

# Examiner's report

## P6 Advanced Taxation (MLA)

### December 2014



#### 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 well on question 3, while it appeared that candidates found questions 4 and 5 most challenging. This is probably due to candidates not concentrating on topics which were previously not examined (question 4), and a lack of technical knowledge of Value Added Tax (question 5), which is in line with comments in previous Examiner's Reports.

A number of common issues arose in candidates' answers:

- Fundamental issues which are examined time and again are not fully understood by candidates.
- Candidates fair well when they are required to reproduce information they have studied, but do not apply such information where analytical thinking is required.
- 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 question 1) and candidates do not recognise the exception, precious marks are lost.
- 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.
- Not learning lessons from earlier examiner's reports and hence making the same mistakes. This is obvious from candidates' answers to question 2, where the conditions for the application of the participation exemption were often missed.

#### Specific Comments

##### Question One

This 35-mark question was based on Borg Co and Galea Co combining their businesses and the different options available and tested candidates' knowledge of the capital gains rules and duty on documents and transfers.

Part (a) for 25 marks required candidates to consider the tax implications of the two options currently being considered by Borg Co and Galea Co.

Candidates' generally did not perform adequately on this part of the question. The main problems encountered were that candidates did not consider the application of the tax relief on the exchange of shares in option A, and did not identify that the value shifting rules should not apply as the companies do not own immovable property situated in Malta. The majority of candidates were confident as to the application of the capital gains rules with respect to share transfers, and understood the concepts of the value shifting rules, as well as the application of tax relief with respect to the intra-group transfer of assets, however, their knowledge appeared to be concept

based, resulting in candidates not applying their knowledge to the facts of the case. This resulted in an information overload as to the value shifting rules, the implications of the value shift and how tax is calculated, without however, identifying that it did not apply in this case.

Candidates should have considered each step of the restructuring step by step, and applied the capital gains rules thereto taking the facts of the case into consideration. It appeared that since past questions have considered the reorganisation of companies that owned immovable property, candidates simply assumed that the companies owned immovable property, even providing the extra tests which must be satisfied should the company have owned immovable property. The question did require candidates to consider whether the value shifting rules applied, and therefore comment on the conditions for their application, however candidates were expected to identify that these rules did not apply as the companies did not own immovable property, and explain the bona fide condition.

Candidates also failed to recognise that since in Option B there was a mere transfer of assets (and not shares or immovable property) there were no stamp duty implications. This showed a fundamental lack of understanding of the duty on documents and transfers legislation.

Part (b) for 6 marks required candidates to provide calculations of the income tax and stamp duty transfers in order to support their explanations in Option A. Candidates generally performed quite well on this showing that they fully understood 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 resident but not domiciled entities and the application of the various tax accounts.

Candidates performance in part (a) for 20 marks was generally inadequate, which is surprising given that these topics have been examined on numerous occasions in the past and other than the taxation of companies incorporated outside Malta but tax resident in Malta and the application of the participation exemption to holdings in collective investment vehicles, which is the result of a recent amendment and therefore candidates should have been particularly aware of, there were no innovative areas.

The application of the participation exemption has been examined on numerous occasions, yet candidates still seem to find difficulty with the rules relating to it. As per my comments above, it appeared that while candidates knew the concepts (as proven by long lists as to the conditions required to apply the participation exemption) candidates failed to apply their knowledge to the facts at hand. The most common mistake was candidates erroneously concluding that Malta Hold Co did not have a participating holding in Property Co as Property Co owns immovable property. This would only be true if Property Co owned immovable property situated in Malta, which was not the case at hand. This therefore proves that candidates are either not reading the questions carefully, or have still not understood the rules of the participation exemption, and this can be assumed to be due to the fact that candidates do not read the law.

Candidates also failed to comment on the application of the imputation system with respect to dividends received from Interest Co, as well as to correctly comment on the allocation of profits to the untaxed account of Interest Co, where no income was received in a Maltese bank account.

Through the answers to part (a) it was clear that candidates knew the rules only superficially, as their application of the rules was often incorrect.

Part (b) and (c) required candidates to comment on the tax treatment of dividends distributed, the procedural means of claiming refunds and the taxation of an exit strategy. Candidates' replies to these questions was generally adequate, even though few candidates scored full marks here.

### Question Three

Question 3 considered two scenarios:

- Part (a) for 10 marks considered the tax treatment of Mr Jones, a Maltese resident that worked mainly in Libya.
- Part (b) for 10 Marks considered the income tax and VAT implications of renting property to a company registered for VAT purposes by Extreme Property Co, a company which was indirectly owned by Mr James, an individual resident but not domiciled in Malta.

The vast majority of candidates opted to answer this question, and most candidates performed quite well in it. Candidates did particularly well in part (a) which tested the application of double tax treaties and taxation of employment income.

Part (a) considered the tax implications of an individual resident but not domiciled in Malta which is working mainly in Libya. Candidates were required to consider issues such as the residence of Mr Jones, who was considered resident in both Malta and Libya, apply the double tax treaty in order to determine taxing rights between Malta and Libya, and consider the taxation in Malta of individuals employed under a contract of employment which requires them to carry out their employment activities mainly outside Malta.

Candidates were very confident in the application of the tie-breaker rules and the application of the taxation of employment article under the double tax treaty, however a number of candidates failed to consider the rules in relation to taxation of employees that were employed under a contract of employment requiring them to work mainly outside Malta.

Part (b) required candidates to consider the VAT and income tax implications of the rental of property. Part (b)(i) required candidates to consider the VAT implications, and here candidates performed quite well. Part (b)(ii) required candidates to consider the income tax implications of the rental of immovable property. In particular candidates were required to consider the deductions allowable against the rental of immovable property, and the limitation of deduction of the interest income in view of the interest being paid to a non-resident entity which is related to the company.

Candidates performed well with respect to the deductions allowable against income derived from immovable property, however, the majority of candidates failed to comment on the limitation of deduction, which is a relatively recent amendment which should have been simple enough for candidates to identify.

### Question Four

Question 4 for 20 marks required candidates to consider the taxation of prescribed and non-prescribed fund, as well as the taxation of their investors, an individual resident and domiciled in Malta and another individual resident but not domiciled in Malta that invested via a non-resident entity.

Less than 25% of the candidates opted to answer this question, and the majority of candidates that did answer this question did not manage to identify the main issues. The taxation of prescribed and non-prescribed funds, as well as the taxation of investors of prescribed and non-prescribed funds is completely different, however, the majority of candidates answering this question did not recognise this.

A prescribed fund is exempt from tax in Malta with the exception of income derived from immovable property situated in Malta and investment income where different rates apply depending on the nature of the investment

income. On the other hand a non-prescribed fund is exempt from tax on all of its income other than income derived from immovable property situated in Malta.

In view of the different tax treatment of the funds, the tax implications of investors of such funds will also vary. There is also a difference between the taxation of individuals resident in Malta and the taxation of investors that are not resident in Malta, provided they are not owned and controlled by individuals' resident and domiciled in Malta.

Candidates answering this question failed to identify the nuances of this question. In fact it appeared that few candidates had prepared for the topic being examined in this question. This is probably due to the fact that in the last years this topic has not been examined.

#### **Question Five**

Question 5 examined candidates' knowledge of different VAT scenarios. VAT questions are not always popular, however, it was more popular than question 4.

The performance of candidates in this question was not adequate, which reinforces the comments in previous examiners' reports, wherein it is commented that candidates do not appear to have studied VAT.

Part (a) of the question for 5 marks related to the supply of goods and services on board a cruise liner, and required candidates to consider the different VAT implications in relation to the supply of goods and services on board a ship. The majority of candidates performed considerably well in this part, identifying that in both cases the place of supply for both is the point of departure. A number of candidates got confused as to the definition of point of departure, but for the most part, candidates performed well.

A few candidates simply stopped at stating that the place of supply is the point of departure, without going into the nuances of the law in each case (i.e. the supply of goods and services), which is a pity as this resulted in candidates' failing to secure precious marks.

Part (b) for 8 marks required candidates to consider the VAT implications of non-resident service providers providing different services to a Maltese company registered for VAT, and the application of the reverse charge mechanism. Candidates performed well with respect to the normal supply of services to a Maltese company, but failed to correctly consider the VAT implications of supply of passenger transport, which takes place proportionately to the distances covered.

Part (c) for 7 marks required candidates to consider the VAT implications of the construction of a ship and the lease of a ship. This part considered the VAT implications of goods and services in relation to ships used for navigation on the high seas for the purposes of commercial activities, and therefore candidates needed to consider the exceptions to the general rules. Unfortunately few candidates identified these, which resulted in candidates not performing well in this part.