

Examiner's report

F6 (MLA) Taxation

December 2015

General Comments

There were two sections to the examination paper and all of the questions were compulsory. Section A consisted of 15 multiple choice questions of two marks each, which covered a broad range of syllabus topics. Section B had four questions worth 10 marks each and two longer questions worth 15 marks, each testing the candidates' understanding and application of key areas in Maltese taxation.

The following paragraphs report on each section and focus on some of the key learning points.

Specific Comments

Section A

Section A questions seek to provide a broad coverage of the syllabus; accordingly, future candidates should study all areas of the F6 MLA syllabus in order to be in a good position to answer Section A questions correctly and should not attempt to question spot.

It was pleasing to note all candidates attempted all of the questions. Overall performance has improved over the previous session, which was the first exam since the introduction of the new exam format, including particularly the introduction for the first time of multiple-choice questions within the paper.

The following example questions have been reviewed with the aim of giving future candidates an indication of the types of questions asked, guidance on dealing with exam questions and to provide a technical debrief on the topics covered by the specific questions selected.

Sample Questions for Discussion

Example 1

Company A is a service company registered in Malta with a financial and fiscal year ending on 31 December. On 1 February 2014, Company A purchased computer equipment costing €15,000. This computer equipment had to be sold during December 2014, and the proceeds on disposal were €10,600.

What is the balancing allowance which arises in the year of assessment 2015 as a result of the disposal of the computer equipment?

- A €0
- B €650
- C €4,400
- D €1,540

This question tested the ability of candidates to determine the balancing allowance arising on the disposal of a capital asset. The correct answer was A, namely no balancing allowance applies. The reason for this is that the disposal of the asset took place within the same fiscal year as the acquisition thereof, and therefore no wear and tear allowances had previously been allowed in respect of the said asset, and accordingly, a balancing statement should not be prepared. This fact was overlooked by a large majority of candidates. .

Example 2

Company X is a tax resident of Country Y, which does not have a double tax treaty with Malta. In 2014, Company X entered into a contract to perform construction work in Malta for a sole trader who is ordinarily resident and domiciled in Malta. In terms of the contract, the Maltese sole trader is required to pay a gross total of €95,000 for the complete works as specified in the contract. The total progress payments made by the Maltese sole trader to Company X during 2014, net of any applicable withholding tax, amounted to €13,000. The Commissioner for Revenue has not issued any notice in relation to this contract.

What is the amount of tax withheld by the Maltese sole trader during 2014?

- A €7,000
- B €0
- C €4,333
- D €4,550

This question assessed the ability of candidates to identify and calculate the withholding tax applicable upon the payment of income (chargeable to Maltese taxation) to a non-resident person. In this case, given that the recipient of the income is a non-resident company, the applicable withholding tax rate is the standard income tax rate applicable to companies, namely 35%. Given that the payment net of tax amounted to €13,000, the withholding tax element is computed as follows:

$13,000 \times 35\% / (100\% - 35\%) = €7,000$. Therefore, the correct answer is A. Again, a majority of candidates failed to answer this question correctly.

Section B

Question One

This 10-mark question required the computation of the tax payable upon the sale of a real estate asset situated in Malta, using the most beneficial method of taxation available. Since the seller had owned the apartment for less than 12 years, there was the option to opt out of the property transfer tax regime and apply the traditional capital gains computation instead.

Disappointingly, a considerable number of candidates did not identify the two possible alternative taxation methodologies, and hence failed to calculate the tax payable under both options with a view to determining the most beneficial method of taxation available.

Candidates are reminded that due to legislative changes, this option no longer applies for transfers of immovable property situated in Malta as from 1 January 2015 (subject to a transitional provision which is not examinable at the level of the F6 MLA paper.)

Question Two

This 10-mark question dealt with the taxation of foreign-sourced dividend and interest income of a company registered in Malta.

Part (a)(i) for 4 marks required an explanation of the tax treatment (including tax accounting) of a foreign-sourced dividend, including determining whether the participation exemption applies thereto. A number of candidates failed to correctly identify whether the shareholding giving rise to the dividends constitutes an equity holding. Some candidates also failed to identify the applicable participating holding criterion and/or the applicability of the

anti-abuse provision namely that although the investee company is not resident or incorporated within the EU, and is not subject to foreign tax of at least 15%, it is engaged in active trading operations and as such it satisfies the anti-abuse condition that not more than 50% of its income is derived from passive interest or royalties.

Part (a)(ii) for 5 marks required calculation of the tax payable in Malta on the foreign-sourced interest income as well as the associated refundable tax credit arising to the shareholder on a dividend distribution of the corresponding profit. While most candidates calculated the tax payable correctly, some failed to identify the applicable tax account to which the profit should be allocated and to apply the correct type of refund.

Part (b) for 1 mark was a binary question regarding a partnership *en commandite* without shares. In this case, no specific explanation was required, and candidates who went beyond a simple 'Yes / No' answer were in effect wasting time. Candidates are again reminded to follow the instructions provided in the question - the operative word in part (b) of the question was to 'state' whether such a partnership constitutes a company for Maltese tax purposes, clearly implying that no particular explanation was being sought. Candidates are yet again generally reminded to carefully consider the requirement verb within the question, in order to help them to understand the nature of the answer required.

Question Three

This 10-mark question tested candidates' applied knowledge of value added tax (VAT) within the context of a hotel operator. The question required the calculation of output tax and input tax for the given VAT period based on information provided about the transactions undertaken during the period. This included the identification of the applicable VAT rates (including the special reduced rate of 7% applicable to hotel accommodation) and, where applicable, VAT exemptions on both the output (sales) and input (purchases) side.

A substantial proportion of candidates demonstrated a good overall appreciation of the VAT treatment of the transactions in question, which affirms the observation made in the previous examiner's report for the F6 MLA paper that an increasing number of candidates are devoting the required attention to this important and compulsory part of the syllabus in their studies.

It is pertinent to point out however, that a large proportion of candidates did fail to account correctly for cross-border services received under the reverse charge mechanism. In this respect, it appears that candidates ought to pay more attention to the VAT treatment of cross-border services.

Question Four

This question covered the capital gains taxation implications of three consecutive share transfers in the same company by three related persons.

Part (a) for 3 marks required the identification of each of the three share transfers as a transfer of a controlling interest, or otherwise as a transfer of a non-controlling interest. While most candidates correctly concluded that the first two transfers did not constitute a transfer of a controlling interest, difficulties appear to have been encountered by a number of candidates in relation to the third transfer. The third transfer did in fact constitute a transfer of a controlling interest because although individually it was a transfer of a 10% shareholding (which is below the 25% shareholding threshold normally required for a transfer of a controlling interest), all three transfers had to be considered together as a global transfer, on the basis that they were effected by related persons within a period of 18 months.

Part (b) for 7 marks required a calculation of the chargeable capital gain in respect of each of the aforesaid transfers. The computation was generally performed correctly in relation to the first two transfers; however, the third transfer again proved problematic. On the one hand, candidates who incorrectly characterised the third transfer as not being a transfer of a controlling interest understandably did not apply the correct computational methodology set out for transfers of a controlling interest. On the other hand, however, even where the

controlling interest methodology was used, in a number of cases the computation was performed incorrectly, with the main reasons for this being incorrect adjustment for goodwill and/or failure to correctly net off the value taken into account in the preceding transfers.

Therefore, despite highlighting this topic as an area of relative weakness in previous examiner's reports, it continues to be an area that requires improvement.

Question Five

This 15-mark question set out the scenario of a trading company and assessed the core topic of corporate income tax computations and tax accounting. Most candidates did well in part (a) of the question, namely the corporate income tax computation, while the performance on part (b) relating to tax accounting was mixed.

Part (a) was worth 12 marks and called for a corporate income tax computation for the company. Candidates' performance in this part of the question was mostly satisfactory, with a majority of candidates showing a satisfactory appreciation of deductible and non-deductible expenses. However, several candidates got confused by the fact that the bank interest income was stated net of tax, rather than gross of tax.

Part (b) for 3 marks required the allocation of the distributable profits of the company to the applicable tax accounts. Some weaknesses were evident in this area, in particular in the actual calculation of the distributable profits figure, and in the allocation of the residual amount to the untaxed account.

Question Six

This 15-mark question consisted of an individual income tax computation.

Part (a) for 12 marks required a calculation of the chargeable income and corresponding tax charge of a married couple who are ordinarily resident in Malta, but not domiciled in Malta. One of the spouses carried on a business activity on a self-employed basis, which therefore necessitated taking into account the allowable deductions for tax purposes against the turnover from the independent business activity.

This part of the question was generally answered very well, and most candidates demonstrated a good appreciation of the remittance basis of taxation, and the ability to calculate tax payable using the most advantageous method. Key areas of weakness were the failure to apply wear and tear allowances to the capital asset investments relating to the independent business activity, and the failure to take into account the credit for foreign tax paid.

Part (b) for 3 marks was a non-computational question requiring a brief explanation of the responsibilities of a married couple for the filing of tax returns and payment of tax. While most candidates mentioned the filing of a joint tax return, fewer candidates referred to the concept of a responsible spouse including the appointment and designation thereof, as well as the joint liability of the couple for the tax payable.