



Examiner's report

F6 Taxation (MLA)

June 2009

General Comments

The June2009 F6 Taxation (Malta variant) paper was the fourth paper under the new format and consisted of five compulsory questions that broadly tested candidates' knowledge in the following five areas of study:

Question Number	Area of study	Marks
1	Personal tax	30
2	Corporate tax	25
3	Tax on capital gains	20
4	Tax accounting/Group loss relief	15
5	Value added tax	10

The candidates' overall performance in this session was very disappointing as was the percentage of candidates who managed to obtain a pass mark.

It is clear that many candidates were ill-prepared for this examination with quite a number of them demonstrating a surprising inability to understand even the basic concepts of the topics being tested. The question relating to Value Added Tax (VAT) was very badly answered and contributed significantly to the overall low pass mark rate as the vast majority of candidates obtained very few points in this question.

The poor performance is exacerbated by the generally unstructured presentation of answers demonstrating an approach to answering the questions that is not well planned.

All candidates attempted questions 1 to 4 whilst a few candidates did not attempt question 5.

Candidates are once again urged to read the question and the examiner's requirements carefully before starting to attempt the question. It has been noted that some candidates waste precious minutes in answering a question that was not asked or providing more details than requested in the question.

Specific Comments

Question One

This question carried 30 marks and broadly sought to test candidates' knowledge of personal tax matters, in particular:

- The tax status of persons who are ordinarily resident but not domiciled in Malta.
- The tax liability on income remitted or not remitted to Malta and on capital gains arising in Malta and outside Malta.
- Fringe benefits tax on the use of a company car and company property.
- Basic business profit computation.
- Computation of taxable income from the rent of property.
- Deductibility or otherwise of capital losses against other sources of income.
- Tax on sale of own residence and the conditions for the tax exemption to apply.
- Tax liability on sale of property that has been owned for less than five years.

The overall performance of candidates in this question was satisfactory. Most candidates displayed good knowledge of the following topics:

- Computation of the fringe benefit on the use of a company car and property.
- Basic computation of business profit.

- Non-taxability of funds remitted to Malta on the closure of a UK bank account.
- Non-deductibility of a capital loss on sale of shares against other sources of income and its carry forward to be deducted against future capital gains.
- The inapplicability of the tax exemption on the transfer of one's own residence in those cases where the person has not lived in it for more than three years.
- The option to tax a capital gain on the sale of a property at 12% of transfer value or at the marginal tax rate on the gain in those cases where the property has been owned for less than 5 years.

Common mistakes in this question included the following:

- Interest incurred on funds borrowed to buy the property which was subsequently rented out is deductible only from the date from which income starts being earned. A significant number of candidates took an interest deduction even for the period in which no income was being generated from the property.
- The chargeable dividend from an Italian company, after deducting the related interest on funds borrowed to buy the shares was nil. Most candidates did not deduct the interest payable and taxed the gross dividend.
- Some candidates taxed the dividend received from the final tax account of BG Ltd. instead of excluding it from the computation of the chargeable income as provided by law.
- The vast majority of candidates, even those who carried forward the capital loss on the sale of shares in Ballu Ltd. in 2008 failed to deduct such capital loss from the computation of the capital gain on the sale of the property in 2009.
- The tax payable on the sale of property consists of a provisional tax payment of 7% of the consideration received, payable on the deed of sale, whilst the balance is due on the tax return submission date. Most candidates answered this part of the question wrongly.

Question Two

This question, which carried 25 marks, presented a company's management accounts and tested candidates' knowledge of the adjustments required to arrive at the company's taxable income.

The company's transactions and the adjustments that were required included:

- Dividend income received from non-resident companies and from the different tax accounts of Maltese companies.
- Income from the rent of property and from ground rent.
- Realised and unrealised foreign exchange gains and losses.
- Recovery of bad debts previously written off and bad debts provisions.
- Depreciation on company assets including commercial and non-commercial vehicles.
- Gains on sale of fixed assets.
- Wages and salaries that are unreported under the Final Settlement System Rules.

The candidates' performance in this question was not entirely satisfactory. The topics that candidates demonstrated a good knowledge of included:

- The taxability of a debt previously written off that was recovered this year.
- The add back of depreciation and the deduction of wear and tear allowances.
- The exclusion of the gain on the sale of fixed assets from the computation of the taxable profit.

On the other hand, common mistakes made by candidates in this question included the following:

- The inclusion, as one of the deductions against rental income, of a 0.4% maintenance allowance that actually applies to transfers of immovable property.
- The failure to limit the deduction of interest payable to the income generated from the asset bought through the borrowed funds. This mistake led a number of candidates to calculate a loss on rental income.
- The flat rate foreign tax credit was computed on the basis of the income gross of foreign tax instead of the income net of foreign tax.
- A number of candidates opted for double taxation relief whilst in fact the flat rate foreign tax credit resulted in a lower tax charge.
- Dividend received from the untaxed account was taxed by some candidates at the rate of 15% instead of simply being allocated to the untaxed account of the recipient company.

Question Three

This question carried 20 marks and sought to test candidates' knowledge of the taxation of capital gains on the transfer of shares constituting a controlling interest in a company and shares that do not constitute a controlling interest.

The particular topics that were tested in this question included the following:

- The computation of the market value of shares for the purpose of computing the deemed consideration received on the transfer of shares constituting a controlling interest in a company.
- The computation of the capital gain on the transfer of shares that do not constitute a controlling interest in a company.
- The computation of the allowable tax deduction to take into account the property's increase in value in accordance with the official inflation index.
- The non-taxability of gains on the transfer of shares having a fixed rate of return.
- The net of tax proceeds on the two options presented in the question, that is, the sale of shares and the sale of the property and subsequent liquidation of the company.

The candidates did not perform satisfactorily in this question. In general, however, the following aspects of the question were satisfactorily answered:

- The rule that in a transfer of a controlling interest, the market value of the shares is deemed to constitute the proceeds on the sale of the shares for capital gains tax purposes.
- The non-taxability of gains on the sale of shares having a fixed rate of return.
- The computation of the market value of the shares by adjusting the net asset value for the increase in the value of the property and for goodwill.

The areas in which the candidates fared badly included the following:

- In calculating goodwill for the purposes of computing the market value of the shares, a number of candidates took into account the net of tax profits rather than the profits gross of tax.
- In allocating the profits on the sale of the property to the final tax account, most candidates did not deduct the property's carrying amount in the financial statements resulting in an over allocation to this tax account.
- A number of candidates brought to charge to tax the return of the share capital on the liquidation of the company.
- Most candidates wrongly computed the net of tax proceeds by deducting the tax payable from the capital gain or the deemed consideration received rather than from the actual proceeds on the sale of the shares.

Question Four

Question 4 carried 15 marks and sought to test candidates' knowledge of basic tax accounting, deductibility of expenses, double taxation relief, investment income provisions and group loss relief. In particular, the following areas of the syllabus were examined in this question:

- The non-deductibility of interest payable on funds borrowed and subsequently deposited in a bank account that generated interest subject to the 15% final withholding tax.
- A tax deduction of a flat 20% of rental income received, that is however not allowable in respect of ground rent received.
- The allocation of profits to the immovable property account, the Maltese taxed account, the Final Tax Account and the Foreign Income Account.
- The transfer of losses between the same company's taxed accounts.
- The computation of the tax payable after taking into account the unilateral relief provisions.
- The restrictions that apply to the surrender of losses from a company's various taxed accounts to another company's taxed accounts.

Candidates' performance in this question did not reach the expected level especially considering the fact that the topics that were assessed constituted basic tax concepts. In general, candidates' knowledge of the following topics was at an acceptable level:

- The tax deduction consisting of 20% of the income receivable from the rent of property that is however not allowable against ground rent received.
- The fact that the 15% tax withheld by the bank on investment income constitutes a final tax in the hands of the recipient.
- The computation of unilateral double tax relief on the receipt of dividend from a company resident in Turkey.
- Losses which, had they been profits would have been allocated to the foreign income account can be surrendered to a group company to be deducted from the latter company's profits allocated to the foreign income account.

On the other hand, candidates demonstrated a lack of basic tax knowledge in the following areas:

- Though most candidates effected a transfer of losses between one taxed account of L Limited to another, a significant number chose to set off the loss in the Maltese taxed account against the profit allocated to the Final Tax Account, which is not permissible in terms of law.
- Most candidates did not effect a correct allocation of profits to L Limited's untaxed account.
- A significant number of candidates did not appreciate the fact that in terms of law, losses in the Immovable Property Account or the Maltese Taxed Account may be surrendered to the Immovable Property Account or the Maltese Taxed Account of a group company.
- Some candidates took a tax deduction on the interest payable on funds borrowed from a related party, which funds were used to deposit in a bank account. Since the bank withheld 15% final tax on the gross interest, no deductions are allowable.

Question Five

This question carried 10 marks and sought to test candidates' knowledge of the circumstances under which a person is required to register for VAT under articles 10 and 12 of the Value Added Tax Act.

It is disheartening to note that even though this question related to a very basic area of the VAT law, only very few candidates managed to obtain a pass mark. The candidates' performance in this question indicates that a significant number of candidates are possibly not devoting enough study time to this topic.

Some areas in which the candidates fared relatively well are:

- The requirement for a taxable person to register within 30 days from the date on which he renders a supply for consideration in Malta.
- The requirement for a non-taxable legal person or a taxable person not registered under article 10 to register under article 12 when his intra community acquisitions exceed the prescribed threshold.

On the other hand, practically none of the candidates made any reference to the following circumstances that are relevant in the VAT registration process:

- The situation where the Commissioner of VAT may notify a person requesting him to register for VAT.
- Persons not established in Malta are required to register under article 10 of the VAT Act within 30 days from the date of a supply on which, in terms of article 20 of the Act he is liable for the payment of the VAT.
- A person has the option to register for VAT but in these circumstances the Commissioner shall only register such person if he is satisfied that that person is likely to be entitled, if he becomes so registered, to claim input tax credits.
- A person may voluntarily register under article 12 of the Act even if his intra community acquisitions do not exceed the prescribed threshold.