Examiner's report

P6 (MLA) Advanced Taxation
December 2016

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. A minority of candidates left Question 1 to later which is a risky strategy given the weight of this question.

Candidates performed particularly well on question 2 which related to a topic which is often examined, but it appears that candidates also understood the finer detail of the topic. The question which candidates found most challenging was question 5, which a minority of candidates attempted. Fifty percent of the marks for Question 5 related to recently added topics, so candidates should have given priority to learning these.

A good portion of candidates appeared to be well prepared for this exam and article published on P6 exam techniques may have helped. Candidates preparing for the P6 exam are encouraged to read the article as well as Examiner's Reports. There is no expiry term for the Examiner Reports and the article.

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

- Candidates should sit for 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. By way of example question 3 contained elements of F6 however candidates' performance on that question could have been better.
- Candidates do not use their time wisely. The questions in P6 often include key information which is instrumental to correctly answer the question. It is therefore important that candidates read the questions carefully and underline the main issues. Candidates fail to score precious marks often because they do not identify a key part of the question, or do not read the facts well.
- Candidates are on average better prepared for the Section A, but are not well prepared for Section B. 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, this results in a failure to secure marks. This point cannot be stressed strongly enough as it often results in candidates missing the main point of a question. It is important that when studying reference is made to the law. Candidates must also ensure that they are using up-to-date material to ensure that any changes in law or the syllabus are not missed.

Specific Comments

Question One

This 35-mark question related to the tax implications of the transfer of immovable property by companies or an individual that is not resident and not domiciled in Malta. It tested candidates' knowledge of the recently amended property transfer rules.

Candidates were asked to consider the tax implications of the transfer of various properties, which obviously required the application of different rules. Overall candidates showed a discreet knowledge of the property transfer rules.

Most candidates found the interaction between the old rules and the new rules challenging, specifically, what happens if a taxpayer had, under the old rules, opted out of the property transfer rules in view of the development qualifying as a project. The vast majority of candidates assumed that the opt out would continue applying going forward and therefore failed to comment on the application of the new rules to the remaining properties, however, this was incorrect as the old rules no longer remained applicable, meaning that the prior election was invalid.

Another common mistake was the application of the intra-group rules. While candidates do know the rules and can list the conditions very faithfully, it appears that their application can be more challenging. Specifically, one of the options required candidates to consider the tax implications of the transfer of the luxury apartments to a related company, however, given that the luxury apartments were not a capital asset of JN Ltd, in order for the intra-group tax relief to apply the company must have owned the property for 12 years, which was not the case here and the vast majority of candidates did not identify this. It is also important to keep in mind that the intra-group relief is tax relief and not an exemption.

Finally, but similar to the previous comment, the option of transferring the property to Jens Noe personally upon a liquidation of JN Ltd also proved to be problematic for candidates. Once again, while candidates generally appeared to know the conditions for the application of the exemption on the transfer of property to the 95% shareholder upon a liquidation of the company, even listing the requirement that the asset is held as a capital asset, the majority of candidates did not identify that the exemption did not apply to the facts at hand as the assets were not a capital asset.

A number of candidates also applied the old rates to this question, which implies many candidates were not aware that the law with respect to property transfers was amended with effect from 1 January 2015. Candidates have to keep abreast with the changes to the law, and especially where the amendment is recent they should dedicate particular attention to the amendments, both from a professional perspective, as well as for examination purposes.

On a more positive note, candidates generally performed well on the other property transfers, especially the transfer of the palazzo in Valletta, where candidates correctly identified that a reduced rate of tax was applicable and the conditions for its application.

Question Two

This 25 mark question required candidates to comment on the Malta tax implications of Charlotte Jewitt's Malta holdings. The question sought to test candidates' knowledge on the participation exemption, tax refund system and the application of the tax accounting rules.

In general candidates performed well on this question, identifying most of the issues and applying the law correctly.

What candidates found most challenging was the application of the secondary allocation of taxed profits between group companies. While candidates know the rules, the application of the rules was more challenging in that only a minority of candidates correctly allocated the MTA profits of Artisan MT Ltd to its IPA account, even though they previously would have indicated that any excess profits would need to be allocated to the IPA of a related company. Furthermore, given that this is an advanced paper, candidates are expected to define what is meant by a related company, and not simply come to the conclusion (although correct) that Artisan MT Ltd is the only related company for the purpose of the secondary group allocation.

Candidates performed particularly well on the application of the participation exemption rules to Jewett MT Hold Ltd's holding in the three non-resident companies. The intricacies of the application of conditions for the application of the participation exemption were identified correctly, other than with respect to the holding in the Singapore Fund which is set up as a limited partnership. The application of the participation exemption on this holding required candidates to consider the rules with respect to holding in limited partnerships and collective investment vehicles. Only a few candidates explained these requirements thoroughly, albeit most candidates correctly identified that the participation exemption applied.

Question Three

This 20-mark question was divided into two parts. Part (a) for 11 marks required candidates to consider the fringe benefits and VAT implications of Petra Brown's use of assets owned by Luxury Life Ltd, and Part (b) for 9 marks required candidates to comment on the VAT implications of services provided by and to Airline Ltd, a company which carried out international transport of passengers.

Candidates' performance on this question was unsatisfactory. Firstly, candidates seem to have chosen this question more out of necessity than out of choice, which has become a constant with all VAT questions. Candidates throughout the years have always struggled with VAT questions. Question 3 was no exception even though this question also had an element of fringe benefits.

Part (a)(i) for 6 marks required candidates to comment on the taxation of Mrs Brown in respect to the director fees received and the benefits. Candidates generally performed well on this part identifying that the director fees were taxable in Malta, and there was a fringe benefit, however, candidates' knowledge with respect to the rules relating to the determination of the value of the fringe benefit varied. Candidates also ignored the fine line between private use and business use of the apartment in determining the fringe benefit. This was one of the finer details of the question, which is spelt out quite emphatically in the guidance issued by the tax authorities.

Part (a)(ii) for 5 marks required candidates to consider the VAT implications of the use of the apartment and yacht by Mrs Brown and her husband. Candidates generally performed well on this question, identifying that the use of the apartment and yacht was within the remit of the VAT rules, and that the use of the apartment was VATable at 7% and the use of the yacht should be treated as a short term hiring. Unfortunately in this part of the question candidates did not enter into the necessary detail to explain their answer and just provided the conclusion, which though correct, means that candidates did not score all the marks available.

Part (b) for 9 marks related to the VAT implications relative to companies engaged in the international transport of goods or passengers. Candidates where required to comment on the VAT implications of the transport of passengers, the sale of food and beverage during the flight and the maintenance of the aircraft. While candidates generally correctly identified that the international transport of goods or passengers was an exempt with credit supply, the VAT implications of the other services caused more confusion. The greatest challenge related to the place of supply of the services. It is imperative for candidates to be confident on the place of supply rules. Where candidates did not score as well, this was mainly due to a failure to provide sufficient depth to their answers.

Question Four

This 20-mark question related to the taxation of Mr Barone, an individual resident but not domiciled in Malta. Candidates in general performed well in this question.

Part (a) for 4 marks required candidates to comment on Mr Barone's tax status as well as the taxation of his pension income and trading activities, and the application of the Malta-Italy double tax treaty. While candidates correctly commented on Mr Barone's tax status, the taxation of his trading in derivatives and the application of the Malta-Italy double tax treaty with respect to pension income was challenging. As a person resident but not domiciled in Malta, Mr Barone is taxable on income arising in Malta no matter if the income is received in a bank account outside Malta. However, the fact that the income was being received in a bank account outside Malta appears to have confused candidates who concluded that the income is not taxable in Malta, even though the question specifically provided that the income should be treated as trading income. Furthermore, with respect to the Malta-Italy double tax treaty, which would provide that income is taxable only in the resident State, candidates incorrectly concluded that the pension income is taxable where received. None of the provisions in the OECD Model Tax Convention provide that taxing rights is in the country where the income is received. Taxing rights are shared between the source State and the residence State. Another common mistake candidates made is to assume that a tax treaty grants taxing rights, which is incorrect, a tax treaty only restricts taxing rights, meaning that even when Malta is granted taxing rights, if in terms of Maltese law the income is not taxable it does not become taxable by virtue of the treaty, the other State is simply restricted from taxing.

Part (b)(i) for 12 marks required candidates to comment on the conditions for the application of the Highly Qualified Person Rules. Other than mixing up some of the conditions with those in the various residence programmes, candidates generally performed well on this question.

Part (b)(ii) for 4 marks required candidates to comment on rules relative to employment exercised outside Malta. Candidates generally performed well on this question albeit further details could have been provided such as the fact that the reduced rate would also apply to income derived in Malta when performing services related to the overseas employment.

Question Five

This 20-mark question was divided into two parts, Part (a) for 12 marks required candidates to comment on the tax implications of Simulate Ltd should it transfer its management and control, or domicile to Malta. Part (b) for 8 marks related to the taxation of Mr Ray Grech on dividends, interest and royalties in terms of double tax treaties (in part (i)) and in terms of the EU Directives in part (ii). Candidates that chose this question performed poorly.

Part (a)(i) for 2 marks simply required candidates to comment on the tax status and basis of taxation of Simulate Ltd should it remain not resident in Malta, should it transfer its management and control to Malta and should it transfer its domicile to Malta. Candidates generally performed well on this, which is expected given that this is a fundamental concept under Maltese law.

Part (a)(ii) for 6 marks required candidates to consider the source of the income derived by Simulate Ltd. This required candidates to consider the source rule applicable to income derived from the international transport of goods or passengers which is found in the Income Tax Act, however candidates generally did not refer to this rule. This rule was a recent addition to the syllabus of P6 but it appears that few candidates had studied this, resulting in this part of the question being particularly challenging. The source rule did not apply to the case at hand given that aircraft is not used in the international transport of passengers but is used for the benefit of the airline, so candidates would have been expected to consider the general principles of tax law and argue as to whether the income is sourced in or outside Malta on the basis of the activities carried on by Fly UK. These

analytical considerations, as a result of candidates not identifying the source rule, were completely missed. Candidates need to make sure they are familiar with the syllabus in order to ensure that they have covered all topics.

Part (a)(iii) required candidates to comment on the most opportune moment when to apply for the step-up. This question required candidates to consider the step-up rules and the points at which point it was feasible, or even possible to apply for the step-up. A company that is tax resident in Malta (even if by virtue of having its management and control in Malta) may not apply the step-up upon transferring its domicile to Malta. The candidates were therefore required to comment on the detailed rules as to when the step-up can be benefitted from, in order to reach the right conclusion, however, the majority of candidates simply stated at which point in time the step-up should be applied for without giving any detail as to the rules. Once again the provisions relating to step-up were new to the syllabus; however, it appears that few candidates knew these rules.

Part (b)(i) for 6 marks required candidates to comment on treaty provisions relating to dividends, interest and royalties. Candidates' performance on this part varied. The majority of candidates knew the treaty rates applicable in each scenario but little more than that. Candidates must study the distributive rules of the OECD Model Convention, and not merely understand them at a high level. Part (b)(ii) for two marks required candidates to comment on the applicability or otherwise of the EU Parent-Subsidiary Directive and the Interest and Royalties Directive. The Directives are not applicable in the case at hand as the recipient of the relative income would be an individual. Unfortunately candidates did not perform well on this question, even though it requires a basic understanding of the Directives.