

# Examiner's report

## P6 (MLA) Advanced Taxation

### June 2016

The ACCA logo consists of the letters 'ACCA' in a white, bold, sans-serif font, centered within a solid black square.

#### 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 5, while the question candidates found most challenging was question 4, which a minority of candidates attempted and related to the application of incentive legislation, a topic which has not been examined in a number of sittings – which may have led candidates to not study the topic, which in itself is a risky strategy.

A large portion of candidates appeared to be well prepared for this exam and it was apparent that many candidates had taken note of the article published on P6 exam technique.

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

- Fundamental issues which are examined time and again are not fully understood by many candidates. By way of example, income derived from immovable property situated outside Malta is not allocated to the immovable property account; the setting up of a subsidiary outside Malta does not equate to a permanent establishment outside Malta.
- 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 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.
- Candidates perform well when they are required to reproduce information they have studied, but do not apply such information where analytical thinking is required.
- Candidates do not read the questions carefully and plan their answers prior to writing. 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' performance is affected often because they do not identify a key part of the question, or do not read the facts carefully. By way of example: in Question 5 it was specifically stated that Pamela King was not deemed to be a resident of China, yet a number of candidates applied the tie breaker rule under the Malta-China treaty in order to determine whether she is resident in Malta or China.
- 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 relates to the transfer (whether by way of donation or the outright transfer) of shares in Clockwork Ltd between family members. It tested candidates' knowledge on the application of the capital gains rules as well as duty on documents and transfers.

Candidates were asked to consider the tax implications of various transfers: firstly the donation of shares by Joe Cachia to his two children, and thereafter the potential tax implications upon the transfer of shares by Mr Cachia's children to Clive Cachia and the transfer of shares by Joe Cachia to his brother Clive Cachia. The question mainly sought to test candidates' knowledge of the tax implication of a donation, and the interaction of the said donation on subsequent transfers.

Besides the implications of a donation, the question tested candidates knowledge on various aspects of the capital gains rules, including the rules relating to the transfer of a controlling interest (especially with respect to the 18-month rule), the rules relating to the intra-group transfer of assets, and the application of the de-grouping provisions. The majority of candidates understand these topics relatively well, in fact candidates generally performed well on this question, particularly on the computational elements. However, many candidates found it harder to explain their answer and did not fully explain how to determine the market value of a company in part (a) of Question 1, i.e. the letter to the client. Many candidates then correctly applied all the rules in the computational part, example by showing that the goodwill of Clockwork Ltd to be zero in the computation but not commenting on it in the letter, emphasising that candidates are more prepared for the computational marks.

What candidates found most challenging was the interaction of the donation of shares with the subsequent transfers. Common mistakes were:

- Claiming that the donation was taxable from a capital gains perspective, but exempt from a duty on documents and transfers perspective, when the opposite is true;
- Applying the de-grouping charge on the donation, when the law specifically provides that a donation of shares to descendants does not give rise to the de-grouping charge; and
- The tax implications on the subsequent transfer of shares by Mario and Isabelle Cachia, particularly with respect to the cost of acquisition of the shares which they acquired by donation.

These common mistakes indicate that candidates do not know the rules relating to donations well, most probably due to the fact that this area was not previously examined. Section A of the exam requires analytical thinking, and without knowledge of the law, one will not appreciate the intricacies of the subject.

Part (b) of the question related to the calculation of the income tax payable on the potential transfer of shares by Joe Cachia to his brother Clive. Most candidates performed well on this part of the question, but unfortunately a number of candidates did not read the requirements well and calculated the duty on transfers too, which was not required and therefore did not score marks and resulted in candidates wasting time.

### **Question Two**

This 25-mark question required candidates to comment on the Malta tax implications of the Storm group. The question sought to test candidates' knowledge on the participation exemption, tax refund system, the taxation of branch profits and the taxation of companies resident but not domiciled in Malta, and the application of the tax accounting rules.

Candidates' performance on this question was disappointing as while candidates' demonstrated knowledge of the rules, they were unable to apply that knowledge. Fundamental concepts, such as the difference between active and passive income as well as the difference between a branch and a company are often not understood. A number of candidates also do not properly understand the interaction of the tax accounting rules and the refund system, as well as the interaction of the refund system with double taxation relief.

In a question which includes a large corporate structure, candidates are encouraged to consider the tax implication of each entity one at a time. Candidates showed a good understanding of the participation exemption rules with respect to dividends which would be derived from Dubai Ltd, as well as the implications should the participation exemption not apply, however only a minority of candidates identified that the interaction of the deduction of interest with the application of the flat rate foreign tax credit could potentially result in the optimal scenario. Candidates also seemed to mix up the rules relating to deduction of interest where loans are received from related parties for the acquisition of immovable property with the case at hand.

The taxation of Storm Properties required candidates to consider the interaction of the refund system with double taxation relief where profits are allocated to the Maltese Taxed Account. When profits are allocated to the Maltese taxed accounts, a company can claim double taxation relief, with the shareholder still benefitting from the application of the 6/7ths refund – it is only where the profits are allocated to the foreign income account that the 6/7<sup>th</sup> refund would not apply where double taxation relief is claimed. A minority of candidates applied the 6/7ths refund after having claimed the flat rate foreign tax credit. This is obviously wrong. It is recommended that future candidates study the rules relating to the various refunds well.

The taxation of the Malta branch was generally well answered, however the majority of candidates did not understand the application of the refund system when there is a branch in Malta. In fact, candidates wrongly held that the refund would be claimed by Storm NL, rather than by Storm Holding UK upon a distribution of profits by Storm NL.

The taxation of Rentals BVI Ltd, a company resident but not domiciled in Malta, was generally explained well by candidates, however, candidates failed to consider the taxation of dividends distributed by Rentals BVI to Storm Malta correctly. Given that Storm Malta is resident in Malta, the participation exemption does not apply, however, given that dividends were distributed from the untaxed account there is not further tax at the level of Storm Malta Ltd.

### **Question Three**

This 20-mark question sought to test candidates' knowledge of VAT legislation. It was divided into three separate parts, which required candidates to consider the VAT implications in three separate, unrelated situations. Question 3 was answered by the vast majority of candidates, which is not surprising as VAT is a topic which is often examined on a regular basis. However, candidates' performance on this question was varied. While candidates showed a good knowledge of the general place of supply rules, the main difficulties related to the exceptions to these general rules – which as per the article on exam techniques for P6 is what candidates should expect out of a VAT question.

Part (a) for 6 marks related to the VAT implications of the export of goods via a disclosed agent. The main features of this question related to the identification of the VAT rules in relation to disclosed agents and exports, however, the majority of candidates failed to consider the VAT implications on export.

Part (b) for 6 marks related to the VAT implications on the charter of yachts. The question sought to test candidates' knowledge of the different place of supply rules in relation to the yachts which are chartered for a short term and long term. Candidates generally performed well in this question, by correctly pointing out the general place of supply rule and identifying the different rules which apply to short term charter and long term charter. The main difficulty in this question related to determining the place of supply long term charters, which is where the supplier has his place of business. However this is a minor point.

Part (c) for 8 marks related to the VAT implications of Bruce Smith's consultancy services as well as the VAT implications of services received by Bruce Smith. Candidates found this part to be the most challenging as they did not identify the different VAT treatment for services provided to non-business customers established outside the EU. A further common mistake was deeming supplies provided to Bruce Smith to be Business to Business supplies even though it was expressly stated that he was receiving the services in his personal capacity.

### **Question Four**

Question 4 for 20 marks was divided into three parts and sought to test candidates' knowledge of incentive legislation. Part (a) required candidates to list 8 activities which would be considered qualifying activities, and Part (b) divided into (i) and (ii) required candidates to explain the implications of the acquisitions anticipated by Global Products and in part (b)(ii) to calculate the tax payable on the tax payable in Malta by Global Products.

Question 4 was answered by only a minority of candidates, but generally candidates that answered this question showed a good understanding of the subject. Part (a) does not require much analysis given that it simply required candidates to identify activities which are qualifying activities. Part (b) however, required candidates to consider the rules in relation to autonomous, partner and linked enterprises and to comment on how Global Products' acquisition of three companies would affect its own status as a small enterprise. The application of these rules did not require much analytical thinking but nonetheless required candidates to show a deep knowledge of the various provisions. Candidates generally showed a good understanding of these rules and the impact that the various acquisitions would have on Global Products, the same applies with respect to the calculation of tax payable in Part (b)(ii).

### **Question Five**

This 20-mark question sought to test candidates' knowledge on the taxation of individuals. The question was divided into two parts: part (a) for 15 marks related to the personal tax consequences of Pamela King, part (b) for 5 marks related to the Paul Mifsud and the application of the returned migrant scheme.

The majority of candidates chose to answer this question, with mixed results. Part (a) required candidates to consider the tax implications of Pamela King, an individual resident but not domiciled in Malta, in three different scenarios, the first being the taxation of Pamela King's employment income derived from her work carried out in China. Candidates generally performed well in this part, showing a good knowledge of the OECD Model, albeit a large number of candidates chose to also consider Ms King's residence under the Malta-China double tax treaty – which was not required. Unfortunately, the majority of candidates failed to consider the application of the reduced rate of tax for individuals employed on a contract which requires them to mainly work outside Malta.

The second part of part (a) related to the transfer of shares in either Sail Ltd or Sail Pro. The majority of candidates did not seem to know of the very popular domestic exemption applicable on the transfer of shares in a Maltese company, not being a property company, by a non-resident, and incorrectly held that Sail Pro Ltd would be taxable on the gains derived from the transfer of shares in Sail Ltd, given that the latter is a Maltese company. While this exemption has not been examined in the recent past, it is a central exemption in Maltese tax law, which candidates should have picked up immediately.

What candidates found particularly challenging was the taxation of the pension derived by Pamela, as this required more than just a consideration of the pensions' article of the double tax treaty – one needed to consider the rules relating to government service and the various exemptions therein. Unfortunately, candidates did not appear to know this particular article.

Part (b) related to the rules relating to returned migrants and their application to Paul Mifsud, a Maltese national that emigrated to Canada 30 years ago and was looking to return to Malta. Candidates in general performed well in this question highlighting all the relevant conditions for the application of the returned migrant's rules.