



Examiner's report

F6 Taxation (MLA)

December 2009

General Comments

The December 2009 F6 Taxation (Malta variant) paper was the fifth 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	Income from overseas investments	15
5	Value added tax	10

The candidates' overall performance in this session was very satisfactory. The percentage of candidates who obtained a pass mark was significant and it is clear that most candidates were well prepared for this exam.

It is significant to note however that the candidates' overall positive performance in this session was mainly the result of very good answers to questions 1 and 4 in which the majority of candidates obtained very high marks thus permitting such candidates to fare comparatively poorly in the remaining questions and still obtain an overall pass mark.

As stated above, questions 2, 3 and especially 5 were, in general, poorly answered. The value added tax (VAT) question was the least favoured by candidates, evidenced by very poor performance from a significant number of candidates.

A general improvement in the way that candidates present their answers was noted with satisfaction as this was a consistent negative comment in previous examiners' reports that candidates seem to have made an effort to address.

Specific Comments

Question One

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

- Computation of income from employment and self employment.
- Fringe benefits tax on:
 - Use of a company car.
 - Paid family holiday.
 - Overseas travel allowances and reimbursement of business related travel costs.
 - Use of company property.
 - Payment of private school fees.
 - Payment of health insurance.
 - Payment of childcare centre fees.
- Tax on investment income consisting of interest on government bonds.

- Capital gains tax on sale of preference shares and listed and unlisted securities and donations to family members.
- Deductibility of interest on bank loan used to finance the business.
- The provisions relating to the taxation of income from overseas employment.

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

- Computation of the fringe benefit on the use of a company car and company property.
- The non-taxability of the reimbursement of business travel expenses.
- The taxability of health insurance paid for by the employer, where such health insurance cover is not available to all or a majority of the employees.
- The non taxability of gains realised on the sale of government bonds and listed securities.
- The non taxability of the provision of uniforms and meals in the staff canteen.

Common mistakes in this question included the following:

- A travel allowance given to employees in circumstances where all the travel costs are paid for by the employer is subject to tax. A number of candidates erroneously considered the travel allowance to be exempt from tax.
- Some candidates erroneously taxed the gain realised on the sale of preference shares which is a tax exempt transfer since securities that have a fixed rate of return are not included within the definition of “securities” the transfer of which is subject to capital gains tax.
- A donation to one’s sister is not exempt from tax in a situation where a person has children. Thus the loss realised on the donation of shares by Mario to his sister is a capital loss that is deductible against other capital gains. Most candidates erroneously did not take into account this capital loss.
- Most candidates, in calculating the deductions against Doris’ self employment income, did not include the VAT element on the business expenses, which should have correctly been taken into account as Doris is registered as a small undertaking for VAT purposes and therefore does not recover the VAT incurred on her business costs.

The second part of the question, that related to the special provisions regulating the tax on overseas employment was generally well answered but most candidates failed to refer to the fact that the income from overseas employment constitutes the last part of a person’s income and also failed to mention the fact that a person is taxable under the special provisions contained in article 56(17) of the Income Tax Act only if he opts to be taxed under these provisions instead of the normal provisions contained in the Act.

Question Two

This question, which carried 25 marks, presented a company’s draft income statement and tested candidates’ knowledge of the adjustments required to arrive at the company’s taxable income and the computation of the tax payable.

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

- The add-back of the accounting loss on the disposal of fixed assets.
- The add-back of professional fees incurred prior to the date of incorporation.
- The add-back of unrealised exchange losses on year-end debtor balances.
- The non deductibility of the entertainment allowance that was not reported under the Final Settlement System Rules.
- The non deductibility of the loss realised on the sale of listed shares.
- Allocation of profits to the Final Tax Account.
- Computation of the flat rate foreign tax credit on the dividend received from Alps Limited.

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

- The payment by the employer of employees' childcare costs is tax deductible up to a maximum of €935 per child. Many candidates were not aware of this rule and either disallowed the childcare costs in their entirety or took a tax deduction for the full amount paid by the employer.
- A number of candidates deducted an amount for wear and tear allowances as is equivalent to the proportion of the year during which the company owned the assets. Tax legislation very clearly states that a full year's wear and tear allowances are to be deducted in the year of purchase of the assets.
- Few candidates correctly computed the non-deductible portion of the interest incurred on the loan taken out to buy the office block, because the rental income was less than the total of interest incurred and the 20% further deduction on rental income.

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 shares constituting a controlling interest in a company.

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

- The determination 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 adjustment to the market value of the company required to take into account the increase in value of immovable property owned by the company.
- The adjustment required to take into account the market value of shares held by the company in other companies.
- The computation of goodwill in the particular circumstance where part of the company's profits consists of dividends received from its shareholding.
- The determination of the inflation allowance in a situation where the shareholder bought the shares in the company after the company had bought the immovable property.

Most candidates displayed a good knowledge of the basic concepts of what constitutes a controlling interest in a company and how this affects the computation of the capital gain on the disposal of shares.

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

- In valuing the company's goodwill, few candidates correctly deducted the dividends received from Functions Limited from the pre-tax profits, required in order to avoid double counting of profits.
- In determining the inflation adjustment, a number of candidates failed to take into account the fact that Stephen only bought his shareholding in Palms Limited two years after the company bought the property and thus not all the inflation allowance from the year of purchase of the property to the year of sale of the shares is deductible.
- A number of candidates did not deduct the value of the company that is attributable to the preference shareholders in arriving at the value of the company attributable to the ordinary shareholders.

Part (b) of this question presented candidates with four different transactions and sought to test their knowledge on whether the transactions are subject to tax or not.

In general terms, candidates performed well in this part of the question. However, part (b) of the question was answered wrongly by a number of candidates who erroneously deemed the transfer of shares by an individual to a company, where both the company in which the shares were transferred and the transferee company are more than 50% owned by him, to be tax exempt by virtue of the provisions exempting intra group transfers of assets.

Question Four

Question 4 carried 15 marks and was divided into part (a) and part (b).

Part (a) presented candidates with four scenarios in which a Maltese company held shares in non-resident companies and derived income in the form of dividends and capital gains on the disposal of its holdings.

The question tested candidates' knowledge of the tax rules determining whether a holding constitutes a participating holding and whether the dividends received and the capital gains realised on the disposal of the shares were eligible to benefit from the participation exemption.

Candidates fared very satisfactorily in this question with most candidates displaying a detailed knowledge of the topic. A surprising number of candidates obtained full marks in this part of the question. Other candidates failed to obtain higher marks because they did not provide the details which an examiner would expect from a question which carried eight marks.

Part (b) of the question required candidates to compute the tax chargeable and the tax payable on the income received by Meadows Ltd. from its holdings in the non-resident companies and from the disposal of such holdings.

This part of the question was also satisfactorily answered by candidates and in general terms those candidates who fared satisfactorily in the first part of the question also did well in the second part.

Question Five

This question carried 10 marks and required candidates to list the items, contained in the Tenth Schedule to the VAT Act, the VAT chargeable on which is not deductible, even when bought by businesses.

Candidates were also required to list those circumstances in which, despite the general non-deductibility referred to above, the VAT incurred on the purchase of such items would be deductible.

This question was very poorly answered and only a small percentage of candidates managed to obtain a pass mark, with a significant percentage not obtaining any marks.

A significant number of candidates instead of replying to the question by listing the items, the VAT on which is blocked for VAT purposes, inexplicably listed the goods and services the supply of which is exempt without credit for VAT purposes.

Such answers are regrettably indicative of a serious lack of knowledge of the basic concepts underlying VAT, undoubtedly a result of the fact that not enough time is being devoted by candidates to study this law in sufficient detail to be able to answer a relatively simple question on the subject.