

# Examiner's report

## F6 Taxation (MLA)

June 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.

This is the first examiner's report since the introduction of the new exam format and question types. The following paragraphs report on each section and focus on some of the key learning points.

### Specific Comments

#### Section A

Section A questions aim to provide a broad coverage of the syllabus; accordingly, future candidates should aim to revise all areas of the F6 MLA syllabus rather than attempting to question spot. The following question has 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 question selected.

#### Sample Question for Discussion

David started a new business as an independent trader on 1 January 2015. He incurred the following business expenditure before he actually commenced carrying out his trade:

	Period prior to commencement in which incurred	€
Advertising	20 months	5,700
Cost of feasibility study	12 months	4,500
Formation expenses	3 months	2,600
Staff salaries	3 months onwards	14,500
Staff training	2 months	3,100

**What is the amount of pre-trading expenditure which David will be allowed against his trading income for the year of assessment 2016?**

- A €23,300
- B €0
- C €17,600
- D €30,400

This question tested the ability of candidates to determine which expenditure incurred prior to the commencement of a trade or business was deductible for tax purposes.

While advertising incurred prior to the commencement of the trade may be deductible, in this case the deduction does not apply since the expenditure was incurred more than 18 months prior to the commencement of the trade. The cost of the feasibility study and the formation expenses are not allowable. The correct answer was C,



namely that only staff salaries and training (which were incurred well within the 18 month timeframe) are deductible.

## **Section B**

### **Question One**

This 10-mark question covered the taxation of capital gains on share transfers.

Part (a) for four marks required candidates to calculate the market value of the ordinary shares in a Maltese company for the purposes of the charge to income tax on capital gains. This required the adjustment of the net asset value of the company to determine the market value as defined for capital gains purposes. Disappointingly, a considerable number of candidates were not able to identify the correct net asset value of the company, which is the starting point of the market value calculation.

Many candidates however, did identify the requirement for adjustment in respect of the value of immovable property and goodwill, although some used the incorrect profit figures for the purposes of the goodwill adjustment. Some candidates failed to deduct the book value of the preference shares, which was necessary given that the question required the calculation of the value of the ordinary shares only. Candidates are reminded to read the question requirement carefully.

Part (b) required the calculation of the chargeable capital gain on the transfer of a controlling share interest. In this regard, some candidates did not identify the requirement to take into account the higher of the consideration and of the market value for the purposes of the calculation. While most candidates correctly deducted the original cost, a significant proportion of candidates omitted or miscalculated the inflation deduction in respect of immovable property. Moreover, some candidates did not exclude preference shares on the basis that these fall outside the scope of the charge to tax on capital gains.

### **Question Two**

This 10-mark question dealt with tax accounting and the Maltese tax refund system.

Part (a) for nine marks set out four distinct sources of income and, in respect of each, required the candidates to state the tax account to which the chargeable income after tax is allocated, to calculate the tax payable in Malta, and to calculate the income tax refund claimable by the shareholder upon a dividend distribution.

Overall candidates performed well in this question. However, candidates are reminded to read the instructions provided in the question carefully to ensure that they are answering the question appropriately. For example as regards tax accounting, the operative word in the question was to 'state' the required tax account, which implies that no particular explanation was being sought. Candidates are generally reminded to carefully consider the requirement verb within the question, in order to help them to understand the nature of the answer required.

Part (b) for one mark was a binary question regarding tax accounting. Several candidates answered this correctly, albeit in this case again no specific explanation was required and candidates who went beyond a simple 'Yes / No' answer were in effect wasting time.

### **Question Three**

This 10-mark question tested candidates' basic applied knowledge of value added tax (VAT). The question set out five transactions, each of which was to be addressed from a VAT perspective. More specifically, the question required candidates to state the nature of the transaction, the place of supply, the person liable to pay VAT and the applicable VAT rate (if any) giving the reason, in respect of each transaction.

Again, the operative word throughout the question was 'state', which implies a requirement for a concise and to-the-point answer.

Overall, a good proportion of candidates demonstrated sound knowledge of the VAT treatment of the transactions in question, and it was apparent that candidates are devoting the required attention to this important part of the syllabus.

#### **Question Four**

This 10-mark question covered the identification and application of the basis of taxation of individuals who are ordinarily resident but not domiciled in Malta.

Part (a) for two marks required the identification of the residence and domicile status of the individuals described in the question. Performance on this part of the question was very satisfactory.

Part (b) for eight marks required a calculation of the total chargeable income of such individuals. This was generally answered very well by most candidates. Some candidates failed to correctly calculate the amount of chargeable income in respect of a local dividend receipt, and to identify that foreign source capital gains are not subject to tax in Malta in such a situation, irrespective of whether these gains are received in or remitted to Malta, or otherwise.

#### **Question Five**

This 15-mark question assessed the application of core corporate taxation principles. Many candidates found this question to be particularly challenging and performance on this question was generally the weakest out of all the questions in Section B. The question set out the scenario of a holding company and its two subsidiaries.

Part (a) for four marks required the corporate income tax computation of the two subsidiary companies. These computations were relatively straightforward and performance was generally satisfactory, although some candidates failed to identify the applicability of the participation exemption to the dividend income received by one of the subsidiaries.

Part (b) for six marks required the allocation of the distributable profits of the subsidiaries to the applicable tax accounts. Some weaknesses were evident in this area, for instance some candidates erroneously allocated the gain on the sale of a real estate asset overseas to the immovable property account, whereas foreign source capital gains ought to be allocated to the foreign income account instead.

Part (c) for five marks required a calculation of the dividends receivable by the holding company on the basis that all profits of the subsidiaries available for distribution are distributed by way of dividends. Moreover, this part of the question required the computation of the corresponding tax refund entitlement. Many candidates performed poorly on this part of the question and were unable to correctly quantify the dividend distributable by the subsidiary companies and the tax accounting allocation thereof, as well as the corresponding tax refund entitlement for the holding company. It is recommended that candidates should read the scenario carefully to ensure it is understood well, which would facilitate the correct application of the relevant tax rules.

#### **Question Six**

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

It required a calculation of the chargeable income and tax charge of a married couple who are ordinarily resident and domiciled in Malta. One of the spouses carried on a business activity on a self-employed basis, which therefore necessitated the adjustment of the accounting profits of the business activity for tax purposes.



This question was generally answered very well, with most candidates showing a satisfactory appreciation of deductible and non-deductible expenses, including the personal deduction allowable for kindergarten school fees. Most candidates also demonstrated an ability to calculate tax payable using the most advantageous method.