
Fuel value	
Vehicle value not exceeding €28,000	3%
Vehicle value exceeding €28,000	5%
Maintenance value	
Vehicle value not exceeding €28,000	3%
Vehicle value exceeding €28,000	5%

Private use percentages

Car value			
From		To	
€		€	
0		16,310	30%
16,311		21,000	40%
21,001		32,620	50%
32,621		46,600	55%
46,601	and over		60%

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Question 1 begins on page 6.

ALL FIVE questions are compulsory and MUST be attempted

1 (a) Mario and Doris Debono are married and live together. On 1 January 2008, Mario, who is an electrical engineer, started employment with Software Projects Limited, a Maltese software consultancy company. His remuneration package for 2008 consisted of the following:

(1) An annual salary, inclusive of statutory bonuses, of €42,000
(2) One paid holiday per year, which cost the company €5,000
(3) Free use of a company car (Note 1)
(4) Health insurance cover for himself and his family (Note 2)
(5) Payment of private school fees in respect of Mario's son (Note 3)
(6) Payment of childcare centre fees in respect of Mario's daughter (Note 4)
(7) An allowance of €120 for every day that he spent outside Malta on business related travel (Note 5)
(8) The unrestricted use of an apartment in Gozo (Note 6)

Notes:

1. Mario had at his disposal a new motor vehicle, valued at €22,000. All expenses, including fuel, were paid for by the company.

2. The health insurance premium paid by the company with respect to Mario Debono and his family amounted to €1,200 in 2008. The company's policy is to provide health insurance cover only to its electrical engineers, who make up 15% of its workforce.

3. Mario's son attends a private primary school and in 2008 the school fees amounted to €2,000.

4. Mario's daughter attends a registered childcare centre and in 2008 the fees amounted to €1,200.

5. In 2008 Mario spent 20 days outside Malta on business related travel. In addition to paying Mario the daily allowance of €120 per day, the company also paid all expenses related to his travels, including airfares, lodging and meals, which amounted to €200 per day.

6. The company had bought the apartment in 1998 for the equivalent of €50,000. It is estimated that its market value in 2008 was €120,000.

Doris is employed as a nurse and her basic salary, inclusive of statutory bonuses, is €28,000 per year. The hospital where she is employed provides all nurses with a free daily meal in the staff canteen, which costs the employer €600 per year per employee; as well as two uniforms per year, which cost €100 each. As Doris is required to use her car in the course of her employment, Doris' employer gives her a car cash allowance of €120 per month.

Doris also runs a small business consisting of the door-to-door sale of kitchen utensils. Since she only achieves a turnover of €2,000 per month, Doris is registered as a small undertaking for value added tax (VAT) purposes. In 2008 Doris bought a small van for use in the business. The van cost her €18,000 (exclusive of VAT) and the purchase was partly financed through a bank loan on which she incurred €480 interest in 2008. She has also spent €2,000 (exclusive of VAT) on fuel and van maintenance during the year. Other business related expenses incurred during the year, all of which she bought from persons registered as small undertakings for VAT purposes, amounted to €1,400.

In 2005 Mario had bought €5,000 5·6% Malta government bonds. He receives the interest thereon, net of withholding tax, on the 31 May of every year. On 1 June 2008, he sold the bonds for €5,400.

During 2008, Mario disposed of shares he held in a number of companies, as follows:

1. He sold 2,500 ordinary shares in Floorings Limited, a Maltese private company, for €4,500. Mario had bought these shares in 2006 for €0·90 per share and his shareholding constituted 0·5% of the ordinary shares in the company.

2. He donated 1,000 ordinary shares of €1 each in Garden Limited, a Maltese private company, to his sister. Mario had bought these shares for €1·10 per share and the market value of each share on the date of donation was €0·80 per share.

3. He sold 4,000 8% preference shares of €1 each in Nuria Limited, a Maltese private company. He had bought these shares at par in 2000 but managed to sell them for €1·10 per share.

4. He sold 2,000 ordinary shares in Pastelli Limited, a Maltese company the shares of which are listed on the Malta stock exchange, for €2,800. He had bought these shares for €3,000 in 2004.

Required:

(i) Compute the chargeable income of Mario and Doris Debono for the year of assessment 2009.

(24 marks)

(ii) Compute the tax chargeable on Mario and Doris Debono for the year of assessment 2009, assuming that they choose the method of computation (joint or separate) that results in the least amount of tax.

(2 marks)

(b) Sub-article 17 of Article 56 of the Income Tax Act provides for a beneficial tax system on income derived from overseas employment. Briefly explain the provisions of this sub-article. (4 marks)

(30 marks)

2 The accountant of Starry Limited prepared the following draft income statement for the period starting from the company's incorporation on 3 April 2008 to 31 December 2008:

	Note	€	€
Gross profit from importation business			308,250
Rent	1		22,000
Dividends	2		32,000
Interest	3		1,800
			364,050
Overheads and expenses			
Loss on sale of fixed assets	4	12,000	
Pre-trading expenses	5	1,400	
Advertising		3,050	
Exchange differences	6	2,800	
Wages and salaries	7	128,500	
Depreciation	8	39,300	
Loss on sale of shares	9	1,000	
Interest	10	31,400	
			219,450
Profit before taxation			144,600

Notes:

1. Rent comprises ground rent of €8,000 received on an emphyteutical grant of a plot of land and rent of an office block of €14,000.

2. Dividends comprise net dividends from the following sources:

	€
A dividend, net of 35% tax at source, from the Maltese taxed account of Stingy Ltd	6,500
A dividend from the final tax account of Queralbs Limited	10,050
A dividend, net of 35% tax at source from the immovable property account of Properties Limited	9,750
A dividend, net of 5% withholding tax, from Alps Limited, a company resident in Switzerland	5,700
	32,000

3. Interest comprises €680 received on a corporate bond, net of 15% withholding tax, and €1,120 received in respect of a loan to a related company.

4. The company had bought computer equipment for its importation business, which turned out to be inadequate for its needs and had to be disposed of at a loss of €12,000.

5. Pre-trading expenses comprise the following:

	€
Professional and other fees payable in connection with the company's incorporation	800
Advertising	600
	1,400

6. Exchange differences comprise the following:

	€
A realised gain on the payment of an amount due to a supplier	(400)
An unrealised loss on the translation of year-end balances due from customers	800
A realised loss on the disposal of the computer equipment (note 4)	2,400
	2,800

7. Wages and salaries comprise the following:

	€
Cash wages and salaries reported under the Final Settlement System (FSS)	76,200
Entertainment allowances given to senior management, not reported under the FSS	12,400
Childcare fees reimbursed in respect of 20 children of employees (€1,400 per child)	28,000
Other fringe benefits reported under the FSS	11,900
	128,500

8. The depreciation charge for the year is made up as follows:

	Computer equipment (20%)	Two non-commercial vehicles (20%)	Furniture and fittings (15%)	Total
	€	€	€	€
Cost	120,000	52,000	120,000	292,000
Depreciation (nine months)	18,000	7,800	13,500	39,300

9. The company had bought ordinary shares in Festa Limited, a company whose shares are listed on the Malta Stock Exchange, as a long-term investment, but was forced to sell the shares at a loss of €1,000 in December 2008.

10. The interest incurred was in respect of the following:

	€
On a bank loan used to buy the office block that is rented out (note 1)	13,000
On a shareholders' loan used to buy the plot of land on which ground rent is received (note 1)	6,000
On a bank loan used to buy the corporate bond (note 3)	300
On a bank overdraft used to finance the company's working capital requirements	11,600
On a bank loan used to buy the shares in Festa Limited (note 9)	500
	31,400

Required:

(a) Compute the chargeable income of Starry Limited for the year of assessment 2009 by adjusting the profit as per the draft income statement of €144,600. (18 marks)

(b) Compute the tax payable by Starry Limited for the year of assessment 2009. (5 marks)

(c) Calculate the profits that will be allocated to Starry Limited's final tax account for the year of assessment 2009. (2 marks)

(25 marks)

3 **(a)** Palms Limited is a company registered in Malta, whose shareholdings on 31 December 2007 were as follows:

Stephen Calleja	48,000 ordinary shares of €1 each, fully paid up
Robert Caruana	12,000 ordinary shares of €1 each, fully paid up
Marika Vincenti	5,000 6% preference shares of €1 each, fully paid up

Stephen Calleja, who is the sole director of the company, had bought his shares in 2003 for €50,000, whilst Robert Caruana and Marika Vincenti had subscribed for their shares at par on the company's incorporation in 1998.

The company's balance sheet on 31 December 2007 was as follows:

	Note	€
Fixed assets	1	130,000
Investment	2	20,000
Current assets		45,000
		195,000
Share capital – ordinary shares		60,000
Share capital – preference shares		5,000
Retained earnings	3	95,000
Revaluation reserve		20,000
		180,000
Liabilities		15,000
		195,000

Notes:

1. Included in the company's fixed assets is a property which the company had bought in 2001 for €40,000 and which was revalued in 2005 by €20,000 to €60,000. The current market value of the property is €85,000.
2. The investment consists of a 40% shareholding in Functions Limited. Functions Limited's net asset value on 31 December 2007 was €58,000 and its average pre-tax profits in the last five years amounted to €21,850 per year, 50% of which it distributes annually to its shareholders. Functions Limited does not own immovable property.
3. The retained earnings figure of €95,000 is made up of undistributed profits generated by the company as well as dividends received from Functions Limited as per the table below:

	Palms Limited			Dividends received from Functions Limited		
Year	Profits before tax	Tax	Profits after tax	Gross dividend	Tax at source	Net dividend
	€	€	€	€	€	€
Balance brought forward	72,655	25,430	47,225	N/A	N/A	N/A
2003	12,000	4,200	7,800	4,370	1,530	2,840
2004	14,000	4,900	9,100	4,570	1,600	2,970
2005	7,500	2,625	4,875	4,170	1,460	2,710
2006	18,000	6,300	11,700	3,600	1,260	2,340
2007	22,000	7,700	14,300	5,140	1,800	3,340
Balance at 31 December 2007	146,155	51,155	95,000			

In October 2008, the shareholders were approached by an investor who wanted to buy all of the shares in the company and made them the following offer:

For all the ordinary shares held by Stephen Calleja	€200,000
For all the ordinary shares held by Robert Caruana	€40,000
For all the preference shares held by Marika Vincenti	€7,000

Required:

(i) Briefly explain the capital gains consequences for each of the three shareholders (Stephen Calleja, Robert Caruana and Marika Vincenti) if they were to accept the offer to sell their shares to the investor. (3 marks)

(ii) Compute the chargeable capital gain on Stephen Calleja if he accepted the offer and sold his ordinary shares to the investor on 3 December 2008. (13 marks)

(b) Transfers of capital assets, including transfers of securities, are chargeable to tax in the manner laid down in article 5 of the Income Tax Act. However, this article provides for exceptions, by virtue of which certain transfers of securities are not subject to tax.

Required:

State, giving reasons, whether the transfer of each of the assets listed below will or will not be subject to tax:

- **the transfers of Malta government bonds;**
- **the transfer of an intangible asset consisting of an industrial patent;**
- **the transfer of ordinary shares that are listed on a stock exchange recognised under the Financial Markets Act; and**
- **the transfer of ordinary shares for a consideration by an individual in a company of which he holds 90% of the ordinary shares to a company in which he holds 100% of the shares.** (4 marks)

(20 marks)

4 Meadows Limited is a Maltese holding company which was incorporated on 30 November 2007. Its first financial statements cover the period from the date of incorporation to 31 December 2008 and thus its first year of assessment is the year of assessment 2009. The company's Memorandum and Articles of Association includes a clause enabling it to derive income from anywhere in the world including, but not limited to, income which would fall to be allocated to the foreign income account as defined in article 2 of the Income Tax Act.

Meadows Limited's income and capital gains during its first financial period comprised the following:

1. A dividend of €120,000 received from Firenze SpA, a company resident in Italy. Meadows Limited had bought the shares in Firenze SpA on 5 January 2008 for €1,500,000 and the shares represent 7% of the issued share capital of the Italian company. Meadows Limited's shares do not entitle it to any special rights with regard to the appointment of directors in Firenze SpA or any other rights or options whatsoever, apart from an entitlement to dividends. No tax was withheld in Italy on the payment of this dividend.
2. On 20 April 2008, Meadows Limited sold the shares in Firenze SpA for €1,650,000. No tax was withheld in Italy on the sale of the shares.
3. A dividend of €80,000 derived from a 15% equity shareholding in Eiffel S.A., a company resident in France. No withholding tax was levied in France on the payment of this dividend.
4. A dividend of €90,000 derived from a 40% equity shareholding in a company resident in Liberia. The Liberian company's income consists solely of passive interest and no tax is levied in Liberia on this income. No tax was withheld in Liberia on the payment of this dividend.
5. Net interest received from various corporate bonds issued by non-Maltese companies amounting in total to €27,000. The withholding tax suffered by Meadows Limited on this interest was at the rate of 10%.

Required:

(a) State, giving reasons, whether the dividends and capital gains derived by Meadows Limited on the transactions listed in (1) to (4) above qualify for a tax exemption in terms of the participation exemption provisions of article 12(1)(u) of the Income Tax Act. (8 marks)

(b) Calculate the chargeable income and the tax payable by Meadows Limited for the year of assessment 2009, assuming that the company can and does avail itself of the flat rate foreign tax credit method of relief for double taxation. (7 marks)

(15 marks)

5 The 10th Schedule to the VAT Act specifically provides that the value added tax (VAT) chargeable on certain supplies of goods and services is not recoverable even if such supplies are made to a taxable person. However, the same schedule also provides for exceptions to this rule.

Required:

(a) Identify the supplies of goods and services referred to in the 10th Schedule to the VAT Act, the VAT chargeable on which is not recoverable by a taxable person. (5 marks)

(b) Identify the supplies of goods and services listed in the 10th Schedule to the VAT Act on which VAT is recoverable notwithstanding that the recovery of VAT thereon, as identified in your answer to requirement (a) above, is generally disallowed. (5 marks)

(10 marks)

End of Question Paper