

# Examiner's report

## P6 Advanced Taxation (MLA)

### June 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 questions 2 and 5. The questions candidates found most challenging were questions 3 and 4. This is most likely due to the inclusion of new syllabus areas in Question 4 and a lack of technical knowledge on permanent establishment issues in question 3. In line with comments included in previous Examiner's Reports it is once again clear that candidates are not well prepared on valued added tax (VAT) issues.

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.
- Fundamental issues which are examined time and again are not fully understood by candidates, this is evidenced by the fact that most candidates claimed the application of the group relief provisions in question 1, even though the conditions were not satisfied.
- Candidates were able to reproduce information they have studied, but were not always able to apply such information where analytical thinking is required.
- Candidates were on average better prepared for Section A, than Section B. This is perhaps due to candidates attempting to question spot – which is risky in a subject such as P6 which has a broad syllabus.
- 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 results in a failure to secure marks. Advanced Taxation requires more than a superficial understanding of concepts, and therefore if a question focuses on the exception to a concept (such as questions 1 and 2) and candidates do not recognise the exception, precious marks are missed.

#### Specific Comments

##### Question One

This 35-mark question was based on the transfer of shares in JV Co by Qatar Co, and tested candidates' knowledge of the capital gains rules and duty on documents and transfers.

Part (a) for 24 marks required candidates to consider the tax implications of the two options currently being considered by Mrs Becker. Candidates' performance on this question was mixed. In general candidates adequately answered the question and scored marks, however, the majority of candidates failed to identify some of the key issues present in the scenario, some of which are discussed further below.



The first option required candidates to consider an outright transfer of Qatar Co's holding in JV Co (a 50% holding), thereby testing candidates knowledge of the rules relating to the transfer of a controlling interest and the determination of the market value of JV Co. Candidates generally performed very well in this option, outlining very carefully how a company's market value is determined in terms of the capital gains rules.

There were however some very common mistakes here, as the majority of candidates did not point out that the goodwill of Qatar Co was nil given that its profits consisted solely of dividends distributed by Listed Co in the same financial year they were earned. Furthermore, candidates did not consider the alternative method of calculating the market value of JV Co (which is listed on the stock exchange) by means of a share valuation prepared by an independent expert, together with the expert's report where the capital gain differential exceeds 10% and is not more than €30,000. Unfortunately in view of this, candidates missed some marks in this area.

The second option considered the tax implications of a restructuring by means of a transfer of the shares in Listed Co by JV Co to its shareholders (Qatar Co and Borg Co) and the subsequent listing of shares and transfer of the listed shares to US Co. Candidates were here required to consider the rules relating to intra-group transfers, as well as the rules relating to the transfer of the original shares listed on the stock exchange. The majority of candidates fared less well in this option, as candidates mostly considered the first transfer to benefit from the intra-group tax relief (even though Qatar Co and Borg Co each held exactly 50% of the shares in JV Co), and erroneously concluding that the transfer of the listed shares was exempt from tax.

It is clear that candidates' knowledge is mainly concept based, resulting in candidates struggling to apply their knowledge to the facts of the scenario. Although the question clearly stated that Qatar Co and Borg Co held 50% each, candidates often stated that in order to satisfy the tax relief the transfer must be between companies that are controlled to the extent of more than 50% by the same shareholders, they did not make the connection of this rule to the case where the shares are equally split between two shareholders.

In part (b) for seven marks, candidates were required to support their answer in part (a) with a tax computation for Option 1. Candidates generally performed well on this showing that they fully understand the means to determine the market value of a company.

Many candidates presented their answers to part (b) before their answer to part (a) as it helped them build their arguments in the explanations to part (a) which is understandable, however, this could have also been the cause of candidates failing to identify the application of exceptions.

## **Question Two**

This 25-mark question covered the application of the participation exemption, the application of the tax refund system, the taxation of branches in Malta, the taxation of income derived from immovable property and the application of the various tax accounts.

Candidates were asked to consider the Malta tax implications of the International Milk group, i.e. IM (Malta) Co, IM (Malta) Fin Co, the Malta branch of IM Hold Co, and IM (Malta) Prop Co. In general candidates performed adequately in this question but missed marks along the way on basic concepts

The income of IM (Malta) Co related to dividend income derived from two minority holdings situated in UK and Dubai. Candidates were required to consider the application of the participation exemption on such dividends, even though the holding is just a minority holding. Candidates showed an understanding of the application of the participation exemption, identifying the fact that IM (Malta) Co had a participating holding in both companies and that the anti-avoidance conditions were satisfied. It was encouraging, to see that these concepts have been well understood.



The income of IM (Malta) Fin Co related to interest income derived through a loan provided to a UK related company (British Milk). Candidates were required to consider the most tax efficient way of being taxed on this income;

- whether to claim double tax relief, and therefore allow the shareholders to claim the 2/3rds refund upon a distribution of dividends,
- to not claim double tax relief and allow the shareholders to benefit from the 6/7ths refund;
- or to claim the flat rate foreign tax credit and allow shareholders to claim the 2/3rds refund.

Candidates correctly applied the rules in this part, correctly outlining the different options available to the company.

This was the first time that the tax implications of a branch in Malta with income arising in Malta were examined, and many candidates struggled with this aspect of the question. The income of the branch was royalty income from group companies. Many candidates did not understand the tax treatment of branches in Malta – wrongly assuming that the branch would be exempt from tax in Malta either because it is a branch (thereby confusing the tax implications of a branch of a Maltese company, with that of a Maltese branch of a foreign company) or because of the exemption from patent, copyright or trademark income, albeit nowhere was it mentioned that the royalties were from that intellectual property. Where candidates correctly identified that the branch would be subject to tax in Malta, they often failed to explain the application of the refund system correctly. The refund would be paid to International Milk Co, upon a distribution of dividends of the Malta taxed profits by IM Hold Co.

Candidates however found the taxation of IM (Malta) Prop Co most challenging. The company rented out two properties – an apartment block and an office block. The reference to the fact that the income from the office block was deemed to be of a trading nature seems to have led candidates to consider that the income would be allocated to the Maltese taxed account, rather than the immovable property account. Furthermore, few candidates considered the application of the reduced rate on the rental of the apartments for residential purposes. Candidates also failed to identify that there would be no secondary allocation of profits to the IPA in view of IM (Malta) Prop Co not having MTA profits and the fact that the group does not qualify as a group for the purposes of the indirect allocations for groups as IM Hold Co is not resident in Malta.

Candidates generally structured their answers to this question very well, tackling one company at a time, and considering each item of income separately. They however at times failed to go into the level of detail which would be expected at this level, by way of example simply explaining that there is an equity holding without listing the conditions for the existence of an equity holding. However, the performance in this question was generally good.

### **Question Three**

This 20-mark question was based on the provision of services in Malta by two non-resident service providers, Boccati Design and Eugenio to Mrs Ambrosio. Candidates were expected to consider the income tax implications of the activities, as well as the application of the double tax treaty for 13 marks, and the VAT implications for seven marks. The vast majority of candidates attempted this question however unfortunately performance in this question was very poor. Part (a) of the question clearly outlined that candidates were supposed to consider the tax implications of the service providers in terms of both domestic law as well as in terms of the treaty, however, very few candidates considered the application of domestic law, thereby losing precious marks.

Candidates were required to consider the application of Article 73 of the Income Tax Act with respect to income paid to non-residents, including the different rates applicable to companies and individuals, and the relative formalities thereto.

Candidates were then expected to consider the difference in treatment once the double tax treaty has been applied with specific reference to the rules relating to permanent establishments. While it appears candidates are familiar with the concept of a permanent establishment (as it was generally mentioned in the answers) it is clear that candidates are not comfortable explaining the different types of permanent establishments and the applicable rules. Candidates are reminded that they need to ensure that they can supply the level of depth required at this level in order to secure marks and are encouraged to review the published answers in detail.

Part (b) for seven marks proved to be particularly challenging for candidates. Many candidates performed inadequately on this part of the question, which is a recurring theme whenever candidates need to consider VAT issues in a transaction. It is clear that candidates are not prepared to answer VAT questions and even basic things, such as the place of supply rules seem to be challenging for candidates. Future candidates should be aware that VAT is an essential topic and needs to be given adequate attention during preparation for this exam.

#### **Question Four**

Question 4 for 20 marks considered two different scenarios, however, only a minority of candidates opted to answer this question, which required candidates to consider recent amendments to the Income Tax Act.

For 10-marks, part (a) required candidates to consider the Malta income tax and VAT implications of the lease and potential sale of an aircraft by Finance Co, an Irish company, to Fly Co, a Maltese company. Candidates were required to consider the taxation of non-residents as well as refer to the source rule applicable to income derived from the ownership, leasing or operation of aircrafts in international traffic. Given that the source rules determine that such income arises outside Malta, Finance Co will not be subject to tax in Malta on income derived from the lease, or from the sale of the aircraft.

Candidates were also required to consider the VAT implications of these transactions which are exempt with credit. Candidates' performance on this question was not adequate, few if any mentioned the source rule, however identifying that the treaty would anyway restrict Malta's taxing rights.

For 10-marks part (b) required candidates to consider the tax implications for Pear Intellectual Co on the re-domiciliation from the British Virgin Islands to Malta, and the ongoing tax implications of its operations and related VAT implications.

The question required candidates to consider the application of the step-up rules on the re-domiciliation of the company to Malta, which very few candidates actually considered. The application of the Interest and Royalties Directive and the application of the double tax treaty were dealt with more proficiently.

Overall however, candidates performance in part (b) was also inadequate for this level, however, performance was better than in part (a). The VAT considerations were largely off point, as per other areas where VAT was considered, however, candidates scored marks through their application of the Directive, and the application of the double tax treaty.

#### **Question Five**

Question 5 for 20 marks split over five different questions required candidates to consider Mr Agustsson's application for the Resident Programme Rules. The vast majority of candidates attempted this question. The question, split into various parts, required candidates to consider the conditions for application of the Programme, the definition of dependants, the potential application for the Programme by the estate agent and the taxation of Mr Agustsson once he qualifies for the Programme, and what could lead to him losing entitlement to the programme.

Candidates performed well in this question, and for many this was the best attempted question in the exam. A minority of candidates confused the different rules applicable to different Programmes, however, this is a



common mistake. This question required less analytical thinking than the other questions, and the part which required most analytical thinking, i.e. part (d)(ii) is what candidates found most challenging.