

Examiner's report

F6 (MLA) Taxation

June 2016

General Comments

There were two sections in 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, candidates should study all areas of the F6 MLA syllabus in order to be in a good position to answer Section A questions correctly.

It was pleasing to note that all candidates attempted all of the questions. Overall performance in this section has continued to improve over the previous session and many candidates are achieving a good mark in Section A. A good performance in Section A greatly facilitates the task of obtaining an overall pass in this exam, and therefore candidates are encouraged to devote due importance to this section, which accounts for 30% of the overall mark allocation.

The following sample question is reviewed with the aim of giving future candidates an indication of the types of questions asked and guidance on dealing with such exam questions.

Sample Question for Discussion

Martin is an individual who is ordinarily resident but not domiciled in Malta. His wife, Janet, is ordinarily resident and domiciled in Malta. On 1 May 2015, Martin received foreign source passive royalty income amounting to €25,000, of which €10,000 was received by Martin directly in Malta while the balance of €15,000 was credited to Martin's bank account outside Malta and was not remitted to Malta. Martin's marginal income tax rate in Malta is 35%.

What is Martin's chargeable income during the year of assessment 2016 in respect of his royalty income?

- A €0
- B €10,000
- C €8,750
- D €25,000

This question tested the ability of candidates to recognise that the so-called remittance basis of taxation is no longer applicable to persons whose spouse is both ordinarily resident and domiciled in Malta. A majority of candidates overlooked this and incorrectly answered the question on the basis that the remittance basis continues to apply even in such situations. The correct answer was D

It is imperative that candidates are up to speed with pertinent developments which fall within the syllabus, as long as the relevant legislation was passed before the cut-off date as described in the study guide, namely the 30th of September of the year preceding the exam sitting.

Section B

Question One

This 10-mark question required the computation of the tax payable upon five distinct immovable property transfer transactions. While a good number of candidates performed very well in this question, it was evident that some candidates are not yet up to speed with the revised immovable property transfer tax regime. This is a core topic in the syllabus, with which candidates are expected to be very well versed.

It is pertinent to highlight that as from 1 January 2015, specifically in relation to immovable property which is situated in Malta, the former dual system consisting of a 12% final withholding tax on the transfer value or the application of income tax on the capital gain has been replaced by a single final withholding tax system. The withholding tax rate is generally of 8%, albeit the applicable tax rate differs in certain circumstances.

Candidates are again reminded to be mindful of relevant legislative changes that are passed before the cut-off date.

Question Two

This 10-mark question dealt with the taxation of dividend income and capital gains for a company registered in Malta, which in turn was owned by an individual who is neither ordinarily resident nor domiciled in Malta.

The question specifically stated that where applicable, the company always elects to apply the participation exemption. However, some candidates appeared to overlook this instruction and unnecessarily suggested the alternative treatment of paying tax and claiming a full tax refund instead. Furthermore, in this question, some candidates failed to recognise that the participation exemption can apply to domestic participating holdings as well as to branches established outside Malta.

Further, many candidates developed their answer beyond the requirements of the question to also include the tax accounting for the dividend income and capital gains in the question. While the tax account applicable to each particular stream of income and gains could be relevant insofar as it determines the applicable shareholder tax refund upon a dividend distribution, the question requirements clearly did not refer to tax accounting. In this respect, it is important for candidates to carefully read the question posed and clearly answer that and only that which was asked for.

Question Three

This 10-mark question tested candidates' applied knowledge of value added tax (VAT) by requiring the calculation of output tax chargeable on nine distinct and varied transactions. The transactions were presented in tabular format, setting out the nature and value of each supply, as well as the pertinent attributes of both the supplier and the customer in each transaction.

A substantial proportion of candidates performed very well in this question, demonstrating that in their studies candidates are now devoting the required attention to this important and compulsory part of the syllabus.

It may be pertinent to point out that some candidates did overlook the fact that persons registered for VAT under the Article 11 type of registration do not charge VAT on their supplies. Furthermore, candidates ought to be aware that the importation of goods into Malta is - save for any applicable VAT exemption - generally chargeable to VAT even if the importation is made by a private individual and not in a business capacity.

Question Four

This question was specifically devoted to the application of roll-over relief, which applies where a capital asset which had been used in a business for a period of at least three years is transferred and replaced within one year by another asset used solely for a similar purpose in the business.

Part (a) for 3 marks required candidates to briefly describe the basis for the application of roll-over relief to the scenario in the question - which relates to immovable property (specifically, a retail store) – and also to state whether any action is necessary on the part of the taxpayer in order to take advantage of this relief. Virtually all candidates demonstrated a good appreciation of the concept of roll-over relief, although a large proportion failed to mention that in order to take advantage of this relief, the taxpayer is required to make a declaration to the notary at the time of the contract to exclude the transfer from the scope of the property transfer tax system.

Part (b), also for 3 marks, required candidates to calculate the cost of acquisition of the replacement asset. In this respect, many candidates failed to take into account the reduction in cost of acquisition due to application of roll-over relief. This suggests that while candidates are generally well aware of the concept of roll-over relief, many candidates could have performed better as regards the actual application of the concept, particularly the computational mechanics. Furthermore, some candidates failed to include the stamp duty that had been incurred upon acquisition of the asset as part of its cost of acquisition, whereas some others incorrectly deducted (rather than added) the stamp duty from the cost of acquisition.

Part (c), for another 3 marks, required an explanation of the tax consequences and calculation of the corresponding tax arising in the situation where the replacement asset is sold after less than two years. Many candidates successfully identified that in this situation, the roll-over relief originally claimed is no longer available, leading to the sale of the original asset becoming taxable. Furthermore, the transfer of the replacement asset itself is also taxable in its own right. However, a minority candidates failed to apply the correct property transfer tax methodology, reflecting the comment made above in relation to Question 1 of Section B that some candidates are not yet sufficiently conversant with the revised immovable property transfer tax regime.

Finally, part (d) carried one mark and required a recalculation of the cost of acquisition of the replacement asset for tax purposes in the situation where the reduction in cost of acquisition due to application of roll-over relief exceeds the actual cost of acquisition. This required candidates to recognise that in such situations, the cost of acquisition cannot be negative and would instead be nil. While some candidates answered this part of the question correctly, the majority of candidates did not, again suggesting that candidates could perform better in the actual application and computation of this relief.

Question Five

This 15-mark question set out the scenario of a local group of companies whereby one company provides loan financing to another company, enabling the latter to finance the acquisition of a commercial real estate asset in Malta. This asset is in turn leased to a third company within the group, which is a company actually engaged in trade.

Part (a) carried 13 marks and required income tax computations (including tax accounting) for each of the aforementioned three companies forming part of the group. Most candidates did well in the corporate income tax computations, although a number of candidates failed to apply the specific tax computation rules applicable to the company which derives income exclusively from the rental of the immovable property asset situated in Malta, applying instead the usual tax computation format consisting of adjusting the accounting profit figure for tax purposes. While this format is not of itself incorrect, candidates who started with the accounting profit figure rather than the rental income figure and then taking the specific deductions applicable in this case tended to get confused and to fail to correctly apply the specific tax computation rules relating to income from immovable property situated in Malta. Furthermore, performance on the tax accounting aspects was mixed, and a common mistake was failing to correctly apply the annual market rent allocation, and others failing to allocate income from the financing of immovable property situated in Malta to the immovable property account.

Part (b) carried 2 marks and related to the application of VAT to the letting of property described in the scenario. It was pleasing to note that many candidates answered this part of the question correctly, reaffirming the comments made in relation to Question 3 that candidates appear to be devoting the required attention to VAT in their studies.

Question Six

This 15-mark question consisted of individual income tax computations for two brothers who are both ordinarily resident and domiciled in Malta.

This question was generally answered well, with most candidates demonstrating a good appreciation of the basic concepts of individual tax computations including the taxation of fringe benefits, part-time income and capital gains.

Some common areas of weakness were the incorrect application of the 15% part-time tax rate where the main and part-time employers are related parties, the failure to take into account the tax exempt portion of the fringe benefit consisting of a long service award, and the incorrect application of the capping applicable to the deduction in respect of home for the elderly fees.