

Examiner's report

P6 Advanced Taxation (MLA)

June 2012



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 64 marks and the three questions in section B carried a maximum of 18 marks each, so that a maximum of 100 marks could be achieved by each candidate.

The vast majority of candidates attempted all four questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or poor exam technique.

Very few candidates managed to get an average mark in questions 1 and 2. From section B, candidates appeared to find questions 3 and 5 most challenging.

Candidates are reminded of the need to read the questions properly so as to understand correctly the requirements of the question. As an example, question 1 tested candidates' knowledge of share *transfers* and share *issues* however many candidates did not distinguish between the two.

It is important for candidates to give thought to layout and presentation, labelling answers properly, using legible hand writing and always starting new questions on a fresh page. Points cannot be awarded where the marker does not understand what the candidate writes!

Candidates are advised to prepare to be tested both on their in-depth knowledge of syllabus subjects and their ability to apply what they know to the questions set. In the examination, full workings need to be shown, presented clearly and labelled so as to be easy to follow. It is important that computations are presented in the appropriate formats.

Candidates are also reminded that their understanding of the fundamental knowledge required in the F6 syllabus needs to be fully up-to-date to answer questions at P6 level. The computational answers show that candidates sometimes lack fundamental knowledge of tax, for example, very few candidates answered question 3 correctly which simply required an explanation of the term "property company".

Overall the performance of candidates was satisfactory, with a number of candidates preparing very good answers.

Specific Comments

Question One

This 36 mark question was split into two parts. The first part, to which 29 marks were attributed, tested candidates' abilities with respect to the income tax and stamp duty implications of property transfers, intra-group transfers, share transfers and the issue of shares, 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 land from A Ltd to B Ltd qualified for tax relief and that the transfer/issue of shares in C Ltd results in tax becoming payable however detail of these provisions was lacking. Candidates are reminded that it is not enough to simply state that a transaction is taxable or exempt. The majority of marks are gained by outlining the reasons for the conclusion drawn.



The second part, to which 7 marks were attributed, tested candidates' abilities to compute the income tax and duty implications of share transfers and the value shifting provisions on the allotment of shares in a company to a new shareholder.

Most candidates faithfully reproduced the formulae pertaining to the determination of the value transferred and the cost of acquisition on a value shift, and a few candidates went on to arrive at the correct determination of the market value before and after the shift. Knowledge of the income tax implications was very good. The duty implications of the transfer of value were less well known, with few candidates realising that adjustments were required to establish the real value of the shares acquired for duty purposes.

Candidates often demonstrated a lack of knowledge regarding the applicable tax provisions regulating the transfer/issue of shares. Very few candidates explained in detail the applicable provisions with many simply stating that the transfer was exempt or taxable without providing reasons. A small number of candidates incorrectly treated the transfer of shares from Albert to David as an issue of shares.

Common errors in part (a) included failing to apply and explain:

- the intra-group transfer provisions;
- the value shifting provisions.

In part (b), many candidates attempted to calculate the tax and duty liability on the transfer/issue of shares however candidates who did not answer part (a) correctly generally found part (b) similarly challenging.

Question Two

This 28-mark question was split into two parts with the first part, carrying 20 marks, testing candidates' knowledge of the reliefs available to a company receiving trading income from both activities carried out in Malta and a permanent establishment situated in Country Z. Candidates were required to have a good understanding of the tax refund system and were asked to select the combination of relief and refund which provided the minimum tax leakage to the non-resident shareholders of the company. Candidates were also required to have an understanding of the tax accounting system and the applicability of a reduced rate of tax in those cases where the applicable tax treaty provides for such reduced rate. The question clearly stated that the applicable reduced treaty rate was 15%.

The responses to this question once again showed that candidates knew the types of reliefs available and the consequent refunds that could be claimed, but found it harder to apply this knowledge to the scenario presented in the question. 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, but were unable to determine which was the best solution with respect to the branch profits. Candidates need to practise preparing accurate computations so as to be able to select the correct solutions. A few candidates did very well to produce the correct solution to the treatment of the branch profits, and demonstrated good knowledge of the refund system.

Only two candidates mentioned that Subco A Ltd could apply a 15% reduced rate of tax instead of 35%. Many candidates correctly explained the notional rent (annual market rent) allocation.

The second part of the question tested candidates' ability to prepare a tax computation in respect of the two sources of income showing the minimum tax leakage. Candidates need to know how to compute treaty relief correctly, and to be aware that the 35% tax charge is applied to the net income before claiming the 6/7ths refund. Many candidates prepared a correct computation of the FRFTC relief. However the majority of candidates did not apply the 15% reduced tax rate in respect of the local source trading income.



Question Three

This question consisted of three separate parts, with part (a) testing candidates' knowledge of the term "property company", which many candidates correctly explained, however some candidates were totally unaware of this term found in the Income Tax Act.

The second part of the question, which carried eight marks out of a total of 18, tested candidates' knowledge of the participation exemption and the capital gains article of the OECD Model Convention (MC). This part required knowledge of the term "property company"; understandably those who did not answer part (a) correctly were unable to answer part (b) correctly. Very few candidates mentioned the capital gains article of the OECD MC, whilst many candidates mentioned article 12(1)(c) of the ITA (exemption in respect of transfer of shares by non-residents) even though this was not required by the question.

The third part of the question, which carried four marks, tested candidates' knowledge of the details required to be included in a dividend certificate. Very few candidates mentioned the majority of the details listed in the ITA.

Question Four

This question was divided into two parts which referred to the same scenario. The first part dealt with the decision as to whether to carry out a business through a company or a partnership, and the tax implications in both cases. Those who attempted this question did very well. A small number of candidates mentioned that, in the case where a company is to carry out the business, the interest paid by the individual shareholders on the loan taken out to invest in the company is lost unless the company pays out a dividend in the same calendar year that the interest is paid. Although many candidates managed to work out the correct tax computations very few explained in detail the provisions regulating partnerships (tax transparency) and the advantages and disadvantages when compared to a limited liability company.

The second part of the question was split into two parts, and required candidates to demonstrate their knowledge of the value added tax implications in respect of supplies made and received by the AK business. Part (i) required knowledge of what constitutes a supply of goods and a supply of services. Most candidates knew that the supplies made by the AK business consisted solely of supplies of services (including the supply of the parts) however very few candidates were aware of the detailed provisions of the VAT Act regulating the determination of the date when VAT becomes chargeable.

Part (ii) required candidates to prepare a computation of the input and output tax based on the information provided in the question. The majority of candidates who answered this question did very well.

Question Five

Question 5 consisted of two parts, both referring to the same scenario. The majority of candidates attempted this question however it was not very well answered on the whole. The scenario consists of two companies directly owned by two individuals, receiving various sources of income both local and foreign.

Part (a) tested candidates' skills in analysing a group of companies and their respective sources of income and expenses, with the objective of identifying problems with the current structure that resulted in a relatively higher tax burden. The main problem with the current structure was the fact that TRM Ltd and GHM Ltd did not form a group for the purposes of the group loss relief provisions, which means that losses incurred by GHM Ltd could not be surrendered to TRM Ltd. Many candidates who answered this question managed to identify this issue and correctly stated that a restructuring exercise needed to be carried out so as to make both companies qualify for the group loss relief provisions. However very few worked out correct tax computations showing the tax treatment of the foreign source income and the set-off of losses. Many candidates correctly explained that the bank interest received by TRM Ltd, which is currently taxed at 15%, could be offset against losses claimed by TRM Ltd once a group is formed, which means that no tax would be paid on the interest.

Part (b) tested candidates' knowledge of the group loss relief provisions as well as the tax efficient utilisation of tax losses and income streaming. Some candidates correctly recommended that a holding company be formed which in turn would acquire both TRM Ltd and GHL Ltd forming a group for the purpose of the group loss relief provisions, while others recommended that GHL Ltd acquires TRM Ltd which is also correct. The latter is more tax efficient since dividends distributed by TRM Ltd to GHL Ltd would benefit from losses carried forward by GHL Ltd. Very few candidates mentioned that losses incurred by GHL Ltd during the year the group is formed cannot be surrendered to TRM Ltd. Also very few candidates worked out the correct tax computations and the corresponding tax saving when compared to the current group structure.