

Examiner's report

P6 Advanced Taxation (MLA)

June 2011



General Comments

The examination consisted of five questions; two compulsory questions were set in section A, and there were three questions in Section B from which candidates were to answer two. Question 1 and question 2 in section A carried 32 marks and 28 marks respectively and the three questions in section B each carried 20 marks. The examination had an approximate 2:1 split requirement for computation and narrative respectively.

Most candidates attempted all four questions. Question 5, which examined Value Added Tax scenarios, was the least popular with candidates.

Candidates found the examination challenging, producing incomplete answers to questions. Candidates are reminded of the need to prepare to be tested both on their in-depth knowledge of syllabus subjects and their ability to apply what they know to the questions set. In the examination, full workings need to be shown, presented clearly and labelled so as to be easy to follow. It is important that computations are presented in the appropriate formats.

Specific Comments

Question One

This 32-mark question was split into three parts. The first part, to which 23 marks were attributed, tested candidates' abilities with respect to the income tax and duty implications of the value shifting provisions on the allotment of shares in a company to one of the shareholders.

Most candidates faithfully reproduced the formulae pertaining to the determination of the value transferred and the cost of acquisition on a value shift. However, few candidates arrived at the correct determination of the market value before and after the shift. Otherwise, knowledge of the income tax implications was good. The duty implications of the transfer of value were less well known, with few candidates realising that adjustments were required to establish the real value of the shares acquired for duty purposes.

The second and third parts of the question tested candidates' ability to arrive at the cost of acquisition of company shares on transfers subsequent to the value shift. Candidates found this difficult and often strayed from the point by bringing up the issue of controlling interest, which was not a consideration in arriving at the correct solution. Most candidates did mention correctly that the non-resident shareholder was not exempt on the transfer of shares in view of the fact that the company was a property company.

Question Two

This 28-mark question was split into two parts with the first part, carrying 22 marks, testing candidates' knowledge of the reliefs available to a company receiving trading income from a permanent establishment and dividend income from a company situated in a state which charged a zero rate of tax. Candidates were also required to have a good understanding of the tax refund system and were asked to select the combination of relief and refund which provided the minimum tax leakage to the non-resident shareholders of the company.

The responses to this question once again showed that candidates knew the types of reliefs available and the consequent refunds that could be claimed, but found it harder to apply this knowledge to the scenario presented in the question. Many candidates knew the mechanics of applying double taxation relief and the flat rate foreign tax credit and the consequences of not claiming any relief at all, but were unable to determine which was the best solution in terms of applying both to the scenarios in the question, i.e. the business income and the dividend income. Candidates need to practise preparing accurate computations so as to be able to select the correct

solutions. A few candidates did very well to produce the correct solution to the treatment of the dividend income, and demonstrated good knowledge of the mechanics of underlying tax relief.

The second part of the question tested candidates' ability to prepare a tax computation in respect of the various sources of income showing the minimum tax leakage. Candidates need to know how to compute treaty relief correctly, and to be aware that the 35% tax charge is applied to the net income before claiming the 6/7ths refund. Many candidates prepared a correct computation of the FRFTC relief.

Question Three

This question, which consisted of two parts, tested candidates' knowledge on a mixed scenario involving the treatment of overseas employment, rental income, capital gains, tax on property transfers and treaty relief. This was the examination question with the best quality of responses. It appears that candidates were particularly well versed in the capital gains provisions. Most candidates knew when the own-residence exemption applied and when to opt for taxation in terms of article 5 rather than article 5A of the Income Tax Act. Many candidates also knew how to apply the rules on the computation of rental income. Fewer candidates were able to respond correctly to the part of the question with respect to the treatment of overseas employment.

The second part of the question, which carried three marks out of a total of 20, tested candidates on the same scenario but with a different residency status. Many candidates were able to reply correctly with respect to the tax implications in the source state but not to address the tax implications in the state of residence.

Question Four

This question was divided into three parts which examined three different subject matters. The first part was divided further into two parts.

Question 4(a) required candidates to demonstrate their knowledge of the taxation of returned migrants. Part (i) presented candidates with five different sources of income and required them to determine which sources were exempt from tax. Most candidates knew that returned migrants are taxed on the remittance basis of taxation and were therefore able to respond correctly.

Part (ii) required candidates to prepare a computation based on the information provided in part (i). Here candidates were less successful if they did not know which sources were taxable at 15% after allowing for the tax-free bracket, and which sources were taxable at the normal rates without the tax-free bracket. Some candidates ignored the tax-free bracket completely.

Question 4(b) tested candidates' knowledge of the taxation of gains on the transfer of shares by a transferor who held such shares before they were admitted to listing on the Malta Stock Exchange. The majority of candidates knew that the transfer of such shares was taxable. However, many candidates did not know that the chargeable gain was restricted to the market value of the shares immediately before their listing and that a special rate of tax of 15% applies.

Question 4(c) presented a scenario in which a company owning a plot of land gave a turnkey contract to a subsidiary company to develop the property. The question tested candidates' knowledge of the restriction applicable to related companies which is contemplated in article 14(4) of the Income Tax Act. This provision caps the deduction for the construction expenses to the extent that the total deductions do not exceed the consideration received on the transfer of the property. A few candidates were able to demonstrate their knowledge of this provision.

Question Five

Question 5 consisted of two parts, both dealing with VAT.

Part (a) tested candidates' knowledge of the recent changes in the VAT treatment of administrative and consultancy services provided by a firm established in Malta to taxable and non-taxable persons inside and outside of the EU. Most candidates did not make a distinction between the two categories of services.

Part (b) presented candidates with two different scenarios and required them to establish whether the services provided in each scenario were to be considered as taking place within or outside Malta. Candidates were fairly successful in providing correct answers to this part although responses would have benefitted from more attention to detail to demonstrate detailed knowledge of the relevant provisions of the legislation. This was particularly evident in Scenario 2 in which a taxable person established in Malta provided legal services to a non-taxable individual resident in the UK and a non-taxable legal person registered for VAT in the UK. Although most candidates were able to establish where the services were considered to be taking place, few provided their reasons. Well prepared candidates made mention of the general and the specific rules, and of the distinction between B2B (business to business) and B2C (business to consumer)