

Examiner's report

P6 Advanced Taxation (MLA)

December 2012

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General Comments

The examination consisted of five questions: two compulsory questions in section A, and three questions of which candidates had to answer two, in section B. The two questions in section A carried 60 marks, and the questions in section B carried 20 marks each.

It was pleasing to see that candidates had prepared well for the paper so were able to attempt all four questions and perform well. There was little evidence of time pressure - where part questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or having spent too much time on other question parts.

It is important to write clearly and to plan the layout and organisation of the answers. New questions should always be started on a fresh page. Full workings need to be shown, presented clearly and labelled so as to be easy to follow. Computations should be presented in the appropriate formats.

It was noted that, even though question 3 dealt with tax deductions core to the subject of taxation (losses, interest and capital allowances) few candidates attempted the question. Question 3(a) dealt with a recent amendment to the Duty on Documents and Transfers Act consisting of an exemption from duty in the case where property is transferred by a company to its shareholders upon liquidation. It was clear that many candidates were not aware of this amendment while others gave excellent answers.

Candidates are advised to ensure that they are aware of updates to the syllabus, and to study the whole syllabus so as to be able to produce good answers to the questions in part B in particular.

Question 5(a) also dealt with a recent amendment, this time to the Income Tax Act providing for a 15% rate applicable to highly qualified individuals not domiciled in Malta. It was pleasing to see that this question was answered very well by the majority of candidates.

Candidates are reminded of the need to read the questions and requirements carefully, so as to provide relevant and accurate answers, and to be guided by the marks allocated so as to provide the appropriate level of detail. As an example, question 1 tested candidates' knowledge of tax and duty implications of property transfers and share transfers so it was necessary to distinguish between a transfer of shares and an issue of shares, and to consider the option of roll over relief; question 3(a) required candidates to discuss the *duty* implications so it was important not to discuss the *income tax* implications.

In this paper, candidates are tested both on their in-depth knowledge of syllabus subjects and their ability to apply that knowledge. A full understanding of the F6 syllabus is assumed at this level. Questions at P6 cannot be answered correctly if fundamental knowledge required at F6 level is absent (see questions 2(b) and 4, for example).

Specific Comments

Question One

This 34-mark three part question was based on a new company, B Ltd, owned by two individuals, set up for the purpose of carrying out a business. B Ltd was to acquire a shop from A Ltd while the latter is to acquire another shop as a replacement. Part (a), to which 17 marks were attributed, tested candidates' understanding of the income tax and stamp duty implications of property transfers, intra-group transfers, replacement of a business asset and share transfers, as well as the case where a company, as a result of a change in the shareholders, ceases to be a member of a group after having acquired a property from another group company.

Many candidates were aware that the transfer of the shop from A Ltd to B Ltd qualified for the intra-group exemption and that the subsequent transfer of shares in B Ltd results in tax becoming payable as a result of the de-grouping provisions however very few mentioned that the transfer could have qualified for roll over relief which was the best option to avoid the application of the de-grouping charge.

Some candidates stated that the de-grouping charge applies also in respect of stamp duty which is not the case. Candidates were expected to state whether a transaction is taxable or exempt and to provide detailed reasons for the conclusion drawn. Some candidates went into great detail explaining the value shifting provisions which were not relevant to this question. Many candidates provided a good explanation as regards the computation of the capital gain arising on the share transfer but very few explained that, for the purpose of calculating the real value of the shares for stamp duty purposes, an adjustment was required to take into account the inter company loan outstanding.

Part (b), to which 4 marks were attributed, tested candidates' understanding as to how the income tax and duty implications if Matthew acquired the shares on the incorporation of B Ltd instead of acquiring them from Frank. The fact that 4 marks were allocated indicated that one was not required to restate detail provided in part (a). It was important to mention that roll over relief could still be availed of but stamp duty would be payable as a result of no group relationship existing between A Ltd and B Ltd.

Most candidates explained in part (c) the tax implications applicable to the transfer of the Valletta shop as a result of claiming roll over relief in respect of the Mosta shop. This part was very well answered by candidates.

Part (d) required calculations relevant to parts (a), (b), and (c). A small number of candidates did well to provide proper calculations in respect of roll over relief. Many candidates were able to prepare accurate calculations in respect of the share transfer. The duty implications of the share transfer were less well known, but a few candidates did realise that adjustments were required to establish the real value of the shares acquired for duty purposes.

Question Two

This 26-mark question was split into two parts with part (a), carrying 16 marks, testing candidates' knowledge of tax treatment and the reliefs available to one company (Subco A Ltd) receiving trading income from activities carried out in Malta, and another company (Subco B Ltd) receiving a dividend from a foreign company. Candidates were required to have a good understanding of the tax refund system and were asked to select the combination of relief and refunds which provided the minimum tax leakage to the non-resident shareholder of the companies involved. Candidates were also required to have an understanding of the tax accounting system including the manner by which profits are allocated to the various tax accounts.

Most answers to this part were excellent; candidates knew the types of reliefs available and the consequent refunds that could be claimed, and were able to apply this knowledge to the scenario presented. Many candidates knew the mechanics of applying double taxation relief and the flat rate foreign tax credit and the consequences of not claiming any relief at all.

A common mistake was to adjust the €380,000 for €20,000 in order to arrive at the chargeable income of Subco A Ltd. The question stated that the chargeable (taxable) income of Subco A Ltd was €380,000 so no adjustment was required. The €20,000 adjustment was the difference between the accounting profit and the chargeable income to be allocated to the untaxed account.

Many candidates correctly explained the notional rent (annual market rent) allocation.

Most of the candidates correctly stated that the dividend received from Blackco Ltd was not to be treated as being received from a participating holding however candidates did need to explain the reasoning behind their



statement (most of the reasons were listed in the information provided in the question itself which states that the preference shares carry limited rights).

Part (b) of the question tested candidates' ability to determine the tax treatment of interest payable under option 1 and rent receivable under option 2. Candidates found this challenging. Very few candidates knew that the interest was a disallowed expense under option 1 or that Burrell Ltd, under option 2, was obliged to deduct tax at the rate of 35% when making payment of rent to Wes Ltd.

Question Three

This question consisted of two parts. Part (a), which carried ten marks out of a total of 20, tested candidates' knowledge of the stamp duty implications of property transfers made by companies on liquidation, and required knowledge of a recently introduced stamp duty exemption. Those candidates who were aware of this exemption correctly explained in detail that the transfer made by Alsan Ltd to Aldo and Sandra was exempt from duty. Some candidates were unaware of this new exemption found in the Duty on Documents and Transfers Act. Many candidates correctly explained that a reduced stamp duty rate applied under option 2.

Part (b), which carried ten marks, tested candidates' knowledge of the VAT rules on the place of supply of services. Many candidates correctly explained the general rule applicable to the place of supply of services. Explanations given to the determination of the place of supply under scenarios 1 and 2 were generally detailed and correct. A number of candidates appeared not to have studied this aspect of the syllabus.

Question Four

This question was divided into three parts, which referred to the same scenario, being three of the options available to an individual in deciding how to acquire an existing restaurant business, i.e. whether (1) to acquire the business by way of a transfer of assets and liabilities to an existing company; or (2) to acquire shares in the company operating the business directly; or (3) to use the existing company to acquire shares in the company operating the business. One was expected to determine which option would maximize the benefit of any potential tax deductible losses and available wear and tear deductions.

Although question 4 dealt with fundamentals of taxation, the underlying knowledge for which was covered in the F6 syllabus, few candidates attempted this question.

Part (a) required candidates to explain the tax treatment of interest payable and receivable by both Foodstuffs Ltd and Paul. The tax deductibility of interest depends on the purpose for which the loan was utilised. Some candidates correctly stated that the interest deduction against dividends cannot create a tax loss which means that, if no dividends are distributed or the interest amount exceeds the dividend amount, the interest deduction is wasted. It was important to explain clearly why the interest is or is not deductible.

Part (b) required candidates to explain the tax treatment of transferring an asset, in this case equipment, on which capital allowances were claimed. A number of candidates instead went into detail explaining capital gains implications but the question required candidates to explain whether the transfer of the equipment gave rise to a balancing charge or allowance.

Part (c), which carried the majority of the marks, required candidates to apply their knowledge to determine which option would maximize the benefit of any potential tax deductible losses and available wear and tear deductions, following on from the previous two parts. Some candidates were not aware of the rules regulating the group loss relief provisions, wrongly stating that the losses carried forward by Diner Ltd could be surrendered to Foodstuffs.

Question Five

Question 5 consisted of two parts. Part (a) was based on a non-resident individual qualified as an actuarial professional who is to take up employment with a Maltese company. The majority of candidates attempted this question which was very well answered. Candidates knew the “Highly Qualified Individuals” rules, which is a new topic to the syllabus.

A number of candidates wrongly concluded that Lara was not entitled to benefit under such rules since she was considered to be resident in country Y under the applicable treaty. When dealing with questions of jurisdiction candidates are advised first to lay down the domestic rules applicable to a scenario, and then discuss the implications of any applicable treaty provision. Some candidates concluded that Lara would be treated as non-resident in Malta under the domestic rules and would be subject to the non-resident rates, which was not the case. Some went into detail explaining the tie breaker rules but this was unnecessary because the question stated that, under such rules, Lara was considered to be resident in country Y.

Part (b)(i) tested candidates' knowledge of two terms essential to the subject of international taxation: economic and juridical double taxation. Most candidates provided excellent answers.

Part (b)(ii) required candidates to explain what is meant by a full imputation system and to explain whether such a system eliminates or reduces distortions caused by economic double taxation, while part (b)(iii) required candidates to outline the relevant provisions of the Income Tax Acts dealing with the workings of the imputation system.

Candidates needed to provide answers to both parts (ii) and (iii). Some candidates explained how the Income Tax Act provides for a full imputation credit without discussing the general concept of a full imputation system (required in part (ii)). A number of candidates explained that the imputation system is a refund system whereby shareholders receive a refund of the company tax, which is not the case. The imputation system refers to the tax credit attached to a dividend, a refund of which is claimed only if the applicable tax rate is lower than 35%.