Fundamentals Level – Skills Module

Taxation (Malta)

Tuesday 2 December 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 €
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 2013 (year of assessment 2014) are to be used in answering the questions.

Individual income tax

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 and over		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 Honey Limited (HL) is a company incorporated in Malta which is managed and controlled in Malta. The shares in HL are fully owned by Nicholas Smith, an individual who is not ordinarily resident in Malta and not domiciled in Malta.

The assets of HL and related income and gains earned during the financial year ended 31 December 2013 consisted of the following:

(1) A 25% ordinary shareholding in Stonehenge Limited (SL), a trading company which is incorporated and tax resident in the United Kingdom (UK). The ordinary shares confer a right to 25% of SL's profits available for distribution and 25% of the voting rights, but no entitlement to assets available for distribution on a winding up of SL. HL received a dividend of €240,000 from SL. No dividend withholding tax was suffered but SL was subject to UK corporate tax at the rate of 20%.

(2) A 5% equity shareholding in Rhine Limited (RL), a trading company which is incorporated and tax resident in France. The shares in RL had been acquired during 2010 for a consideration of €2,500,000. HL received a net dividend from RL of €110,000 (after the deduction of withholding tax at 5%). RL was subject to French corporate tax at the rate of 25%. On 31 December 2013, HL disposed of its entire investment in RL realising a capital gain of €440,000.

(3) A 15% equity shareholding in Alps Limited (AL), a company which is incorporated and tax resident in Switzerland. The shares in AL had been acquired during 2011 for a consideration of €250,000. The activity of AL consists of the receipt of passive interest income and no tax, whether by way of withholding or otherwise, was suffered either on the income of AL or on the dividend distributed to HL. HL received a dividend of €25,000 from AL. On 31 December 2013, HL disposed of its entire investment in RL realising a capital gain of €124,000.

(4) A 100% equity shareholding in Buzzard Limited (BL), a company which is incorporated in Malta and managed and controlled in Malta. BL is engaged in providing professional services to customers based in the Middle East from its office premises in Malta. HL received a net dividend of €45,500 from BL. The dividend was paid out of BL's Maltese taxed account.

(5) A 50% equity shareholding in Falcon Limited (FL), a company which is incorporated in Malta and managed and controlled in Malta. FL is engaged in the letting of real estate situated in Malta. HL received a net dividend of €25,675 from FL. The dividend was paid out of FL's immovable property account.

(6) A fixed-term deposit with a Maltese bank on which net interest of €5,000 was received. Tax at 15% had been deducted from the interest by the bank.

(7) Intellectual property rights valued at €650,000, the use of which was licensed to a licensee based in Canada for a gross royalty fee of €45,000. Withholding tax at 25% was deducted from the royalty income by the licensee, and proper documentary evidence that this tax has been paid is available.

The expenditure of HL during the financial year ended 31 December 2013 consisted of:

– audit fees of €11,500;
– director's fees of €10,000; and
– registration fees of €500.

For tax purposes, none of these expenses are considered to have been incurred wholly and exclusively in the production of the income.

HL is registered with the Inland Revenue Department for the purposes of lodging claims for Malta tax refunds.

Where applicable, HL always elects to apply the participation exemption. Where the participation exemption does not apply, HL claims any available relief for double taxation in such a way as to minimise its tax payable in Malta.

Required:

(a) **State, giving reasons, whether Honey Limited (HL) is entitled to lodge any claims for a refund of Malta tax in respect of any of its sources of income and, if so, calculate the amount of any such tax refunds.** (5 marks)

(b) **State, giving reasons, whether the participation exemption will apply to the income received and/or capital gains realised in respect of HL's shareholdings in Stonehenge Limited, Rhine Limited and Alps Limited.** (7 marks)

(c) **Compute HL's chargeable income, tax charge and tax payable for the year of assessment 2014.**

Note: You should present your computation in columnar format, using a separate column for each tax account, including the untaxed account. (13 marks)

(d) **State the definition of a group of companies for the purposes of the group relief provisions of the Income Tax Act.** (4 marks)

(e) **Where an allowable loss, which had it been a profit would have been allocated to the immovable property account of the surrendering company, is surrendered by way of group relief, state whether the claimant company may deduct the surrendered loss from income which stands to be allocated to:**

(i) **its foreign income account; and**
(ii) **its Maltese taxed account.** (1 mark)

(30 marks)

2 Graham and Paula jointly carry on a retail business in partnership, sharing profits and losses between them in the ratio 3:5. The results of the partnership for the financial year ended 31 December 2013 were as follows:

	Note	€	€
Turnover			610,000
Cost of sales			(323,000)
Gross profit			287,000
Administration expenses	(1)	(130,220)	
Selling and distribution expenses	(2)	(6,700)	
			(136,920)
Operating profit			150,080
Other income	(3)	1,750	
Finance expenses	(4)	(8,160)	
			(6,410)
Net profit before tax			143,670

Notes:

(1) Administration expenses comprise:

	Note	€
Accountancy fees		5,000
Bad debts written off		4,400
Decrease in provision for doubtful debts		(4,400)
Depreciation		6,700
Legal fees	(i)	2,000
Loss on disposal of computer equipment	(ii)	1,500
Motor vehicle expenses	(iii)	12,000
Stationery		2,500
Sundry expenses	(iv)	1,120
Unrealised exchange differences		1,200
Utility costs		3,200
Wages and salaries	(v)	80,000
Social security contributions	(vi)	8,500
Other employee costs		6,500
		130,220

(i) Legal fees consist of fees paid to procure legal advice in relation to a possible future restructuring of the partnership which would include its conversion into a limited liability company.

(ii) Computer equipment which had been purchased during 2011 for €4,000 and had a net book value as at 1 January 2013 of €2,500 was disposed of on 30 June 2013 for €1,000.

(iii) Motor vehicle expenses represent the rental payments made on the lease of a hatchback car which is made available at all times for the exclusive use of Paula. The vehicle is three years old and is officially valued at €34,000. Paula pays for all the fuel costs associated with the use of this car.

(iv) Sundry expenses comprise:

	€
Administrative penalty in respect of the correction of an error in a previous VAT return	470
Fines for the late filing of certain income tax and FSS forms	650
	1,120

(v) Wages and salaries include partner salaries and partner drawings as follows:

	Salaries	Drawings
	€	€
Graham	20,000	5,000
Paula	20,000	7,000
	40,000	12,000

(vi) Social security contributions comprise:

	€
Employer's share of employee social security contributions (Class One)	2,800
Amount paid in respect of Graham's Class Two contributions	2,400
Amount paid in respect of Paula's Class Two contributions	3,300
	8,500

(2) Selling and distribution expenses relate entirely to customer entertaining expenses of €6,700.

(3) Other income comprises:

	€
Profit on sale of fixtures and fittings, which had been purchased during 2009 at a cost of €2,000 and had accumulated depreciation up to 31 December 2012 amounting to €800	500
Local bank interest income received net of tax withheld at 15% in terms of the investment income provisions	800
Interest received from the value added tax (VAT) Department on an overdue VAT refund	450
	1,750

(4) Finance expenses comprise:

	€	€
Interest paid to the VAT Department in respect of the correction of an error in a previous VAT return		260
Interest payable to the partners:		
– on capital account		
Graham	3,000	
Paula	5,000	8,000
– on current account		
Graham	(500)	
Paula	400	(100)
		8,160

Additional information:

1. For the purpose of calculating wear and tear allowances for the year of assessment 2014, the fixed assets of the partnership are as follows:

	Historic cost as at 1 January 2013	Additions at cost	Disposals at cost	Historic cost as at 31 December 2013	Net book value as at 31 December 2013
	€	€	€	€	€
Fixtures and fittings	13,000	1,000	(2,000)	12,000	7,600
Computer equipment	20,000	2,400	(4,000)	18,400	15,300
Other plant (lift)	15,000	0	0	15,000	12,500

None of the assets of the partnership has been fully depreciated for tax purposes.

2. The partnership constitutes the main occupation of Graham and Paula, and they are both considered to be self-employed full time within the partnership. In addition to their income from the partnership, they also fulfil the following separate roles on a part-time basis:

   – Graham teaches on a part-time basis at a local tuition school. He earned gross emoluments of €7,000 from this activity for 2013.
   – Paula is a non-executive director of a local privately owned company, for which she receives an annual director's fee of €10,000.

3. Both Graham and Paula are single individuals. Graham has a four-year-old daughter, Kate, whom he maintains under his custody. Kate attends a registered private kindergarten school and Graham paid school fees of €2,800 for her in 2013.

Required:

(a) Prepare the partnership's income tax computation for the year of assessment 2014, showing the allocation of chargeable income between Graham and Paula.

Note: You should start your computation with the net profit before tax figure and include all of the items referred to in notes (1) to (4), indicating by the use of zero (0) any item for which no adjustment is required. (15 marks)

(b) Calculate the chargeable income of each of Graham and Paula for the year of assessment 2014. (7 marks)

(c) Calculate the individual income tax charge of each of Graham and Paula for the year of assessment 2014, using the most beneficial method of computation. (3 marks)

(25 marks)

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Question 3 begins on page 12.

3 Valluta Limited (VL) is a company which was incorporated in Malta on 1 July 2006. The share capital of VL is made up of 10,000 ordinary shares of €1 each, fully paid up. These shares had been subscribed to upon the incorporation of VL by its shareholders, as follows:

John Bonello	1,500 shares
Mary Bonello (John's wife)	1,500 shares
Mario Mercieca (unrelated to John or Mary)	7,000 shares

There have been no changes in the shareholdings of VL up to and including the financial year ended 30 June 2013.

On 31 December 2013, John Bonello transferred his full shareholding in VL to Mario Mercieca for an agreed consideration of €20,000.

On 1 February 2014, Mary Bonello transferred her full shareholding in VL to Silvio Mercieca (Mario's son), also for a consideration of €20,000.

The balance sheet of VL as at 30 June 2013 was as follows:

	Note	€
Non-current assets		
Property	(1)	150,000
Plant and equipment		27,500
Investment in Neptune Limited	(2)	2,500
Current assets		10,000
Current liabilities		(8,500)
Long-term liability		(6,000)
		175,500
Share capital		10,000
Reserves		165,500
		175,500

Notes:

(1) The property consists of commercial real estate situated in Gozo which had been acquired on 30 June 2008, and which is shown on the balance sheet at historical cost. The property has recently been valued by an architect at its current market value of €420,000. No immovable property transactions were undertaken by VL during the financial year ended 30 June 2014.

(2) The investment in Neptune Limited (NL) represents the cost of a 25% equity stake in that company, which had been acquired on 1 March 2008. Based on its financial statements, NL had a net asset value of €40,000 as at 30 June 2013. NL does not own any immovable property nor does NL own shares in any other entities. No share transactions in NL or in any other entity were undertaken by VL during the financial year ended 30 June 2014.

The figures for profit/(loss) before tax of VL and NL for the last five financial years are as follows:

Year ended 30 June	**VL**	**NL**
	€	€
2009	35,000	1,200
2010	55,000	2,100
2011	(10,000)	2,450
2012	44,000	2,850
2013	59,000	3,100

The shareholdings in both VL and NL confer full, proportionate percentage voting rights and entitlement to profits.

Required:

(a) Define a controlling interest for the purposes of capital gains tax and state, giving reasons, whether the transfers of shares in Valluta Limited (VL) by John and Mary Bonello qualify as a transfer of a controlling interest. (7 marks)

(b) Compute the capital gain chargeable to tax, if any, made on the disposal of their shareholdings in VL by:

(i) John, in the year of assessment 2014; and (2 marks)

(ii) Mary, in the year of assessment 2015. (11 marks)

(20 marks)

4 EMC Limited (EMC) is a company established in Malta which is registered for value added tax (VAT) purposes under Article 10 of the Value Added Tax Act. EMC is engaged in the business of purchasing and reselling a range of computer equipment for both domestic and business use. The following information relating to the VAT period 1 July 2014 to 30 September 2014 has been extracted from EMC's accounting records:

	Note	€
Turnover		
– Local sales to retail customers		14,000
– Local sales to business customers		25,000
– Intra-EU supplies made to EU VAT registered persons		9,000
– Exports		5,400
Purchases of equipment for resale		
– Domestic purchases		26,000
– Intra-EU acquisitions		12,600
– Imports	(1)	4,700
Local overhead expenditure		
– Goods at standard VAT rate	(2)	900
– Services at standard VAT rate	(3)	1,600
– Electricity bills at reduced VAT rate		750
Bank overdraft interest charged to EMC Limited		250
Services received from a consultant established in Italy	(4)	2,400
Capital goods expenditure	(5)	25,000

Notes:

(1) VAT at the standard rate was paid to Malta Customs on the imported equipment for resale before the goods were released into free circulation. EMC was issued with a document of importation evidencing the importation VAT paid.

(2) Local overhead expenditure on goods includes an amount of €150 spent on alcoholic beverages.

(3) Local overhead expenditure on services includes €580 relating to staff entertainment, and €160 for servicing the general manager's company car.

(4) The consultant is registered for VAT in Italy, but is not established or registered for VAT in Malta.

(5) Capital goods expenditure refers to the purchase by EMC of a brand new vehicle for the exclusive use of the company's general manager as a company car.

All amounts in this question are stated **exclusive** of VAT.

Required:

(a) For the value added tax (VAT) return period ended 30 September 2014, calculate EMC Limited's:

– output tax;
– input tax; and
– VAT payable or excess credit.

Clearly identify any items of revenue which are exempt with credit or exempt without credit, and any items of expenditure for which the input tax is not deductible. (11 marks)

(b) State by when EMC Limited should file its VAT return for the period ended 30 September 2014, if it does so manually and on time. (1 mark)

(c) Explain how a VAT excess credit can be used and, if not used, by when any VAT refund would become payable. (3 marks)

(15 marks)

5 David Galea is a highly experienced engineer who was born in Malta and who has always resided in Malta. Towards the end of 2012, David accepted employment with Zejt Limited (ZL), a company engaged in operating an oil refinery in Libya, to become the chief engineer for its plant situated in Libya.

David's employment with ZL will be on a fixed-term contract of two years commencing on 1 January 2013. The contract expressly requires the performance of David's duties to be predominantly outside Malta. David will work in Libya for 20 days each month, during which time he will live in accommodation provided by ZL to employees situated close to the plant so that he can be 'on call' throughout this time. ZL estimates the monthly cost of the accommodation provided to be €900 per employee. The remainder of the days in each month will be time off for David, and he will return to his family home in Malta to spend time with his wife and two children. It has been determined that the cost of travel between Malta and Libya, and the cost of the accommodation in Libya, would be considered to constitute 'costs of travel for a business purpose' in terms of the rules governing the taxation of fringe benefits.

The remaining terms of David's contract with ZL provide for the following:

- A basic annual salary of €120,000 in each of the two years.
- Reimbursement by ZL of the cost of his travelling between Malta and Libya for the purpose of his work, at an expected cost of €2,000 per month.
- A week's paid overseas vacation each calendar year for David and his immediate family, all expenses included, up to a maximum limit of €3,000. David would expect to fully utilise this benefit.
- Worldwide executive health insurance cover at an annual premium cost to ZL of €1,800. ZL does not offer health insurance to most of its other employees.
- Use of a business mobile phone worth €650 on a premium unlimited contract costing ZL €240 per month.
- Use of the following brand new computer equipment provided by ZL:
  - a high-end laptop at a cost to ZL of €2,750; and
  - a tablet computer device at a cost to ZL of €650.
- Provision of an interest-free loan to David upon the commencement of his employment of €20,000.

The only income accruing to David's household during 2013 was that derived from his employment with ZL.

Required:

(a) State, giving reasons, whether David Galea will be considered ordinarily resident and/or domiciled in Malta for tax purposes during the year of assessment 2014, and state the basis of taxation which will apply to him for that year. (3 marks)

(b) Calculate the total chargeable income of David for the year of assessment 2014.

Note: You should list all of the items of income and benefits referred to in the question, clearly identifying any items which are not taxable in Malta by the use of zero (0). (4 marks)

(c) State, giving reasons, the most beneficial method of tax computation applicable to David and calculate his tax charge for the year of assessment 2014 using this method. (3 marks)

(10 marks)

End of Question Paper