

# Examiner's report

## P6 Advanced Taxation (MLA)

### December 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 carried 36 marks and 28 marks respectively, and the three questions in section B each carried 18 marks. The examination had an approximate 2:1 split requirement for computation and narrative respectively.

Most candidates attempted all four questions. Question 3, which examined tax and VAT issues involving the incorporation of a business, was the least popular with candidates.

Candidates did find the examination challenging, and 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, with computations presented in the appropriate formats - it is very important for candidates to practise all of these aspects of exam technique in the period leading up to the exam.

Candidates may benefit from a review of fundamental tax topics in the F6 syllabus which form the foundation for the P6 level. For example, group loss relief sits within both the F6 and P6 syllabuses, and the fundamentals learned at F6 level remain examinable within the advanced taxation exam.

#### Specific Comments

##### Question One

This 36-mark question was split into three parts. The first part, to which 6 marks were attributed, tested candidates' abilities to explain the income tax implications in the case where a company, as a result of a change in the shareholders, ceases to be a member of a group after having acquired a property from another group company. Many candidates were aware that the transfer of the office building from B Ltd to C Ltd qualified for tax relief and that the transfer of shares in C Ltd results in tax becoming payable, and some were able to provide detail of the provisions, outlining the reasons for the conclusion drawn.

The second part, to which 19 marks were attributed, tested candidates' abilities to explain the income tax and duty implications of share transfers and deemed transfer of value arising on the allotment of shares in a company to a new shareholder. The explanations given by most candidates were correct, and very good candidates were aware that in determining the market value/real value of C Ltd in the case of the share transfer, the net asset value to be taken into account was that for the year ended 31 December 2011.

Most candidates faithfully reproduced the formulae pertaining to the determination of the value transferred and the cost of acquisition on a value shift. A few candidates are to be congratulated for arriving at the correct determination of the market value before and after the shift. Candidates' knowledge of the income tax implications was good. The duty implications of the transfer of value were less well known; stronger candidates realised that adjustments were required to establish the real value of the shares acquired for duty purposes and stated that the value of the preference shares is not to be deducted from the net asset value in the case of the allotment of shares.

The third part of the question tested candidates' ability to calculate the income tax and stamp duty liabilities. Candidates found this part difficult, especially the calculations in respect of the allotment of shares.

##### Question Two

This 28-mark question was split into two parts with the first part, carrying 21 marks, testing candidates' knowledge of the reliefs available to companies receiving trading income, both local and from a permanent establishment, and dividend income from a company resident outside of Malta. Candidates were also required to have a good understanding of the group loss relief provisions and the tax accounting and 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, with very good answers going on 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, and some were also able to determine which was the best solution in terms of applying both to the scenarios in the question, i.e. the business income derived from the permanent establishment and the dividend income. Candidates do 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 very 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 allocate profits to the five tax accounts, compute treaty relief correctly, and to be aware that the two-thirds refund is calculated on the tax charge before deducting treaty relief. Many candidates prepared a correct computation of the chargeable income of the subsidiaries (Green Ltd and Yellow Ltd), and a few went on to produce a correct computation of the chargeable income of Holdco Ltd.

### **Question Three**

This question, which consisted of two parts, tested candidates' knowledge of the tax and VAT implications of a transfer of a business, together with the business assets, to a limited liability company on incorporation and the transfer of immovable property. Part (a) required knowledge of the capital gains and tax on property transfers provisions, while part (b) required knowledge of the VAT exemption on the transfer of a business as a going concern and the capital goods scheme. The majority of candidates who opted for this question correctly mentioned that the transfer of the shop and store A qualified for tax relief, and a few candidates also explained in detail the conditions applicable for tax relief to apply.

The second part of the question, which carried 10 marks out of a total of 18, tested candidates' knowledge of VAT in respect of the same transactions. To answer this well, candidates needed to have in depth knowledge of the capital goods scheme implications applicable on the disposal of store B.

### **Question Four**

This question was divided into two parts, which examined two different subjects.

Question 4(a) 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. Most candidates knew that the transfer of listed shares is an exempt transfer and that such a transfer would be taxable if the shares transferred were held by a person who held those shares prior to being listed. On the whole this question was answered very well.

Part (ii) required candidates to prepare a computation based on the information provided in part (i). Many candidates were aware that the applicable tax rate on the gain is 15% and many produced correct computations.

Question 4(b) tested candidates' knowledge of the jurisdictional rules. The majority of candidates knew that Aldo would retain his domestic tax status during his stay in Country G i.e. be taxed on his world wide income. Also many candidates gave a detailed explanation of the applicable tax treaty provision and correctly stated that country G has the right to tax the employment income. It was pleasing to see that some candidates were aware that Aldo has the option to apply the normal rates of tax instead of the 15% flat rate. The computational part was, in general, well answered.

### **Question Five**

Question 5 consisted of two questions, both dealing with the taxation of interest and royalties, in different scenarios.

Part (a), which carried 14 marks out of a total of 18, tested candidates' knowledge of the tax treatment of interest and royalties and of the recent changes in the tax treatment of royalties derived from patents in respect of inventions. A few candidates are to be congratulated for mentioning all the provisions relevant to royalties i.e. the exemption applicable to royalties paid to non-resident persons, the exemption applicable to royalties derived from patents in respect of inventions, and the exemption from Malta tax provided for under the tax treaty.

Here it was important for candidates to plan their answers and use the appropriate structure. This question required candidates, first, to explain the taxability of GRN Limited in Malta and whether the interest and royalties were taxable in Malta (on the basis of source versus status of recipient), then to present explanations in respect of any applicable exemptions. Many candidates mentioned that the royalties and interest were exempt, some then going on to provide valid and detailed reasons. Pleasingly, a few candidates were aware that TGS Ltd is required to withhold tax on the interest paid to GRN Limited and that TGS can apply to withhold tax at a reduced rate i.e. 10%, being the tax treaty maximum rate.

Part (b), which carried 4 marks out of a total of 18, presented candidates with a different scenario and required them to establish whether the tax treatment of the interest and royalties would change from the original scenario if the recipient of the interest and royalties, GRN Limited, was tax resident in Malta. Here, a few candidates did well to mention that the royalties remain exempt from tax if GRN Limited was tax resident in Malta.