



# Examiners' report

## F6 Taxation (MLA) December 2007

The paper in this session was the first one in the new format - having five compulsory questions. The five questions in the paper dealt with the following topics and had the following marks:

Question	Topic	Marks
1	Personal income tax	25
2	Corporate income tax	30
3	Capital gains tax and property transfer tax	20
4	Group relief provisions	15
5	Value Added Tax	10

The candidates' overall performance was comparable to previous sessions and satisfactory. Candidates performed very well in Questions 1, 4 and 5 and quite well in Question 2. However, the candidates' performance in Question 3 was somewhat disappointing and very few candidates answered the question correctly (see further comments below).

The answers presented by many for the other four questions were satisfactory and in some instances high marks were achieved by a number of candidates. Apart from the above comments on Question 3 some marks may also have been lost in answering Question 2 (see further comments below).

Workings were generally shown where necessary but were difficult to follow at times. Many candidates continue to display their answers poorly, with a lack of clear labelling to indicate which questions are being attempted. Each question should begin on a new page and candidates should plan the layout and organisation of their answers. Valuable time can be easily wasted, for example by not tabulating the answer properly. This was particularly applicable to Questions 1, 2 and 4.

### Question 1

This 25-mark question tested candidates' ability to calculate the settlement tax of five particular individuals who were subject to personal income tax using either the joint tax computation or the separate tax computation. In arriving at the settlement tax amount, candidates had to:

- Calculate the chargeable income by identifying the chargeable sources of income and deducting the personal tax deductions were applicable,
- Calculate the tax liability using the appropriate tax rates, and
- Identify the tax credits such as provisional tax payments, tax deducted under the Final Settlement System, double taxation relief etc.

Many candidates answered this question well but common mistakes included:

- There was no need for Anthony to declare the Malta source gross dividend. However, candidates who included the gross dividend in arriving at the chargeable income and then included the tax at source as a credit in arriving at the settlement tax amount were not penalised;
- The interest payable by Bernard on his current account (balance in debit) with the partnership is not allowable for income tax purposes;
- No deduction was given to Bernard in respect of the alimony payments to Bridget;
- No deduction was given to Bridget in respect of the 20% maintenance allowance or further deduction on the rental income;
- The deduction in respect of Alison's school fees were not capped at Lm300 per annum but the full amount paid (Lm480) was deducted;

- The amounts paid under the Final Settlement System (FSS) were deducted in arriving at the changeable income rather than given as a tax credit against the tax charge for the year.

Apart from the above, some candidates did not compute the partnership's profit correctly and did not deduct the partners' wages and salaries and the interest on current accounts.

Also, as indicated above, candidates should give more attention in presenting the answers in a tabular format (where applicable) adding to clarity and using the time effectively.

### Question 2

This question was split into four parts and carried 30 marks with more than one half of the marks being given to the preparation of a company's income tax computation. The other three parts were straightforward questions on capital allowances, the tax payment date, balancing statements and group relief.

In part (a) many candidates failed to adjust the cost of the industrial buildings by adding the Lm15,000 capital expenditure which was incorrectly claimed as an expense in the profit and loss account. Some candidates calculated the wear and tear allowances for a six month period and did not claim the full amount for a year as they should have done.

Although part (b) clearly stated that the income tax computation should start with the profit before tax figure as per financial statements of Lm305,000 some candidates ignored this. Candidates should read the question carefully and give what is required. For example, even the tax charge had to be shown separately on the trading operations, local interest income and the foreign source income rather than just as a lump sum. This part also asked candidates to calculate the tax charge as it would appear in the company's financial statements but very few gave this figure and showed the relevant workings.

In the income tax computation the most common mistakes included:

- The capital expenditure of Lm15,000 was not added back;
- The formation expenses amounting to Lm1,800 were not added back;
- The pre-trading expenditure amounting to Lm3,400 was not added back;
- The training and advertising expenditure were added back when no adjustment was required in respect of these (allowable in terms of legal notice 88 of 2002);
- Interest paid to the Inland Revenue Department was not added back;
- Interest paid to the VAT Department was added back (this is allowable in terms of article 74(b) of the Value Added Tax Act);
- The profit on the disposal of machinery was deducted.

In part (c) candidates were required to state that no provisional tax is payable in the first year of operation and thus had to pay the tax payable in respect of income allocated to the Maltese Taxed Account by the tax return date of 31 March 2008 and the tax payable in respect of income allocated to the Foreign Income Account by 31 December 2008 which is eighteen months from the end of the company's financial year end (30 June 2007). Many candidates failed to make this distinction in their answer in part (c).

Although parts (d) and (e) required a very short narrative answer many candidates failed to mention that:

- No balancing statement is required since no wear and tear allowances have been claimed in respect of the machinery sold during the period;
- Group relief is not applicable since the parent company of both SCM Ltd and TLG Ltd was resident in the UK.

### Question 3

Although a question on capital gains tax has always featured in the previous sessions, it is obvious that many candidates encountered difficulties in this question and the answers were rather poor.

Part (a) of the question was tackled by many candidates but in arriving at the market value of the ordinary shares they failed to exclude the value of the preference shares (on which any capital gain is not subject to tax) and the adjustment in respect of the goodwill element was incorrect. In the latter, some candidates either included the balance brought forward of Lm46,350 or else did not deduct the loss incurred during 2005.

In the calculation of the chargeable capital gain in respect of the shares transferred by both Mary and Anne, candidates had to distinguish between a controlling interest and a non controlling interest. In the case of a transfer of a controlling interest the market value of the shares is taken instead of the consideration. In this scenario, the taxpayer (Mary) may adjust the cost of acquisition by claiming an inflation element in respect of the immovable property held by the company.

In part (b) candidates simply had to calculate the 12% property transfer tax on the plot of land, the block of apartments and the showroom and offices. The 12% is calculated on the consideration and not on the profit element. Moreover no tax is due in respect of the penthouse since the company could opt for the normal capital gains rules rather than the property transfer tax since the penthouse was being transferred within the first five years when the taxpayer has an option which tax to apply.

Since many candidates failed to answer parts (a) and (b) correctly many did not even attempt to answer the last two parts of the question. It could also be that candidates failed to understand what was required particularly in part (c) of the question. This part required candidates to calculate the cash at bank and the retained earnings (after the disposal of the immovable property) and then distribute the capital and the retained earnings, which were both not subject to any tax in the hands of the shareholders. The return of capital is not subject to tax and the distribution of profits which were subject to the property transfer tax of 12% at the level of the company are not subject to any further tax in the hands of the shareholders.

It is expected that candidates should have a much better understanding of the Capital Gains Rules (Legal Notice 102 of 1993 as amended by Legal Notices 379 of 2002 and 5 of 2005) and the Tax on Property Transfers Rules (Legal Notice 112 of 2006) considering that these topics will always feature in question 3 and it will always carry 20 marks (see Syllabus and Study Guide).

### Question 4

This question tested the candidates' knowledge on the group relief provisions of the Income Tax Act together with the limitations and the conditions applicable.

Many candidates answered this question correctly and in a tabular format as is often used in the suggested answers. However few candidates failed to distinguish the companies' income tax computations between income which is allocated to the Maltese Taxed Account and the Foreign Income Account.

It appears that there are no difficulties in preparing the income tax computation and adjusting for depreciation, capital allowances and capital losses and only a few candidates made mistakes in the transfer of losses from the Foreign Income Account to the Maltese Taxed Account of Bo Limited and in the group relief provisions. Even the unabsorbed capital allowances and capital losses carried forward were treated correctly by a good number of candidates.

There is very little to comment about when candidates perform so well in answering a question.

**Question 5**

The question dealt with Value Added Tax and it is evident from the answers that many candidates found the question straightforward and obtained high marks from the 10 marks allocated to this question. Perhaps the only difficulties encountered by some candidates related to the output tax on the sale of equipment (Lm4,000 at 18%) and the input tax on the expenses and the bad debt.

In the case of expenses, Lm23,300 were standard rated and therefore the input tax amounted to Lm4,194 (18% of Lm23,300) whereas Lm4,400 were at the reduced rate of 5% and therefore the input tax amounted to Lm220 (5% of Lm4,400).

In the case of bad debts, the company is entitled to claim input tax equivalent to 18% of Lm1,600.

The question posed no particular difficulties to a number of candidates.