Fundamentals Level – Skills Module

Taxation (Malta)

Tuesday 4 December 2012

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.

Paper F6 (MLA)

The Association of Chartered Certified Accountants

The Malta Institute of Accountants

This is a blank page.
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 2012 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 and over		35%	19,501 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 by the Malta Tourism Authority	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	1998	580·61
1984	426·18	1999	593·00
1985	425·17	2000	607·07
1986	433·67	2001	624·85
1987	435·47	2002	638·54
1988	439·62	2003	646·84
1989	443·39	2004	664·88
1990	456·61	2005	684·88
1991	468·21	2006	703·88
1992	475·89	2007	712·68
1993	495·60	2008	743·05
1994	516·06	2009	758·58
1995	536·61	2010	770·07
1996	549·95	2011	791·02
1997	567·95		

Fringe benefit rates on cars

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 Judy are two pensioners who hold foreign passports; they are married and live together. Before their retirement, they both held senior positions with their home country's foreign service office, and travelled extensively forming a strong international business network. In 2005 Paul and Judy bought a house in Malta and since 2005 they have spent most of the year (from 15 January to 15 June and from 15 September to 15 November annually) at their home in Malta. Paul and Judy are both in their early seventies and are still in good health but they have decided that, should they ever lose their mobility and certainly before they are 90 years old, they will move to a retirement home in their domicile of origin, the United Kingdom.

Paul takes an interest in the international stock market and keeps busy buying and selling securities. He is the owner (100%) and sole director of Sinistri Limited, a Dutch registered company which trades in diamonds and precious metals. He is also a consultant with a local Maltese company, Deheb Co Limited, which buys gold for export. The Maltese Business Community Association (MBCA) considers Paul to be a worthy business associate and regularly invites him to deliver seminars on business ethics, for which he is paid a nominal fee for services rendered on a freelance basis.

In the basis year 2011 Paul received the following gains and profits:

1. A profit of €100,000 from the sale of shares in a non-resident company in which he held a controlling interest. Paul had bought the shares in 2010 for €300,000 and sold them for €400,000. The net asset value of the shares amounted to €350,000. The sales proceeds, and thus the profit, were received in Judy's Maltese bank account.
2. A profit of €30,000 derived from the sale of shares listed on the Malta Stock Exchange. Paul had bought these shares in 2011 for €50,000 with the intention to trade the shares, but in fact sold them to a non-resident for €80,000 within a few months from the date of purchase. The net asset value of the shares amounted to €60,000. The payment was executed offshore and the non-resident buyer settled the consideration for the acquisition of the shares into Paul's Swiss bank account.
3. A profit of €450,000 derived from the grant of mining rights to a German resident company over one of Paul's holdings of land in a developing country in Africa. This profit was received in Malta.
4. Bank interest from his Maltese bank account of €10,000, net of final withholding tax.
5. A pension of €30,000 from his ex-employer. This sum was received in Paul's Maltese bank account.
6. A salary of €20,000 from Sinistri Limited with respect to services rendered wholly outside Malta. Paul received and retained this salary in a foreign bank account. Paul's contract of employment with Sinistri Limited provides for the payment of the following benefits:
   (i) Sinistri Limited pays Paul's subscription to the Institute of Officers (UK) of €500 per annum. This subscription is paid by electronic transfer to the Institute's UK bank account.
   (ii) Sinistri Limited pays Paul's subscription to the Institute of Officers (Malta) of €150 per annum. This subscription is paid by cheque to the Institute's Malta bank account.
   (iii) Sinistri Limited pays Paul's subscription to the Malta Tennis Club of €250 per annum. This subscription is paid by cheque to the Club's Malta bank account.

   Sinistri Limited also settles all the outstanding fees that Judy accumulates during the months she and Paul spend in Malta. In the basis year 2011, these fees amounted to €5,000 and included the fees paid to a hairstylist, masseuse, housekeeper and cook.
7. Paul received consultancy fees from Deheb Co Limited of €3,000 with respect to services rendered in Malta. He was also paid a fee of €2,000 for seminars delivered for MBCA. Paul is not registered for VAT.

Judy is employed on a part-time basis with Inglizi Limited, a language school where English is taught as a foreign language. She also provides tuition to Maltese schoolchildren on an individual basis. Twenty years ago, Judy wrote a children's book and her French publisher still sends her royalties. When Judy first came to Malta, she had opened a Maltese bank account and she deposits all of her revenues into this account

In the basis year 2011 Judy received the following gains and profits:

1. An annual salary of €5,000 from Inglizi Limited for services rendered in Malta.
2. Tuition fees of €1,200 in respect of the tuition provided in Malta to two children with special needs.
3. Royalty income of €800 paid by her foreign publisher, which was paid into Judy's Maltese bank account. The royalty income was exempt from tax in the source country, France.

Required:

(a) State, giving reasons, the basis on which Paul and Judy will be subject to tax in Malta on both their income and their gains. (4 marks)

(b) Calculate the chargeable income of Paul and Judy for the year of assessment 2012.

Note: You should list all of the items of gains and profits referred to in the question, indicating by the use of '0' any items which are not chargeable to tax. (13 marks)

(c) Calculate the tax payable by Paul and Judy under joint computation for the year of assessment 2012 and determine whether the separate method of computation would have been more tax efficient. (3 marks)

(d) Paul is considering donating all of his shares in Sinistri Limited to Destitute Children Limited (DCL). DCL is a Maltese company whose sole shareholder is a Maltese resident who uses all of the dividends he receives from DCL for the charitable purpose of building a hospital in Angola. According to Sinistri Limited's latest financial statements, its net asset value is €150,000,000 and its goodwill, based on twice the average profits before tax for the last five years, is €1,000,000.

Required:

Advise Paul of the Maltese tax consequences of his proposed donation of Sinistri Limited's shares and calculate the tax payable (if any) by Paul. (2 marks)

(e) Judy is considering entering into the following agreements relating to her publications:

– to transfer all the rights pertaining to her children's book to her French publisher for a one-time consideration of €1,000; and

– to allow an Italian publisher to publish a translation of a novel she has written for a consideration of €10,000.

Required:

Advise Judy on the tax consequences of each of these transactions. (3 marks)

(25 marks)

This is a blank page.
Question 2 begins on page 9.

2 Malta Company Limited (MCL) is a company incorporated in Malta.

MCL had the following sources of income in the year to 31 December 2011:

(1) Trading income

MCL operates two trading divisions in Malta, a wholesale division and a retail division, and a branch overseas.

(i) The wholesale division supplies goods to both the retail division and the overseas branch, as well as selling directly to customers in North Africa. It operates from two warehouses in Malta, occupying a total area of 8,000 square metres, both of which are rented from unrelated parties.

The wholesale division has always been profitable and recorded an accounting profit of €520,000 in the year 2011. The following additional information relates to the credits/charges included in the calculation of this accounting profit:

Interest received (credited):

	€
On a loan made to assist a non-EU supplier experiencing cash flow problems	2,000
On outstanding balances due from non-EU customers paid more than one month late	800
	2,800

No withholding taxes were levied on either of these receipts.

Expenses charged:

	€	€
Damaged stock:		
Write off at cost	8,000	
Payment for disposal	800	
Less: Insurance recovery received	(5,300)	
		3,500
Fine for making a false declaration in customs documents		2,000
Wages of casual labourers paid in cash and not through FSS		6,000
Impaired debts:		
Provision for a debt due from a Libyan customer from whom nothing has been heard for three months	8,500	
Amount recovered in respect of a debt written off as irrecoverable in the year 2010	(3,000)	
		5,500
Exchange losses:		
Realised exchange losses on transactions with suppliers and customers	14,000	
Unrealised exchange losses on the translation of year-end trade receivable and payable balances	6,000	
		20,000
		37,000

All of the fixed assets owned by the wholesale division are depreciated at the same rate as prescribed by the deduction of Wear and Tear Plant and Machinery Rules.

(ii) The retail division sells exclusively to individuals and small businesses in Malta. It operates from a three-storey building in Valletta, owned by MCL, which comprises a retail outlet and showroom on the ground floor and offices on the two upper floors. Each floor is 500 square metres in area. MCL occupies the ground and first floors and rents out the offices on the second floor to TP & Co (see (2) below). TP & Co is unrelated to MCL.

Although previously profitable, the retail division incurred an accounting loss of €40,000 from its trading activities in the year 2011. The following additional information relates to the credits/charges included in the calculation of this accounting loss:

Interest received (credited):

	€
On an account held with a bank in Malta (net of withholding tax)	1,800

Expenses charged:

	€	€
Legal fees:		
Annual retainer	6,000	
Advice in relation to a claim by a former employee dismissed for misconduct	2,400	
		8,400
Interest on late payment of value added tax (VAT)		600
Depreciation:		
On building at 2% of apportioned cost:		
– Ground floor retail outlet and showroom	10,000	
– First floor offices	10,000	
On fixtures and fittings at 10% of cost	4,000	
On delivery vehicles at 20% of cost	12,000	
On the managing director's car at 20% of cost	7,000	
		43,000
		52,000

(iii) The overseas branch operates solely in Country L, from premises rented from an unrelated party.

In 2011 the taxable profits of this branch were €55,000.

Country L is not a member of the European Union (EU) and does not have a double tax treaty with Malta. Country L treats the branch as a permanent establishment and taxes its profits at the rate of 10%.

(2) Rental income

For accounting purposes, MCL recorded net income from the letting of the second floor offices (see (1)(ii) above) of €60,000 in the year 2011, made up as follows:

	€
Gross rents receivable	74,000
Less:	
Repairs	(4,000)
Depreciation at 2% on apportioned cost	(10,000)
	60,000

(3) Dividend income

MCL owns 25% of the equity shares of ABC Limited (ABC), a trading company which is incorporated and resident in Country F. In the year 2011, MCL received a dividend of €10,000 from ABC.

Country F is a member of the EU and has a double taxation agreement with Malta. Country F charges corporation tax at the rate of 12% on the profits of trading companies but does not levy any withholding taxes on dividends paid to EU residents.

Other information

1. MCL owns 60% of the equity shares of LMN Limited (LMN), a company incorporated in Malta in 2009. LMN invests in undeveloped land on Malta and Gozo and its only transaction in the year 2011 was the sale of a piece of land on Gozo, which realised a capital loss of €40,000. LMN has never paid a dividend.
2. MCL uses the flat rate foreign tax credit (FRFTC) and any other reliefs and exemptions available to reduce its Malta tax liability.

Required:

(a) Calculate Malta Company Limited's (MCL) profit chargeable to tax from its Malta trading activities (to be allocated to its Maltese taxed account (MTA)) for the year of assessment 2012.

Note: In the case of each division (wholesale and retail), you should commence your computation with the accounting profit and list all of the items referred to in the additional information, indicating by the use of '0' any item for which no adjustment is required. (13 marks)

(b) (i) Calculate the tax payable by MCL for the year of assessment 2012 and allocate its distributable profits to the relevant tax accounts (other than the untaxed account); (11 marks)

(ii) Explain your treatment of:

(1) the dividend received from ABC Limited; and
(2) the capital loss incurred by LMN Limited.

The total marks will be split equally between each part. (3 marks)

(c) Explain how your answer to part (b)(i) would change if each floor of the Valletta building owned by MCL was 800 square metres, instead of 500 square metres, in area. (3 marks)

(30 marks)

3 **(a)** Maltija Limited (MJL), a company which is both resident and domiciled in Malta, disposed of its factory in Marsa, Malta, for a consideration of €300,000 in November 2011. MJL had bought the factory in 1985 for a consideration of €40,000. In 1991 MJL had pulled down the original factory and rebuilt it at a cost of €80,000. In 2000 MJL had added an extension to the rebuilt factory at a cost of a further €50,000.

In June 2012, MJL bought a new factory in Mriehel, Malta, which it will use for a similar purpose to that for which the Marsa factory had been used. The cost of the Mriehel factory was €500,000.

Required:

(i) State the conditions that need to be satisfied for a valid claim for roll-over relief to be made; (3 marks)

(ii) Explain why it is advantageous for Maltija Limited to claim roll-over relief on the disposal of its Marsa factory, and calculate the capital gain on the disposal and the reduced cost of acquisition of the Mriehel factory for the purposes of any future disposal. (9 marks)

(b) Julianija Limited (JJL) disposed of the following assets in the year 2011:

1. 1,000 shares in Sussidiarja Limited for €25,000. Sussidiarja Limited was incorporated in Malta with a share capital of 20,000 shares, is not quoted on any stock exchange and does not own any immovable property situated in Malta. JJL had bought the shares in Sussidiarja Limited in 2004 for €8,000. The net asset value of Sussidiarja Limited as at 31 December 2010 was €60,000 and the company's two years' average profits for the five financial years immediately preceding the year in which the sale was made is €10,000.
2. 9,000 shares (representing 90% of the company's share capital) in Barranija Limited, a company incorporated in Guernsey which does not own any immovable property situated in Malta, for €150,000. JJL had bought the entire share capital (100%) of Barranija Limited in 2010, when the shares were valued at €10 each. The net asset value of Barranija Limited as at 31 December 2010 was €100,000 and the company's two years' average profits for the five financial years immediately preceding the year in which the sale was made is €20,000.
3. An office block in Sliema which had become unsuitable for JJL's needs. JJL had bought the office building in shell form for €300,000 in 2008 and had immediately spent €50,000 on furniture and fittings. The sale was made on a fully furnished basis for a global consideration of €340,000, of which €300,000 represented the consideration for the immovable property and the remaining €40,000 the consideration for the furniture and fittings contained therein.
4. A temporary *emphyteusis* for 40 years of its boardroom in Tower Buildings, Malta, for €120,000. JJL had bought the boardroom in 2005 for a consideration of €100,000.
5. A business permit for a consideration of €20,000. JJL had paid fees of €1,500 to acquire the permit in 2009.

Required:

Calculate the tax payable by Julianija Limited as a result of the disposals made in the year 2011, taking advantage of any exemptions and/or reliefs available. Clearly identify, and give the reason for, any transaction which is exempt from tax or on which no tax is payable. (8 marks)

(20 marks)

4 **(a) State, giving reasons, whether or not director's fees received by a director of a limited liability company are subject to value added tax (VAT).** (3 marks)

(b) Lettings Limited, which is registered for value added tax (VAT), had the following transactions for the quarter ended 30 September 2011. All amounts are stated excluding any applicable VAT.

1. Received rents of €60,000 from the letting of unfurnished apartments to local families and individuals for residential purposes.
2. Received rents of €40,000 from individuals from other countries in the European Union (EU) and €8,000 from individuals from countries outside the EU, from the provision of accommodation in holiday apartments which is required to be licensed by virtue of the Malta Travel and Tourism Services Act.
3. Received rents from Marcov Limited, a Maltese resident company, of €20,000 for the letting of office premises and of €4,000 for the letting of parking spaces.
4. Incurred the following expenses in respect of the letting of the holiday apartments referred to in (2) above:

	€
Electricity	1,200
Insurance	800
Wages of cleaner	2,400
Purchase of cleaning materials	300
Purchase of replacement furniture	7,000

The furniture was imported from Italy from a supplier who is registered for VAT in Italy.

All of the remaining expenses were supplied locally.

Required:

(i) Calculate the amount of value added tax (VAT) payable by Lettings Limited for the quarter ended 30 September 2011. List all of the items referred to in the question, clearly identifying any which are exempt from VAT and/or for which no credit is available; (9 marks)

(ii) State by when Lettings Limited should have submitted its VAT return for the quarter ended 30 September 2011 and paid the VAT due. (1 mark)

(c) State when a company with an excess credit in a particular VAT return period will be entitled to receive a refund of that credit. (2 marks)

(15 marks)

5 **(a) Explain what is meant by the terms tax avoidance and tax evasion, clearly distinguishing between them.** (4 marks)

(b) Describe the alternative credit methods by which relief for double taxation of foreign source income is given against Malta company income tax. (6 marks)

(10 marks)

End of Question Paper