

Examiner's report

P6 Advanced Taxation (MLA)

December 2015

General Comments

The examination consisted of two compulsory questions and three optional questions. Section A contained two compulsory questions, one of which having 35 marks (Question 1) and the other having 25 marks (Question 2). Section B comprised three questions of 20 marks each, to choose two from.

The vast majority of candidates attempted four questions and there was little evidence of time pressure. Where questions, or rather parts of questions, were left unanswered by candidates this appeared to be due to a lack of knowledge, as opposed to time pressure.

The technique chosen by most candidates was to start with Section A (which carries 60 per cent of the marks) and then move on to Section B, which is the most advisable method. Given that Section A contains 60 per cent of the marks, leaving this to the end may prove to be a risky strategy.

Candidates performed particularly well on question 1, while the question candidates found most challenging was question 5, which a minority of candidates attempted. Question 5 covered a number of topics which have been previously examined, such as double tax treaties, deductions and duty on documents and transfers, however candidates seemed to have found the mixture of topics (as well as the fact that the question related to facets of the topics which were not previously examined) particularly challenging.

A number of common issues arose in candidate's answers:

- Candidates should attempt the P6 Paper only once they feel very comfortable with the principles they would have learnt in F6. Very fundamental principles in Malta's tax law are missed time and again. All previous Examiner's reports have highlighted this point. P6 is not an exam which candidates can take lightly as it does not just require a superficial understanding of concepts, but requires analytical thinking, even if the question may seem easy at first.
- Fundamental issues which are examined time and again are not fully understood by candidates.
- Candidates perform well when they are required to reproduce information they have studied, but are not always able to apply their knowledge where analytical thinking is required.
- Candidates do not use the 15 minutes of reading and planning time wisely. The questions in P6 often include key information which is instrumental to correctly answering the question. It is therefore important that candidates read the questions carefully and underline the main issues. Candidates performance is affected often because they do not identify a key part of the question. This is especially true in Section A.
- Candidates are on average better prepared for Section A, but are not well prepared for Section B. In essence it appears that candidates are not preparing themselves thoroughly for the exam, but are choosing topics to study – which is risky in a subject such as P6 which is so rich in material.
- Once again, it appears that candidates do not read the law when studying, but rely exclusively on notes and lectures. Without reading the law, candidates only understand concepts and not the intricacies of tax law, and this affects candidates' ability to answer the question fully.

Specific Comments

Question One

This 35-mark question was based on the tax implications of the Malta Hold Ltd group and the tax implications of the different activities carried out by the different companies. It tested candidates' knowledge on the application of tax treaties, Malta's refund system, the participation exemption, taxation of income derived from immovable property, the group relief provisions and the tax accounting rules.

Candidates were asked to consider: the tax implications of the activities of Malta Consult Ltd, including the consideration as to whether there was a risk that Malta Consult Ltd had a permanent establishment in other States; the tax implications of Malta Prop Ltd, which rented out two different property blocks to third parties; the income tax treatment of dividends derived by Malta Hold Ltd from its minority investment in IRL Prop Ltd; and the utilisation of tax losses incurred by Malta Fashion Ltd.

As explained above candidates generally performed well in answering this question – which is very encouraging, as the common mistakes highlighted in the past were not repeated. What candidates have to however keep in mind is that in an Advanced exam it is not enough to simply answer the issue highlighted in the question, but one must explain why they come to their conclusion (even where the conclusion is correct). By way of example, a number of candidates did not explain why Malta Consult Ltd would not have a permanent establishment in the source States where its employees travel to, and very few candidates entered into the merits of the income derived by Malta Prop Ltd from the rental of Sunflower Court and Sunshine Court. This resulted in candidates failing to score marks, which were allocated to these explanations.

In general, candidates explained the tax treatment of income derived from Malta Consult Ltd well. With respect to income derived by Malta Prop Ltd, there was some confusion as to when the 15% rate for the rental of immovable property applies – with a number of candidates failing to even mention the 15% rate altogether. Furthermore, as in the previous exam, a number of candidates erroneously come to the conclusion that since the income derived by Malta Prop Ltd was active income, then the profits are to be allocated to the Malta taxed account, and Malta Hold Ltd may benefit from the refund system on the said profits. A grave error in the understanding of the tax accounting rules, but an error which has repeated itself over two successive exams.

The application of the participation exemption with respect to income derived by Malta Hold Ltd from its holding in IRL Prop Ltd was in general answered very well. The common error of assuming that the participation exemption will not apply as the non-resident company owns immovable property outside Malta was generally not made by candidates, which is very welcome, as this has been a common mistake year after year.

An unfortunate common mistake is that candidates entered into the merits as to whether Malta Consult Ltd had a permanent establishment in Malta, Malta Consult Ltd is a Maltese registered company, and therefore cannot have a permanent establishment in Malta – a number of candidates however dedicated time to explaining why Malta Consult Ltd has or does not have a permanent establishment in Malta – thereby effectively losing time. This suggests that while candidates know the OECD definition of a permanent establishment, they do not understand what a permanent establishment actually is and this is an area which requires further understanding and improvement.

Candidates generally structured their answers to this question very well, tackling one company at a time and each source of income separately.

Question Two

This 25-mark question was based on the transfer of property (directly or indirectly) by Peter Zammit to his son Paul Zammit. The question covered the topics of taxation on the transfer of immovable property and duty on documents.

Part (a) for 19 marks required candidates to comment on the income tax and duty on documents and transfers implications on the transfer of immovable property in three different transactions and the filing requirements for the transfer. The planned transactions were an intra-group transfer of a premium office block which was held as a trading asset, the transfer of a warehouse to Paul Zammit upon the liquidation of Maz Ltd, and the *causa mortis* transfer of Peter Zammit's dwelling house to Paul Zammit.

Candidates' performance on this question varied, however, in general candidates did not perform well on this question. It appears that candidates were surprised by the focus on transfer of immovable property against the more often examined transfer of shares. While the rules relating to the transfer of immovable property are in general less complicated than the rules relating to the transfer of shares, it appears that candidates were not adequately prepared for this question.

The first transfer related to the transfer of the premium office block to a related company, which is owned 81% by Peter Zammit and 19% by Paul Zammit. Past exams often included the case where an asset is transferred between group companies, and in fact candidates very quickly assumed that the rules relating to this transfer were the same as in previous exams and the answers generally related to intra-group transfers of capital assets. However, given that the immovable property in question was not a capital asset, but was a trading asset different rules applied – and for the exemption to apply the asset must have been held for over 12 years, which was not the case. A very small minority of candidates identified this issue, suggesting that many candidates either did not know the rules, or did not read the question thoroughly.

The second transfer related to the transfer of the warehouse to Paul Zammit upon the liquidation of Maz Ltd, which is wholly owned by Peter Zammit. Candidates performance on this transfer varied, a number of candidates correctly identified that there are rules exempting the transfer of an asset to a 100% shareholder upon the liquidation of the company, but did not notice that the same rule would also apply on the transfer of the asset to the descendant of the shareholder, at least for income tax purposes. The purpose of this rule is to mirror the fact that for income tax purposes the donation by Peter Zammit to Paul Zammit would not be taxable, but for duty on documents purposes no such exemption applied. The law sought to ensure that whether by way of liquidation or by way of a subsequent donation – the tax implications are mirrored. However, the vast majority of candidates did not identify this issue.

The third transfer, by way of *causa mortis* transfer was mostly well answered, albeit very few candidates commented on the recent change in law allowing for an exemption from stamp duty when the *causa mortis* transfer is to a descendant.

Part (b) for 6 marks considered the income tax and duty on documents implications of the transfer of property by Paul Zammit. Candidates generally performed well on this requirement.

Question Three

This 20-mark question was based on the tax implications of Anne Goll (in part (a)) and Elton Jones (in part (b)).

Part (a) for 13 marks considered the tax implications of Anne Goll, an individual resident and domiciled in Switzerland who is to become a Maltese tax resident individual in order to take up employment as a Commercial Officer with the Gozo International Airport. The question tested candidates' knowledge of Malta's jurisdiction to tax, double tax treaties, the highly qualified persons rules and the rules relating to employment outside Malta.

Candidates performance on this question varied – while the topics being examined have been previously, especially the application of a tax treaty with respect to the determination of treaty residence and taxation of employment income, candidates did not appear to know how to apply the rules to restrict (example) Switzerland from taxing Ms Goll with respect to the work she carried out in Switzerland for Gozo International Airport. Given that candidates generally correctly outlined that Ms Goll would be resident in Malta in terms of the treaty in view of her centre of vital interests moving to Malta, it was surprising to see that even though they correctly outlined the rules with respect to the Employment Income article of a tax treaty, they do not know how to apply it to different cases. Another common mistake was the fact that candidates generally came to the conclusion that Ms Goll would benefit from the highly qualified persons rules even though she is not the CEO of Gozo International Airport – which would be the only case where Ms Goll could have benefitted from these rules.

A number of candidates also failed to comment on the application of the rules with respect to employment outside Malta, thereby failing gain marks in this area. This again can be put down to a failure to read the question properly which specifically asked for this to be considered.

Part (b) for 7 marks tested the candidates' knowledge of the rules relating to taxation of non-resident entertainers and the double tax treaty rules related to income derived by artistes. Candidates' performance on this question was satisfactory. In general candidates demonstrated knowledge of the rules with respect to non-resident entertainers and correctly outlined the rules depending on the length of stay of the individual, and the differences thereto. However, candidates did not seem to know the tax treaty provisions relating to artistes and sportsmen, with a number of candidates considering the application of either the business profits article with a reference to the existence or not of a permanent establishment and others considering the application of the employment income article.

Question 3 was however the most popular choice of candidates in Section B, and also the question in Section B in which candidates performed best. Candidates' performance on this question however still shows a superficial understanding of topics that are tested on a regular basis.

Question Four

This 20-mark question was based on application of the capital goods scheme in relation to input VAT claimed on construction, refurbishment and acquisition of furniture.

Part (a) for 12 marks required candidates to consider the VAT implications of Hill Ltd with respect to the construction and rental of offices and the application of the capital goods scheme upon the conversion of a floor from an office to a private apartment. This required candidates to consider the application of VAT rules with respect to rental of immovable property, the VAT registration requirements, and the application of the capital goods scheme.

In general candidates' performance in this part was satisfactory, and a marked improvement was noticed with respect to candidates understanding of VAT rules in comparison to previous exams. The VAT implications on the rental of immovable property was examined in the past with very limited success by candidates, however, in this session it is clear that the knowledge of the rules has improved. Candidates also showed a good understanding of the rules relating to the capital goods scheme.

Part (b) for 8 marks required candidates to consider the VAT implications of Malta Bank Ltd, a licensed credit institution that had both EU and non-EU customers. Malta Bank Ltd undertook a refurbishment of their offices in 2010 incurring significant VAT. Candidates were required to comment on the registration requirements, the right to claim input VAT and the application of the capital goods scheme upon the change of the bank's customer base in 2015 and 2016.

Candidates' performance in this part was less encouraging than in part (a), while candidates were aware that the granting and negotiation of credit and management of credit is an exempt without credit supply, the majority of candidates were not aware of the special rules applicable when there are non-EU customers. The split of EU and non-EU customers meant that Malta Bank Ltd may register for VAT under Article 10 and would be entitled to claim input VAT subject to the partial attribution method.

The change in customer base however means that in 2015 and 2016 the capital goods scheme would be applied for the input tax claimed by Malta Banks.

Unlike previous years, the VAT question proved to be very popular in this session, and overall candidates' performance showed a big improvement when compared to previous years.

Question Five

Question 5 for 20 marks covered two distinct topics, part (a) for 16 marks related to the tax implications of the operation and sale of a ferry boat by Sailfar Ltd. Part (b) for 4 marks related to the exemptions from duty on documents and transfers.

Part (a) considered the tax implications of Sailfar Ltd, a company incorporated in Jersey but managed and controlled in Malta, including the tax implications of the lease payments and the tax implications of the sale of the first ferry and replacement with a second ferry. Candidates were being tested on their knowledge of Malta's jurisdiction to tax, the application of tax treaties with respect to the operation of ships used in international traffic, and the rules relating to the balancing statement and rollover relief. In part (a)(ii) candidates were required to prepare a balancing statement.

While candidates' knowledge of the rules relating to the balancing statement was encouraging it appears that the vast majority of candidates did not know how to apply the treaty in this case – thereby failing to identify that Turkey would be restricted from taxing both the lease income and the gains from the transfer of the yacht.

Part (b) for 4 marks required candidates to identify the persons that are exempt from stamp duty on the transfer of securities. However candidates were not able to identify the applicable persons, although candidates were required to consider a fundamental exemption in the duty on documents and transfers act.

Question 5 was the least popular question in Part B, and was also the question in which candidates performed least well. It appears that the mix of topics covered in this question was a surprise to candidates, even though the question should have been more than manageable for candidates sitting for P6.