Fundamentals Level – Skills Module

Taxation (Malta)

Monday 6 June 2011

Paper F6 (MLA)

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.

The Association of Chartered Certified Accountants

The Malta Institute of Accountants

SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings need only be made to the nearest Euro
2. All apportionments should be made to the nearest month unless stated otherwise
3. All workings should be shown

TAX RATES AND ALLOWANCES

The following tax rates and allowances for the year of assessment 2011 are to be used in answering the questions.

Individual income tax rates

Resident individual tax rates

Married couples – joint computation:		Other individuals:	
Euro		**Euro**	
0 – 11,900	0%	0 – 8,500	0%
Next 9,300	15%	Next 6,000	15%
Next 7,500	25%	Next 5,000	25%
Remainder	35%	Remainder	35%

Non-resident individuals

Euro	
0 – 700	0%
Next 2,400	20%
Next 4,700	30%
Remainder	35%

Corporate income tax

Standard rate	35%

Value added tax (VAT)

Standard rate	18%
Reduced rate	5%

Capital allowances – Income Tax Act rates

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

Index of inflation

1983	428·06	1997	567·95
1984	426·18	1998	580·61
1985	425·17	1999	593·00
1986	433·67	2000	607·07
1987	435·47	2001	624·85
1988	439·62	2002	638·54
1989	443·39	2003	646·84
1990	456·61	2004	664·88
1991	468·21	2005	684·88
1992	475·89	2006	703·88
1993	495·60	2007	712·68
1994	516·06	2008	743·05
1995	536·61	2009	758·58
1996	549·95	2010	770·00 est

Car fringe benefit calculation and rates

Annual value of benefit = (vehicle use + fuel value + maintenance value) x private use percentage

Vehicle use	% of vehicle value
Vehicle not more than six years old	17%
Vehicle more than six years old	10%

Fuel value	% of vehicle value
Vehicle value not exceeding Euro28,000	3%
Vehicle value exceeding Euro28,000	5%

Maintenance value	% of vehicle value
Vehicle value not exceeding Euro28,000	3%
Vehicle value exceeding Euro28,000	5%

Car value	Private use percentage
Not exceeding Euro16,310	30%
Exceeding Euro16,310 but not Euro21,000	40%
Exceeding Euro21,000 but not Euro32,620	50%
Exceeding Euro32,620 but not Euro46,600	55%

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Question 1 begins on page 6.

ALL FIVE questions are compulsory and MUST be attempted

1 Paul Borg and Anja Moskaya are married and live together. They spend most of their time in Malta.

Paul was born in Malta. He studied abroad and then worked abroad for a while. He returned to Malta in 2008 when he accepted a post as a tenured lecturer at the University of Malta. He intends to settle in Malta permanently. Paul's contract with the University of Malta contains provisions on temporary posting, which provide for an obligation to render services outside Malta. Paul's contract of employment prescribes that for two months each year (July and August) he must work from the University's branch office in Rome. Paul also has a separate contract as a part-time employee with a wholly owned subsidiary of the University of Malta.

Anja was born in Moscow to parents who are neither ordinarily resident nor domiciled in Malta. In 2008, Anja settled in Malta permanently with her husband, Paul. She is in the final year of her PhD, writing up her thesis. Anja comes from a wealthy family and in 2009 her father donated to her a substantial portfolio of foreign investments worth €2,000,000.

Anja and Paul have two daughters, Renee and Berta. Renee attends a Church primary school and Berta a secondary school approved by the Minister.

Paul's father, who is ordinarily resident and domiciled in Malta, had a stroke and now he lives in a home for the elderly.

In the basis year 2010 Paul received the following income:

1. A remuneration package from the University of Malta amounting to €25,000 inclusive of:

	€
Reimbursement for professional subscriptions	1,000
Cash allowance	2,000
Total subsistence allowance for the two months spent in Rome	500
Reimbursement for work related travel	1,500
	5,000

2. A part-time salary of €1,500 from the subsidiary of the University of Malta.

In the basis year 2010 Anja received the following income:

1. A yield of €20,000 from foreign source passive investments, which was retained in Anja's bank account in Switzerland and was not remitted to Malta.
2. A dividend from Muska Ltd of €40,000. Anja owns 100% of the equity shares in Muska Ltd. Muska Ltd which was incorporated in Cyprus (a member of the EU) has only one director, Anja's father. Anja's dividend from Muska Ltd was exempt from tax in Cyprus. Anja did not receive the dividend in Malta because she decided to contribute the full amount of the dividend back to Muska Ltd, to increase the company's share capital.
3. Foreign bank interest of €1,500 which was retained in the foreign bank account and not remitted to Malta.
4. A passive royalty of €10,000 from Ukraine, which was derived from a qualifying patent. The royalty was exempt from tax in the Ukraine. Anja received this royalty income in her bank account in the Ukraine and did not remit it to Malta.

Paul and Anja incurred the following expenditure in the basis year 2010:

1. €10,000 for the maintenance, repair and upkeep of their yacht, Milagros I.
2. €20,000 for the yearly maintenance, repair and upkeep of their house of character in Vittoriosa (Malta) which they bought in 2009 but which was built over 200 years ago.
3. Fees of €4,000 in respect of Paul's father's home for the elderly.
4. Fees of €1,500 paid to Paul's father's physiotherapist.
5. A donation to Renee's school of €1,000.
6. A school fee of €3,000 in respect of Berta's schooling.

7. A tertiary education fee of €1,500 to a recognised tertiary education institution.

8. A tuition fee of €1,000 paid to the tutor who is teaching Anja Maltese.

Required:

(a) State, giving reasons, whether Paul and Anja will be considered as ordinarily resident and/or domiciled in Malta for tax purposes. (2 marks)

(b) Calculate Paul and Anja's chargeable income and tax payable for the year of assessment 2011. (18 marks)

(c) Explain why it would not have been beneficial for Paul and Anja to have opted for the separate method of computation in the year of assessment 2011. (2 marks)

(d) Anja is considering becoming an employee of Muska Ltd and receiving a salary instead of a dividend from the company. She would enter into a formal employment agreement with Muska Ltd which would bind her to work wholly or mainly outside Malta.

Required:

State, giving reasons, how these revised arrangements would affect Anja's tax position.

Note: calculations are not required. (2 marks)

(e) Paul is considering resigning from his full-time post with the University of Malta to take up employment in the private sector, with an employer in which the Government of Malta does not hold an interest.

Required:

State, giving reasons, how such a change in full-time employer would affect Paul's tax position with regard to the part-time employment income received from the wholly owned subsidiary of the University of Malta.

Note: calculations are not required. (2 marks)

(f) Paul and Anja are considering letting out their house of character in Vittoriosa, Malta. They have been approached by a prospective tenant who is interested in a long let because he would like to live in the house as his primary residence. Paul and Anja have furnished their house in Vittoriosa with antiques and works of art, so they intend to lease the property without any furniture or fittings inside. They intend to charge their prospective tenant a rental fee of €100,000 per annum. The €20,000 annual expense for the maintenance, repair and upkeep of the house will continue to be paid by Paul and Anja.

Required:

Explain the general rules for the taxation of income from rents, stating clearly whether or not the €20,000 per annum paid for maintenance, repair and upkeep of Paul and Anja's property will be deductible for tax purposes. (4 marks)

(30 marks)

2 **(a)** Distribution Ltd ('DL') is a property company, registered in Malta. The shareholders of DL are Mr Borghese, an individual who is neither ordinarily resident nor domiciled in Malta and Borgo Enterprises Ltd, a British Virgin Islands (BVI) company, which is wholly owned by Mr Borghese. Mr Borghese hold 50% of the equity shares in DL and Borgo Enterprises Ltd holds the remaining 50% of the equity shares in DL.

The following profits (after tax) were allocated to DL's tax accounts in 2010:

Final tax account FTA	Immovable property account IPA	Foreign income account FIA	Maltese taxed account MTA	Untaxed account UA
€	€	€	€	€
50,000	1,000	20,000	20,000	60,000

Notes

– The profits allocated to the FTA were exempt from tax in terms of the participation exemption.
– The profits allocated to the IPA were the result of an annual market rent allocation.
– The profits allocated to the FIA were derived from passive interest and royalties. With respect to these profits, DL had not availed itself of any double taxation relief.
– The profits allocated to the MTA consisted of trading income that was not attributable to a foreign permanent establishment which had been relieved by double tax relief.
– The profits allocated to the UA resulted from an intra-group exemption.

Both Mr Borghese and Borgo Enterprises Ltd received a dividend distribution out of DL's profits from each of its tax accounts in equal shares, and DL's financial controller filed a refund claim form for each of them.

Neither Mr Borghese nor Borgo Enterprises Ltd derived any other income from Malta in the year of assessment 2011.

Required:

(i) Assuming that Mr Borghese and Borgo Enterprises Ltd filed a tax return each in Malta for the year of assessment 2011, explain the tax treatment of the dividend distribution made to them out of each of Distribution Ltd's tax accounts. (8 marks)

(ii) In respect of each of Mr Borghese and Borgo Enterprises Ltd prepare calculations, in columnar format, of their chargeable incomes and the tax refunds due to them for the year of assessment 2011, stating any limitations or restrictions on the total refund available. (6 marks)

(b) Alpha Ltd is a company incorporated in the UK which is considered to be a UK tax resident under UK law. Alpha Ltd is effectively managed and controlled in Malta and is a resident of Malta for tax treaty purposes.

Alpha Ltd holds 100% of the equity shares in both Beta Ltd and Gamma Ltd, which are Maltese companies, resident and domiciled in Malta. Beta Ltd owns 75% of the equity shares in Target Ltd, a company which is also resident and domiciled in Malta. Gamma Ltd holds the remaining 25% of the equity shares in Target Ltd. All these shareholdings have been held since 2006.

Alpha Ltd, Beta Ltd, Gamma Ltd and Target Ltd are all property companies.

The income tax computation for each of the companies for the year 2010, shows the following taxable trading profit/(loss) before any group relief:

Alpha Ltd	Beta Ltd	Gamma Ltd	Target Ltd
€	€	€	€
(100,000)	(60,000)	30,000	100,000

All four companies have allocated their profits to the Maltese taxed account and have accounting reference dates which begin and end on the same date.

Required:

(i) **Define a group of companies for the purposes of the group relief of losses and state, giving reasons, which of the companies (Alpha Ltd, Beta Ltd, Gamma Ltd and Target Ltd) do or do not constitute a group (or groups) for Maltese tax purposes.** (7 marks)

(ii) **Identify the losses that can be surrendered for group relief purposes, together with the alternative group relief claims that can be made and state the time limit for making any claim(s).** (4 marks)

(25 marks)

3 Disposals Company Ltd ('DCL') was incorporated in the UK in 2007. In 2008, DCL became resident in Malta for tax purposes due to the shifting of its management and control to Malta. In 2009 DCL re-domiciled to Malta. The shareholders of DCL intend to place the company in liquidation but prior to liquidation it is intended to dispose of all of the company's assets. The relevant contracts, as described below, will all be executed in 2010.

1. A plot of land in Bulgaria
   The plot will be sold for a consideration of €60,000. DCL had bought the land in 2007 for €50,000. The plot of land was not acquired for re-sale but as an investment.
2. Head office premises in Swatar, Malta.
   DCL had acquired the perpetual emphyteusis of this property for €100,000 in 2008 and has occupied the property ever since. DCL has agreed to transfer the perpetual emphyteusis of the property to an unrelated third party for €200,000.
3. Ordinary shares (equity) in DCL II
   DCL II is incorporated and resident in Italy; it is not a property company. DCL acquired 99% of the share capital of DCL II, when it was incorporated in 2009, for €80,000. According to DCL II's latest financial statements, its net asset value is €95,000. The shares are to be transferred for a consideration of €105,000.
4. DCL's business undertaking
   DCL will transfer its entire business as a going concern to ABC Ltd, an unrelated company incorporated in a jurisdiction that does not impose a tax on capital gains. DCL's business does not comprise any registered trademarks. DCL will receive a total consideration of €200,000 for the transfer of its business and will derive a profit of €100,000 from the transfer.

DCL's shareholders wish to minimise the tax liability arising from these transactions wherever possible.

Required:

(a) (i) Calculate the minimum tax payable in respect of each of the above transactions, giving brief explanations as to the basis of computation applicable in each case. (14 marks)

(ii) State, how and when the tax will be paid. (3 marks)

(b) Define the term 'securities' for the purposes of capital gains. (3 marks)

(20 marks)

4 Esterna Ltd ('EL') is a partnership en commandite registered under the Companies Act. The partners of EL are persons who are ordinarily resident and domiciled outside Malta. The capital of EL is denominated in shares. EL's place of management is outside Malta.

EL's income for the year ended 31 December 2010 was as follows:

1. A dividend of €15,000 from Barranija Ltd, a company resident for tax purposes in China. Malta does not have a tax treaty with China. The equity shares of Barranija Ltd have a value of €60,000 and EL owns 5% of these equity shares. The dividend received by EL was exempt from tax in China, but Barranija Ltd paid corporate tax in China of €5,000 on the underlying profits. The company income tax (CIT) paid in China is attested by documentary evidence.
2. A net dividend of €5,000 from equity shares in Holdings Co Ltd, from which tax had been withheld at the rate of 5%. EL's holding of Holdings Co Ltd equity shares represents less than 1% of the company's share capital. Holdings Co Ltd is a foreign registered company and is listed on a foreign stock exchange.
3. Gross bank interest of €10,000 from EL's bank account held in Switzerland. This bank interest was exempt from tax in Switzerland.
4. Profits net of foreign tax of €60,000 attributable to EL's branch in Italy. The branch paid tax in Italy at the rate of 27% but all evidence of the tax paid has been lost. The branch trades in commodities, which are exempt from value added tax (VAT) in Italy.
5. A net dividend of €65,000 from the Malta taxed account of Malta Trading Ltd ('MTL'), a Maltese registered company. EL holds 100% of the equity shares in MTL. MTL is not a property company.

Required:

(a) For each of Esterna Ltd's sources of income for the year ended 31 December 2010:

- **identify the relevant tax account and, in the case of Barranija Ltd and Holdings Co Ltd, the nature of the holding (participatory or non-participatory);**
- **compute the chargeable income, the Malta tax due and Malta tax payable claiming the most advantageous reliefs allowable; and**
- **determine the amount after tax to be allocated to the relevant tax account.**

Note: you should use a columnar format but are NOT required to provide a total column for this part.

(12 marks)

(b) Based on your answer to part (a), for each of Esterna Ltd's tax accounts show the amount of profit available for distribution and advise the partners of the total amount of the tax refund that they might claim if the company were to distribute all of these profits. (3 marks)

(15 marks)

5 (a) State the rate (18%, 5% or 0%) of value added tax (VAT), which applies to the following supplies of goods and services:

(i) the supply of accountancy services to a philanthropic organisation;
(ii) the supply of medical accessories to persons with special needs;
(iii) the supply to the public of pharmaceutical goods which are listed in the First Schedule to the Import Duties Act;
(iv) the supply of accommodation in premises which are required to be licensed by virtue of the Malta Travel and Tourism Services Act;
(v) the supply of legal services (debt collection) to a person registered under article 11 (small undertaking);
(vi) the supply of printed matter to a school;
(vii) the supply of works of art, collector's items and antiques to a museum which is beneficially owned by the Government of Malta;
(viii) the letting of property by a limited liability company to a person registered under article 10 for the purpose of the economic activity of that other person;
(ix) the supply of food for human consumption free of charge; and
(x) the sale of immovable property. (5 marks)

(b) Explain the nature of each of the types of supply listed below, giving THREE examples of the categories of supply which fall within each:

– exempt without credit supplies; and
– exempt with credit supplies. (5 marks)

(10 marks)

End of Question Paper