

Examiner's report

F6 Taxation (MLA)

June 2010

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General Comments

The June 2010 F6 Taxation (Malta variant) paper 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	Group companies' tax computation	15
5	Value added tax	10

The candidates' overall performance in this session was quite satisfactory. It is clear that the level of candidates' preparation for this exam was in line with what is expected for a fundamentals paper.

The Personal Tax question (Question 1) was well answered. Most candidates showed a good understanding of the basic concepts underlying the taxation of persons who are ordinarily resident but not domiciled in Malta.

Question 3, which sought to test candidates' knowledge of the tax on capital gains arising on the transfer of immovable property was also satisfactorily answered, with most candidates being able to identify and compute the tax on the different taxing options available to the transferor of the immovable property.

It is also most satisfying to note a very marked improvement in the level of candidates' preparedness for the question relating to VAT (Question 5), which in previous sessions was the question in which candidates fared worst. It appears that candidates in this session dedicated more time to this subject, which was reflected in the overall satisfactory performance.

Questions 2 and 4 required detailed but basic corporate tax computations, allocation to tax accounts and group loss relief computations. The candidates' performance in these questions was not entirely satisfactory, especially to some parts of the questions as will be commented in more detail below. It is once again disappointing to note that a number of candidates persist in not following the questions' instructions to present their response in a columnar format, which would help the candidates themselves in adopting a logical approach to answering the question.

Specific Comments

Question One

The first part of this question carried 22 marks and broadly sought to test candidates' knowledge of personal tax matters in relation to persons who are ordinarily resident but not domiciled in Malta. The specific areas that were tested in this question comprised:

- Computation of income from employment and self employment.
- Fringe benefits tax on:
 - Disturbance allowance.
 - Car cash allowance.
 - Use of mobile phone.
 - Childcare allowance.
- Tax on interest income arising outside Malta that is remitted / not remitted to Malta.

- Tax on sale of fixed interest securities.
- Tax treatment of loss upon sale of shares listed on the Malta Stock Exchange.
- Rental income.

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

- The taxability of interest arising outside Malta only to the extent that such interest is remitted to Malta.
- The non-taxability of gains on the sale of fixed interest securities.
- The computation of the tax on rental income including the limitation on the deductibility of related interest up to the amount of rent received.
- The non-inclusion of dividends received from the Final Tax Account as part of the person's taxable income.

Common mistakes in this question included the following:

- The majority of candidates erroneously included as Aldo's turnover from his business an amount that was inclusive of VAT.
- Most candidates deducted as part of the business expenses the fuel and motor vehicle maintenance costs exclusive of VAT, thus ignoring the VAT rule that blocks the reclaim of VAT on costs related to non-commercial motor vehicles.
- A number of candidates were not aware that a childcare allowance, without limitation, is exempt from tax and mistakenly taxed that portion that exceeds the childcare deduction provided in the Income Tax Act.
- Some candidates mistakenly considered that dividends received from a company whose shares are listed on the Malta Stock Exchange are exempt from tax, probably confusing it with the tax exemption that applies on the transfer of listed shares.

The second part of the question, which carried 8 marks provided four different scenarios regarding which candidates were asked to determine, giving reasons, whether the persons are or are not entitled to benefit from the beneficial tax rate of 15% in terms of the Part-Time Work Rules.

This question was, in general terms well answered. The vast majority of candidates were aware that a pensioner can benefit from the Part-Time Work Rules if he/she undertakes another activity on a part-time basis. Candidates also displayed good knowledge of the fact that only the first €7,000 earned from a part-time activity is eligible for the reduced tax rate whilst the remainder is taxed at the person's marginal rates of tax. Finally, the non-eligibility under the Part-Time Work Rules in respect of persons who employ staff in their part-time work was also well answered by most candidates.

On the other hand, most candidates were surprisingly unaware of the rule that a person whose full time income is derived from self-employment is not eligible to benefit from the Part-Time Work Rules.

Question Two

The first part of this question required candidates to adjust a company's profit as per financial statements to determine the taxable income and allocate profits to the various tax accounts. It also required candidates to compute the tax refunds available to the non-resident shareholders upon a distribution of dividends by the company.

Most candidates made a correct adjustment to the profits as per financial statements with respect to the general and specific provisions for doubtful debts and correctly allocated the profits to the taxed accounts.

On the other hand, the part of the question relating to the computation of the tax refund to which non-resident shareholders are entitled was badly answered by the majority of candidates. The rule establishing that amounts allocated to the Final Tax Account have to be distributed before amounts allocated to the Maltese Taxed Account was ignored by most candidates.

The second part of this question presented candidates with various streams of income that had to be allocated to the various taxed accounts and also included a basic computation of the flat rate foreign tax credit on dividend received from a non-resident company.

Candidates fared satisfactorily in this part of the question with only few candidates making a mistake in the computation of the flat rate foreign tax credit.

The third part of this question sought to test candidates' knowledge of the basic concepts underlying the allocation of profits to the immovable property account both with regard to income directly derived from immovable property as well as the allocations resulting from the ownership and use of property in the business, including the use of property owned by a related company.

Whilst most candidates satisfactorily allocated rental income to the immovable property account, the majority of them fared badly in the allocation of profits to the immovable property account resulting from the use of premises owned by a related company that was rented out to the company in question at less than the prescribed rent per square metre.

Question Three

This question carried 20 marks and was divided into part (a) and part (b).

Part (a) sought to test candidates' knowledge of the fundamental concepts relating to the taxation of capital gains on the transfer of immovable property.

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

- The taxability or otherwise arising on the sale of property that had been owned for more than three years but occupied as the owner's main residence only for two years.
- The circumstances in which the transferor may opt to be taxed at 12% of the transfer value or at his marginal rates of tax on the gain.
- The computation of the yearly maintenance allowance on the value of the property.
- The computation of the inflation index allowance on the cost of acquisition of the property.
- The deductibility, and limitations thereto, of brokerage fees.
- The computation of the tax payable on transfers of property that had been donated more than 5 years prior to the current transfer.

The majority of candidates displayed a good knowledge of the subject resulting in a satisfactory percentage of candidates obtaining a pass mark in this question.

However, many candidates failed to achieve higher marks in this part of the question due to mistakes in the following areas:

- No maintenance allowance was computed on the improvements to premises that were undertaken on the penthouse in Valletta.
- The inflation index allowance cannot create a tax loss and has thus to be limited to an amount that produces no profit and no loss.

- In the case of the tax computation based on the gain upon the sale of the property, as opposed to the computation on the basis of the transfer value, the brokerage fees are limited to 5% of the selling price.

Part (b) of this question requested candidates to briefly explain the rules governing the time by when tax has to be paid on transfers of immovable property.

Candidates did not perform satisfactorily in this part of the question with most candidates referring exclusively to the rules regulating the provisional tax payment of 7% of the consideration and the payment of the remainder of the tax on the tax return date, ignoring the rules regulating the tax payment dates where the transferor chooses the option to be taxed at 12% of transfer value.

Most candidates also ignored the rule that the tax is payable by the Notary Public within 15 days from the date of the transfer, limiting themselves to state that the tax is collected by the Notary Public on the signing of the transfer deed.

Question Four

Question 4 was also divided into two parts and carried a total of 15 marks.

Part (a) sought to test candidates' knowledge of:

- The adjustments required to the profit as per financial statements to arrive at taxable income with respect to depreciation and wear and tear allowances.
- The intra company set off of losses from one source against profits from other sources.
- Surrender of losses between group companies.
- The possibility to carry forward unabsorbed trading losses, capital losses and wear and tear allowances.

In general terms, candidates did well in this part of the question but some failed to identify the correct amount that could be surrendered as group loss relief, mistakenly surrendering the loss obtained after the deduction of wear and tear allowances.

Part (b) of the question required candidates to explain the rules contained in the Income Tax Act regulating the sources against which capital losses, trading losses, wear and tear allowances and losses in the Final Tax Account could be utilised as deductible expenses against the income of the company and other companies in the same group.

Candidates' response to this question was not entirely satisfactory. A number of candidates demonstrated a lack of understanding of basic concepts such as the carry forward and deductibility of unabsorbed wear and tear allowances only against the same source of income produced by the assets on which the wear and tear allowances arose. Most candidates also were apparently unaware of the rule that a loss which, had it been a profit, would have been allocated to the Final Tax Account is excluded from the definition of "loss" for tax purposes and therefore cannot be surrendered to group companies.

Question Five

This question carried 10 marks and presented candidates with ten different transactions on which they were required to state whether the supplier was required to charge VAT and if yes, at which rate. Candidates were also required to explain whether the supplier was entitled to recover the VAT incurred on its own purchases.

As stated earlier, this question was satisfactorily answered. However, a number of candidates still fail to grasp the basic concept in VAT that whenever a supplier charges VAT, whether at the standard rate or the reduced rate, he is always entitled to recover the VAT incurred on its own purchases. A number of candidates erroneously



responded to some of the ten questions by stating that the particular supply is taxable without the right of credit for input VAT.