Fundamentals Level – Skills Module

Taxation (Malta)

Tuesday 3 June 2014

Paper F6 (MLA)

Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.

Tax rates and allowances are printed on pages 3–5.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

The Malta Institute of Accountants

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The question paper begins on page 3.

SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings need only be made to the nearest Euro
2. All apportionments should be made to the nearest month unless stated otherwise
3. All workings should be shown

TAX RATES AND ALLOWANCES

The following tax rates and allowances for the year of assessment 2014 are to be used in answering the questions.

Individual income tax rates

Resident individual tax rates

Married couples – joint computation			Other individuals		
€	€	Rate	€	€	Rate
0	to 11,900	0%	0	to 8,500	0%
11,901	to 21,200	15%	8,501	to 14,500	15%
21,201	to 28,700	25%	14,501	to 19,500	25%
28,701	to 60,000	32%	19,501	to 60,000	32%
60,001 and over		35%	60,001 and over		35%

Parents maintaining a child/paying maintenance

€	€	Rate
0	to 9,300	0%
9,301	to 15,800	15%
15,801	to 21,200	25%
21,201	to 60,000	32%
60,001 and over		35%

Non-resident individuals

€	€	Rate
0	to 700	0%
701	to 3,100	20%
3,101	to 7,800	30%
7,801		35%

Corporate income tax

Standard rate	35%

Value added tax (VAT)

Standard rate	18%
Reduced rate – general	5%
Reduced rate – accommodation in premises required to be licensed in virtue of the Malta Travel and Tourism Services Act	7%

Capital allowances

Industrial buildings and structures

Initial allowance	10%
Wear and tear allowance	2%

Plant and machinery

Wear and tear allowance as indicated in the question where applicable

Minimum number of years over which items of plant and machinery are to be depreciated:

Computers and electronic equipment	4
Computer software	4
Motor vehicles	5
Furniture, fixtures, fittings and soft furnishings	10
Equipment used for the construction of buildings and excavation	6
Catering equipment	6
Aircraft	12
Ships and vessels	10
Electrical and plumbing installations and sanitary fittings	15
Cable infrastructure	20
Pipeline infrastructure	20
Communication and broadcasting equipment	6
Medical equipment	6
Lifts and escalators	10
Air conditioners	6
Equipment mainly designed or used for the production of water or electricity	6
Other machinery	5
Other plant	10

Capital gains

Capital gains index of inflation

1983	428·06	1999	593·00
1984	426·18	2000	607·07
1985	425·17	2001	624·85
1986	433·67	2002	638·54
1987	435·47	2003	646·84
1988	439·62	2004	664·88
1989	443·39	2005	684·88
1990	456·61	2006	703·88
1991	468·21	2007	712·68
1992	475·89	2008	743·05
1993	495·60	2009	758·58
1994	516·06	2010	770·07
1995	536·61	2011	791·02
1996	549·95	2012	810·16
1997	567·95	2013	821·34
1998	580·61		

Car fringe benefit rates

Vehicle use	Percentage of vehicle value
Vehicle not more than six years old	17%
Vehicle more than six years old	10%
Fuel value	
Vehicle value not exceeding €28,000	3%
Vehicle value exceeding €28,000	5%
Maintenance value	
Vehicle value not exceeding €28,000	3%
Vehicle value exceeding €28,000	5%

Private use percentages

Car value From €	To €	
0	16,310	30%
16,311	21,000	40%
21,001	32,620	50%
32,621	46,600	55%
46,601 and over		60%

ALL FIVE questions are compulsory and MUST be attempted

1 Paul and Maria, who are both ordinarily resident and domiciled in Malta, are married and live together in their home in Malta with their two young children. Paul and Maria's first child attends a primary school approved by the Minister, while the second child attends a registered private kindergarten.

Maria is employed as an in-house lawyer with a Maltese commercial bank. Her gross salary for the year ended 31 December 2013 was €35,000. Other details of her remuneration package are as follows:

1. The use of a company car for business purposes. The car, which is three years old, is valued at €20,000. Fuel is paid for by her employer.
2. One paid overseas vacation per year, which for 2013 cost the bank €2,000.
3. A free meal in the bank's staff canteen on each working day. All employees of the bank are entitled to this benefit, which costs the bank €1,500 per annum per employee.
4. Provision of childcare facilities outside of school hours in respect of Maria's youngest child, which cost the bank €2,400 in 2013.
5. During 2013, the bank paid €250 in respect of Maria's membership to a professional body of financial services lawyers, and €450 for subscriptions to specialist legal publications received by Maria, which she uses to keep herself abreast of developments affecting her profession.
6. Throughout the year 2013, the bank provided Maria with a personal loan of €50,000 at the subsidised interest rate applicable to all the bank's employees of 1·5% per annum. For the purposes of the fringe benefit rules, the applicable benchmark rate of interest in respect of loans provided by banks and financial institutions is 4·5%.

Paul, a qualified nutritionist, had carried on a trade as an independent nutritional consultant for several years. However, he found it increasingly challenging to remain self-employed on a purely individual basis, and decided to cease his trade on 31 December 2012. His net trading results for the three years of assessment prior to cessation were:

	€
Trading income for the year ended 31 December 2010	25,000
Trading income for the year ended 31 December 2011	12,000
Trading loss for the year ended 31 December 2012 carried forward	(5,000)

Paul did not work during the first three months of 2013. On 1 April 2013, he commenced employment as a nutritional consultant working for a chain of beauty and slimming parlours in Malta. His annual gross salary of €24,000 is paid monthly in arrears. As part of his remuneration package, Paul also receives the following:

1. Free vouchers entitling the holder to receive beauty and slimming services at any one of the parlours operated by his employer. During the nine months to 31 December 2013, he received and made use of a number of vouchers which were collectively worth €1,200.
2. Paul is required to wear the employer's branded uniform while working. During 2013, he received three sets of uniforms which cost the employer €150 each.
3. Paul is required to use his own car for the purpose of his employment. For this reason, he receives a car cash allowance amounting to €150 per month.
4. Private health insurance cover for himself in respect of which his employer paid a premium of €500 for 2013. The employer provides private health insurance cover to approximately 10% of its employees.

Paul and Maria own a vacation property in Gozo which they have rented out on a long-term basis. The rental income received in respect of the year ended 31 December 2013 amounted to €8,000. Ground rent of €500 and maintenance expenses of €1,000 were incurred by the couple in relation to this property.

During 2013, Maria also received the following income streams from assets she had inherited from a late relative in Canada:

(i) Gross dividend income from shares in a Canadian trading company amounting to €2,000. No Canadian corporate taxes had been suffered on the profits out of which this dividend was distributed, but withholding tax of 15% was levied on the dividend. The net dividend was transferred directly to Maria's personal bank account in Malta.

(ii) Gross interest income of €3,465 from a long-term deposit in a Canadian bank. A withholding tax of 10% was levied on the income. The net interest was received in Maria's current account with the same Canadian bank, and was not remitted to Malta.

During 2013, the following outgoings were paid by Maria in relation to her dependents:

(iii) Medical fees totalling €2,500 in respect of Maria's elderly parents, and fees amounting to €8,000 in respect of their stay at a home for the elderly.

(iv) School fees amounting to €2,000 each in respect of her two children.

Required:

(a) Calculate the total chargeable income of Paul and Maria for the year of assessment 2014.

Note: You should list all of the items of income and gains referred to in the question, indicating by the use of '0' any items which are exempt from tax or otherwise not taxable in Malta. (19 marks)

(b) Calculate the tax payable by Paul and Maria for the year of assessment 2014 using the most beneficial method of tax computation and tax rates. (6 marks)

(25 marks)

2 Karisma Operations Limited (KOL), a company incorporated and managed and controlled in Malta, is engaged in the manufacture and distribution of local traditional liqueurs. KOL is fully owned by Karisma Holdings Limited (KHL), another company incorporated and managed and controlled in Malta which was formed specifically to own the shares in KOL. KHL is owned by a number of individual shareholders, all of whom are not ordinarily resident in Malta and not domiciled in Malta. Both KHL and KOL were incorporated on 1 October 2012. The income statement of KOL for its first financial year ended 30 September 2013 is as follows:

	Note	€	€
Turnover			5,420,000
Cost of sales			(2,950,000)
Gross profit			2,470,000
Add: Financial income	1	90,000	
Financial expenses	2	(50,000)	
Net finance income			40,000
Dividend income	3		70,000
			2,580,000
Less: Administrative and other expenses:			
Staff costs	4	1,400,000	
Advertising	5	250,000	
Audit fees		10,000	
Customer entertainment		9,000	
Depreciation		255,000	
Donations	6	15,500	
Loss on disposal of delivery lorry	7	3,500	
Leasing of company car	8	24,000	
Legal fees	9	20,000	
Other expenses	10	25,000	
Penalty for late filing of VAT returns		2,000	
Bad and doubtful debts	11	25,000	
Repairs and maintenance	12	65,000	
Unrealised foreign exchange differences		(4,000)	
Total administrative and other expenses			(2,100,000)
Net profit before tax			480,000

Notes:

1. Financial income for the year of €90,000 consists of:

   (i) Net interest income of €65,000 received in respect of an investment amounting to €2,000,000 in a foreign money market instrument made with an issuer situated outside Malta. Withholding tax of 10% had been levied on this income. Double tax treaty relief is available and is claimed in respect of this withholding tax.

   (ii) Net interest received from a local bank of €25,000 in respect of the deposit of surplus cash on a flexible term basis. Tax was withheld on the interest in terms of the investment income provisions.

2. The investment in a foreign money market instrument referred to in (1)(i) above was financed by KOL taking out a loan amounting to €2,000,000 from another Maltese company. The financial expenses for the year of €50,000 solely relate to the interest due and paid on this loan.

3. Dividend income of €70,000 consists of:

   (i) A gross dividend of €50,000 received from an equity investment in a company listed on the Malta stock exchange. The dividend had been paid out of profits taxed at the rate of 35% at the level of the distributing company and allocated to its immovable property account (IPA).

   (ii) A net dividend of €20,000 received from a 25% equity shareholding in a Spanish trading company. The shareholding confers a full right to vote, to profits available for distribution and to assets available for distribution on a winding up. The dividend was paid by the Spanish company out of its trading profits which suffered corporate tax at a special low rate of 3%. No withholding tax was levied on this dividend.

4. Staff costs comprise the basic salary costs of all KOL's employees, including the employer's share of social security contributions, as well as staff bonuses awarded during the financial year totalling €250,000.

5. Advertising expenses include €250,000 paid to a marketing agency for devising and running an intensive social media and brand awareness campaign in the six months before KOL was actually incorporated. Since KOL had not yet been incorporated, the amount was initially invoiced to the company's promoters and subsequently paid by KOL immediately after its incorporation.

6. Donations of €15,500 consist of:

   (i) A donation of €15,000 to Heritage Malta made to help finance the restoration of a local historical building. A certificate documenting this donation was duly issued by Heritage Malta to KOL.

   (ii) A donation of €500 to a local music band.

7. One of the delivery lorries purchased by KOL for €26,000 was found to be not fit for its intended purpose and was disposed of on 30 September 2013 for €22,500.

8. KOL paid €24,000 to lease a company car used by the chief executive. The car is valued at €60,000.

9. Legal fees include €10,000 incurred for legal advice and assistance in connection with a proposed change in the issued share capital and capital structure of KOL.

10. Other expenses of €25,000 consist of:

   (i) Statutory registration costs and other professional fees in connection with the formation of KOL of €5,000.

   (ii) Fees of €20,000 paid to a business consultancy firm engaged by the promoters of the company to assist with the preparation of a business plan for the proposed operation. This work was performed and completed during the first quarter of 2012, and paid for by KOL following its incorporation.

11. Bad and doubtful debts of €25,000 consist of:

   (i) Bad debts written off in the course of trading amounting to €10,000.

   (ii) A provision against a specific debt which is unlikely to be recovered of €5,500.

   (iii) A general provision for doubtful debts of €9,500.

12. Repairs and maintenance of €65,000 is broken down as follows:

   (i) The cost incurred in January 2013 for an extension to KOL's business premises of €40,000. This improvement to the premises will increase KOL's output capacity ahead of expected future growth in its market share.

   (ii) Routine maintenance of KOL's distilling plant of €25,000.

Other information:

(i) Property, plant and equipment purchased by KOL during its first financial year was:

	€
Industrial building (brand new)	220,000
Commercial motor vehicles (includes the delivery lorry disposed of on 30 September 2013)	105,000
Plant	180,000
Computer equipment	50,000
	555,000

KOL owns and uses the industrial building which is situated in Malta for the purposes of its business. The aggregate surface area of all floors of these business premises is 220 square metres. No part of the premises is rented out from or to another person.

(ii) A net dividend of €200,000 is to be declared and paid by KOL to KHL out of its profits for the year to 30 September 2013. While the dividend will be distributed out of KOL's tax accounts in such a way as to comply with the requirements of Maltese tax law, the directors of KOL wish to avoid distributing any profits allocated to the foreign income account or the untaxed account.

Required:

(a) Prepare the income tax computation of Karisma Operations Limited (KOL) for the year of assessment 2014.

Note: Your computation of business income should include all of the items referred to in notes 1 to 12, indicating by the use of '0' any items for which no adjustment is required. (17 marks)

(b) Calculate KOL's tax charge and tax payable for the year of assessment 2014. (3 marks)

(c) Calculate the distributable profits of KOL for the year ended 30 September 2013, and allocate the distributable profits to the respective tax accounts.

Note: Assume that no deferred tax is accounted for. (6 marks)

(d) Determine the breakdown of the proposed net dividend amongst KOL's tax accounts, taking into account the requirements of Maltese tax law and the wishes of the directors of KOL, and calculate the tax refund(s) which can be claimed by Karisma Holdings Limited in respect of this dividend distribution. (4 marks)

(30 marks)

3 (a) List any SIX items of information which may be required to be included in a dividend certificate (warrant) drawn up in terms of Article 59(5) of the Income Tax Act. (3 marks)

(b) Charles Borg is a person who is ordinarily resident and domiciled in Malta. During 2013, he undertook the following capital transactions:

1. Sold long-term Malta government bonds bearing a coupon rate of 5·5% for a consideration of €17,500. He had purchased these bonds during 2006 for €15,000.
2. Sold 3·5% cumulative preference shares issued by a Maltese private company which is not listed on a stock exchange for €4,500. He had purchased these shares during 2011 for €2,500.
3. Sold his 50% shareholding in a Maltese private company, which he had formed and co-owned with his brother, Peter Borg, for a consideration of €250,000. The company has a fully paid-up ordinary share capital of €100,000, which Charles and Peter had subscribed for at nominal value on the incorporation of the company during 2005. The company's balance sheet as at 31 December 2012 shows a net asset value of €450,000 and its annual profits over the last five full financial years have averaged €25,000. The company owns an investment property in Malta which is recorded in its books at historical cost of €180,000 but which was valued at €220,000 at the date of the disposal of the shares.
4. Sold his shareholding in a Maltese public company listed on the Malta stock exchange and realised a capital gain of €900 on this sale. At the time Charles acquired the shares, the company had been listed on the Malta stock exchange for several years.
5. Sold an original painting for €4,000. He had inherited the painting during 2001 at which time it was valued at €3,000.
6. Sold a holiday residence in Malta for a consideration of €125,000. He had bought this property during 2009 for €90,000. During 2010, he spent €10,000 on improvements to the property. Charles incurred brokerage fees of €3,000 in connection with the sale of this property.
7. Sold a chalet in the French Alps for €590,000. He had bought the chalet during 2008 for €520,000. Charles incurred legal fees of €2,000 and brokerage fees of €15,000 in connection with the sale of this property.

Charles pays tax at the maximum marginal personal tax rate of 35%.

Required:

Calculate the chargeable capital gain and tax payable by Charles Borg in respect of each of the above capital transactions. Where an election is available, you should assume that Charles will choose the treatment which results in the lowest tax liability. For any transaction which is exempt from tax or otherwise not subject to tax, state the reason. (17 marks)

(20 marks)

4 The following scenarios are independent from one another, and relate to value added tax (VAT).

(a) David Vella, a private individual, purchases a tablet computer device from an online retailer established in the USA. The device is transported from the USA to David in Malta via an express courier service. (3 marks)

(b) Melita Health Limited (MHL), which is established and registered for VAT in Malta, operates a small private hospital in Malta. MHL purchases pharmaceuticals for the purpose of its economic activity from a supplier established in the UK. The supplier arranges for the despatch of the pharmaceuticals from the UK to Malta on behalf of MHL. (4 marks)

(c) Valletta Advisory, a consultancy business which is established in Malta and registered for VAT in Malta, provides the following services:

(i) Business consultancy services to Verona SpA, a business established in Italy and registered for VAT in Italy.

(ii) IT consultancy services to a Maltese public authority, which is a non-taxable person so is not registered for VAT.

(iii) Accounting advisory services to Turisti Limited, a business established in Malta and registered for VAT in Malta. (5 marks)

(d) Grand Harbour Hotel Limited (GHHL), which is established in Malta and registered for VAT in Malta, operates a hotel in Malta. GHHL charges a foreign tourist staying at the hotel an all-inclusive amount for accommodation on a full board basis. (3 marks)

Required:

For each of the transactions (a) to (d):

– **State whether the transaction is a supply of goods, a supply of services, an intra-EU acquisition or an importation.**
– **State the place where the transaction is deemed to take place for value added tax (VAT) purposes.**
– **State who is the person liable to account for VAT and, where applicable, pay VAT.**
– **State the applicable Maltese rate of VAT or, if no Maltese VAT is payable, state the reason.**

Note: The mark allocation is shown against each of the scenarios.

(15 marks)

5 Alpha Limited, Beta Limited, Gamma Limited and Delta Limited are companies which are incorporated and managed and controlled in Malta.

Beta Limited was incorporated by Alpha Limited as its wholly-owned subsidiary company on 1 May 2010. During 2013 Beta Limited was placed into liquidation, and was struck off the companies register effective from 30 September 2013.

Gamma Limited was incorporated as a wholly-owned subsidiary of Alpha Limited on 1 April 2013.

All of the shares in Delta Limited, a single member company, were acquired by Alpha Limited on 1 July 2013. Delta Limited's financial year end was 30 June. However, immediately upon its acquisition by Alpha Limited, arrangements were made to change its financial year end to 31 December in order to coincide with that of the other companies forming part of the Alpha group.

The financial results of the four companies in Alpha group were as follows:

	Alpha Limited 1 January to 31 December 2013 €	Beta Limited 1 January to 30 September 2013 €	Gamma Limited 1 April to 31 December 2013 €	Delta Limited 1 July to 31 December 2013 €
Profit/(loss) before tax as per financial statements	20,000	45,000	(25,000)	(10,000)
Profit/(loss) before tax is stated after taking into account the following:				
Depreciation of property, plant and equipment	(40,000)	(20,000)	(3,000)	(500)
Gain/(loss) on sale of securities	(15,000)	Nil	10,000	Nil

For tax purposes, the following apply in respect of the year of assessment 2014:

	Alpha Limited €	Beta Limited €	Gamma Limited €	Delta Limited €
Unabsorbed trading tax losses carried forward from previous year of assessment	1,000	Nil	Nil	2,000
Unabsorbed capital losses carried forward from previous year of assessment	3,000	2,000	Nil	Nil
Unabsorbed wear and tear allowances carried forward from previous year of assessment	4,000	3,000	Nil	1,500
Wear and tear allowances for the year	24,000	30,000	1,500	1,000
Capital gain/(loss) on the sale of securities	(20,000)	Nil	5,000	Nil

Required:

(a) State, giving reasons, which companies will and will not form part of a loss relief group with Alpha Limited, or are otherwise allowed to surrender/claim losses intra-group for the year of assessment 2014. (3 marks)

(b) In respect of each of the companies which form part of the group during year of assessment 2014 or are otherwise allowed to surrender/claim losses intra-group for year of assessment 2014:

(i) Calculate the amount of any losses available for surrender under group loss relief and the potential profits against which they can be claimed. (5 marks)

(ii) Identify the unabsorbed capital losses carried forward to year of assessment 2015 and unabsorbed wear and tear allowances carried forward to next year of assessment. (2 marks)

(10 marks)

End of Question Paper