

# Examiner's report

## F6 (MLA) Taxation

### June 2017

#### 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 the majority of candidates attempted all of the questions. Overall performance in this section declined marginally over the previous session. A good performance in Section A makes it easier to obtain 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 majority of candidates found the following question difficult. Future candidates should review this question as it provides an indication of the type of questions asked and provides guidance on dealing with such exam questions.

##### **Sample Question for Discussion**

Ace Limited (AL) owns a residential property in Malta. The original cost of acquisition of the property is €175,000 and its current market value is €300,000. Throughout 2016, the property was leased by AL to one of its employees, who paid an annual rent of €8,000 to AL. In 2016, AL paid bills relating to the property totalling €5,000, of which the tenant employee reimbursed €2,000 to AL.

**What is the taxable value of the fringe benefit provided by Ace Limited to the employee in the year of assessment 2017?**

- A €10,000
- B €0
- C €3,750
- D €15,000

This question tested the ability of candidates to correctly calculate the fringe benefit value of the provision of accommodation. The correct answer required candidates to estimate the annual value of the accommodation, which is calculated as 5% of the market value of the property. From this value, the actual amount of rent paid by the employee is to be deducted (naturally, only the excess not paid for by the employee is taxable.) Furthermore, the amount of bills relating to the property which were not reimbursed by the employee should also be included in the taxable value of the fringe benefit.

##### Section B

##### **Question One**

This question carried 10 marks and tested candidates' applied knowledge of value added tax (VAT) in relation to the transactions entered into by a company providing insurance services.

Part (a) of the question, for 2 marks, required the identification of the type of VAT registration which applies to the company, with a brief explanation thereof. While most candidates showed awareness of the fact that

insurance services constitute exempt without credit supplies for VAT purposes, few candidates were able to recognise that the company could exercise a partial right of recovery in view of its services provided to non-EU clients, and as a result was eligible to the normal type of business VAT registration (typically referred to as an Article 10 VAT registration).

Part (b) carried 8 marks and required the calculation of output tax chargeable and input tax creditable in respect of the various transactions entered into by the company, as well as the resulting VAT payable / refundable. The company's clients included Maltese, other EU, as well as non-EU established persons which were serviced respectively by three independent departments. The question provided the allocation of each item of expenditure to the respective departments, thereby allowing a direct allocation of input VAT to supplies conferring a right to recover input VAT (namely insurance services provided to non-EU clients) as well as to supplies not conferring a right to recover input VAT (namely insurance services provided to Maltese and other EU clients.) Furthermore, the expenditure was stated exclusive of any applicable VAT, and therefore candidates were expected to be able to identify whether each item of expenditure was actually subject to VAT or not, and for those items of expenditure which was subject to VAT, to determine the rate of VAT to be applied.

Candidates found question 1 to be challenging. A number of candidates failed to recognise that the expenditure attributable to the non-EU clients department (and only that) is recoverable.

Consistent with previous sessions, some candidates also overlooked the fact that outsourced services received from outside Malta (namely the overseas group services company) – irrespective of whether established in the EU or outside the EU – are deemed to take place in Malta (that is to say, where the business customer is established) and therefore trigger an output tax charge, as well as a corresponding input tax credit (only in relation to the expenditure allocated to the non-EU clients department.)

### **Question Two**

This question, carrying 10 marks, relates to two sequential transfers of shares in a company carried out by siblings.

Part (a) of the question carried 3 marks and required the candidates to state whether or not each of the said transfers constitutes a transfer of a controlling share interest, providing the reasons therefor. The majority of candidates performed well in this question.

Part (b) of the question, for 7 marks, required the computation of the capital gain chargeable to tax in respect of each of the share transfers. Therefore, in respect of the transfer of a controlling interest, it was necessary to determine the market value of the company for income tax on capital gains purposes, including the calculation of goodwill and adjustment for the market value of immovable property. Adjustment for inflation in respect of the immovable property held by the company was specifically excluded by the question. Most candidates performed reasonably well in this question, which was encouraging.

### **Question Three**

This 10-mark question set out five different streams of income derived by a company established in Malta, and in respect of each of these required the identification of the applicable tax account, the computation of the tax payable in Malta as well as any income tax refund claimable by the shareholder upon a dividend distribution. Generally candidates performed satisfactorily in this question overall, however a number of candidates did not recognise that the participation exemption can apply to foreign permanent establishments. Some candidates also incorrectly concluded that income from operations outside Malta which is not attributable to a permanent establishment is allocable to the foreign income account rather than to the Maltese taxed account.

The question also involved a secondary stage re-allocation of taxed profits to the immovable property account in respect of the annual market rent of business premises owned and used by the company. Candidates found this matter challenging and often did not take this correctly into account which resulted in an overstatement of the tax eligible for refund to the shareholder upon a dividend distribution.

#### **Question Four**

This question, carrying 10 marks, was subdivided into two parts carrying 5 marks each.

The first part involved the rental of a residential property and of a commercial property by an individual and required the calculation of the total tax payable by the lessor in relation to the rental investment properties, using the most beneficial method of tax computation. This part of Question 4 required the candidates to recognise that in a given year of assessment, it is possible to choose between the normal income tax regime applicable to income derived from immovable property and the 15% final withholding tax regime, which has recently been extended to rental income derived commercial property (besides residential property.)

The second part of the question consisted of a personal income tax computation for a self-employed individual, and specifically tested the correct application of the income tax deduction rules governing pre-trading expenditure, unabsorbed wear and tear allowances and trading losses.

#### **Question Five**

This question carried 15 marks and required the computation of the chargeable income of a trading company incorporated, managed and controlled in Malta. The computation entailed the correct application of income tax deduction rules for a company engaged in trade in order to adjust the profit before tax figure as per the income statement for tax purposes so as to derive the income chargeable to tax. The question also tested the application of group loss relief.

This question was generally answered well, with most candidates demonstrating a good appreciation of the basic concepts of business tax computations, including calculation of wear and tear allowances.

#### **Question Six**

This question carried 15 marks and related to the personal tax position of two same-sex individuals in a registered civil union. One of the individuals was engaged in full-time employment at a fixed salary plus fringe benefits, whereas the other individual did not have a full-time occupation but derived income and gains from various other sources.

Part (a) of the question, for 3 marks, required identifying, giving reasons, whether the individuals are considered to be ordinarily resident and/or domiciled in Malta during the year under review. This part of the question was answered satisfactorily by most candidates.

Part (b) of the question carried 9 marks and required the computation of the total chargeable income of the individuals.

Part (c) of the question carried the remaining 3 marks and required the calculation of the total tax payable by the couple for the relevant year of assessment. Candidates were required to recognise that the separate computation couldn't be applied in this case – rather, a joint computation using married rates was the correct approach.

Most candidates demonstrated a good understanding of personal income tax computations including the calculation of the taxable value of fringe benefits, as well as the application of the remittance basis of taxation.



However, some did find it difficult to recognise the relatively novel concept that a couple in a registered civil union who live together are to be considered as a married couple for Maltese tax purposes.