



Examiners' report

F6 Taxation (MLA)

December 2008

The December 2008 F6 Taxation (Malta variant) paper was the third 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	15
5	Value added tax	10

The candidates' overall performance in this session was disappointing.

Candidates would benefit from reading the examiner's comments on previous sessions, which would help them to prepare and assist them in how to approach the examination.

Some candidates could improve by increasing their knowledge and basic understanding of fundamental tax principles in their exam preparation. Some candidates appear to fare better when tackling questions requiring a detailed knowledge of certain provisions in the law, rather than tackling question requiring knowledge of the more general and basic provisions. Examples of such instances are provided below in the detailed comments to the various questions.

It is once again suggested that candidates spend a few minutes thinking about the way they will present their answer. This process will inevitably result in a more logical approach to the question and hence a better answer, as well as a neater presentation that will surely make it easier to follow and award marks.

Finally, candidates are urged to read the question and the examiner's requirements carefully before starting to attempt the question. This should avoid wasting precious minutes in answering a question that was not asked or providing more details than requested in the question.

Question 1

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

- Fringe benefits on car cash allowance, mobile phone allowance, health insurance, internet cost reimbursement, use of company car and childcare costs reimbursements;
- Tax on sale of own residence;
- Capital gains/losses on sale of shares that are listed on the Malta Stock Exchange;
- Capital gains/losses on sale of shares that are not listed on the Malta Stock Exchange;
- Rental income and related limitations on interest deductions and loss carry forward;
- Dividends from immovable property account and final tax account;
- Deductions for school fees, childcare costs and sports related expenses;
- Tax deductions under the Final Settlement System;
- Provisional capital gains tax payments on the sale of shares.

Most candidates displayed good knowledge of the following topics:

- Computation of the fringe benefit on the use of company cars;
- Tax exemption on the provision of a health insurance policy by the employer;

- Capital gains tax exemption on the disposal of listed shares;
- School fees deductions.

The topics that some candidates struggled with include:

- Childcare costs that are not considered to be a fringe benefit when reimbursed by the employer, irrespective of the amount reimbursed;
- Provisional capital gains tax that is payable on the disposal of company shares. This was often missed in answers to paragraph (d) of the question;
- The tax deduction computation under the Final Settlement System. Some candidates mistakenly computed this on the basis of 50% of the gross salary;
- The mobile phone allowance which is taxable, unlike a reimbursement of mobile phone costs incurred for the employer's business;
- The use of married tax rates in a situation in which the use of single rates was more beneficial to the couple; and
- The deductibility of the interest expense. Some candidates did not apportion between the interest relating to the acquisition of the shop in Msida, which generated rental income and is therefore tax deductible, and the interest relating to the acquisition of their residence in Balzan, which did not generate any income and therefore is not tax deductible.

Question 2

This question, which carried 25 marks, presented a series of transactions carried out by a Maltese company and tested candidates' knowledge of the tax treatment of such transactions which included:

- Dividend income derived from shareholdings in non-resident companies (participating holding and non-participating holding);
- Capital gain on the sale of a shareholding in a company that does not constitute a participating holding;
- Computation of annual market value of property through which the company operated, for the purposes of allocating profits to the Immovable Property Account;
- Investment income arising on Maltese government stocks and the allocation of such income to the Final Tax Account;
- Allocation of profits to the various tax accounts;
- Refunds of tax to non-resident shareholders of the company upon a distribution of dividends.

Answers to this question were not as good as expected.

On a more specific level, candidates appeared to have a good knowledge in the following areas:

- The computation of the annual market rent amounting to €60 per square metre of office premises that was not leased out to third parties;
- The circumstances entitling shareholders to a six-sevenths tax refund as opposed to situations where a two-thirds refund is available.

On the other hand, candidates' knowledge in the following areas could have been better:

- Interest earned on Government stocks is subject to final withholding tax of 15% and the net amount is allocated to the Final Tax Account. Common mistakes included either exempting the income or charging it at the 35% company rate of tax;
- Some candidates incorrectly allocated to the various tax accounts, the amounts invested by the company rather than the income derived from its investments;

- The Untaxed Account is basically the difference between the company's distributable profits and the amounts allocated to the various tax accounts. Some candidates struggled to make any allocations to the Untaxed Account and failed to include the allocation consisting of a provision on a receivable that impacts the accounting profit but not the tax profit.

Question 3

This question carried 20 marks and sought to test candidates' knowledge of the taxation of capital gains on the transfer of immovable property. More specifically, the following areas of knowledge were tested in this question:

- The circumstances in which a donation of immovable property is exempt or taxable;
- The situations where a transferor of immovable property has the option to be taxed on the capital gain or at 12% of the property's transfer value;
- The capital gains tax computation on the transfer of immovable property following a tax exempt donation and a taxable donation;
- The payment of 7% provisional capital gains tax and the timing of such payment, in those cases where the transferor of property has and exercises the option to subject the transfer to tax on the capital gain, rather than as a percentage of the transfer value;
- The payment of 12% final tax on the transfer value and the timing of such payment where the transfer is subject to tax under this method;
- The fact that on transfers of immovable property subject to tax at 12% on the transfer value, the relevant taxable amount is the higher of the consideration received and the market value of the property.

It appeared that candidates were unprepared for a question concerning capital gains on the transfer of immovable property, perhaps concentrating their studies on capital gains on the transfer of company shares.

Most candidates were aware that in the case of a transfer of property within five years from an exempt donation, the cost to be taken into account in computing the gain is the cost to the donor, that is, the value assigned to the property on the donation deed is ignored.

On the other hand, the following were common mistakes in the answers to this question:

- On the transfer of property following a taxable donation, it is the value assigned on the donation deed that is relevant for determining the cost of the property, not the cost to the donor;
- Missing the fact that a 7% provisional capital gains tax is withheld by the notary publishing the deed, in those transfers where the transferor opts to be taxed on the capital gain at his/her marginal rates of tax;
- Missing that any shortfall between the payment of the provisional capital gains tax and the actual tax suffered has to be paid by the tax return date, or in the case where the provisional capital gains tax exceeds the actual tax chargeable, the refund is receivable within six months of the tax return date, if the tax return is submitted within the time stipulated by law;
- Not appreciating the fact that the 'transfer value' of a property is only relevant in the context of a transfer of property subject to tax at 12% of such transfer value under article 5A of the Income Tax Act, whilst in the case of a transfer subject to tax on the gain under article 5 of the Act, only the consideration received for such transfer is relevant;
- Missing the fact that the option to be taxed at 12% on the transfer value or at the marginal tax rates on the gain is available to transferors who transfer a property within five years from the date of acquisition. Some candidates, in a situation where the property was transferred within five years of acquisition, incorrectly stated that the transferor had no option but to be taxed at 12% of the transfer value;
- Some candidates had the mistaken understanding that in the case of taxable donations, tax is payable by the donee and not by the donor.

Question 4

Question 4 carried 15 marks and sought to test candidates' knowledge of basic tax accounting and dividend distribution rules. In particular, the following areas of the syllabus were examined in this question:

- The re-allocation of certain undistributed profits existing at the end of the year preceding the year of assessment 2008, to the Final Tax Account introduced with effect from the year of assessment 2008;
- The allocation of profits on certain transactions to the various tax accounts;
- Determining the distributable profit on the sale of a property subject to tax at 12% of the transfer value;
- The notional allocation to the Immovable Property Account of the difference between €60 per square metre and the amount per square metre charged by a related company for the use of office premises from which the company operated;
- The new rules concerning the sequence that has to be maintained when distributing profits, that is, that profits allocated to the Immovable Property Account and the Final Tax Account must be distributed before profits allocated to the Maltese Taxed Account.

Candidates' performance in this question was satisfactory.

Almost all students correctly allocated the closing balance in the Maltese taxed account on 31st December 2006 that had been subjected to 15% final withholding tax on investment income to the opening balance in the Final Tax Account. The majority of candidates also correctly allocated the net income from bank interest to the Final Tax Account.

However, some responses to part (d) of the question, relating to the dividend distributions was very unsatisfactory. Although a few candidates did show a good knowledge of the new rules regulating dividend distributions from the various tax accounts.

Question 5

This question carried 10 marks and presented candidates with ten different transactions on which they were required to state the VAT treatment, that is, whether the supply is subject to VAT, at what rate and whether input tax on related purchases is deductible or not. Candidates' performance was satisfactory.

Candidates fared particularly well in their answers to questions on the VAT treatment of interest charged by commercial banks, the provision of medical treatment in a hospital and the sale by an individual of his private motor vehicle.

Common mistakes were made in response to the questions concerning the sale of television sets while placed in a customs duty suspension regime (such transactions are exempt with credit) and the hiring of safety deposit boxes by a commercial bank (such hiring is subject to VAT at 18%).

Some candidates also failed to state that the VAT rate on the provision of accommodation, the minor repairing of bicycles and the sale of works of art is the reduced rate of 5%. Another common mistake was stating that input tax is not deductible in relation to certain transactions that are subject to VAT.