

# Examiner's report

## P6 Advanced Taxation (MLA)

### June 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.

Candidates appeared to understand the topics being examined, albeit only a few candidates showed an in-depth understanding of the topic. A vast majority of candidates opted to answer Questions 3 and 4, with a minority opting to answer Question 5. The performance of candidates in Questions 1 to 4 was relatively good, however, Question 5, dealing with value added tax issues, was particularly challenging for the candidates that attempted it.

Handwriting and layout of answers (especially in Questions 1 and 2) were generally of good standard.

The following are common issues identified in candidates' answers:

- Poor time management between questions; some candidates wrote far too much for Question 1, at times considering irrelevant issues, which put them under time pressure to finish remaining questions.
- It appears that candidates do not have the depth of knowledge required to understand the intricacies of tax law.
- Candidates should sit 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 – such as the distinction between active income and passive income.
- Candidates very often do not apply the theory they have learned to the facts at hand.

It appears that candidates took a more holistic view in preparing for the exam. The candidates in this sitting did seem well prepared for most topics, albeit value added tax still seems to be a weak point.

#### Specific Comments

##### Question One

This 35-mark question mainly focused on issues relating to capital gains legislation and duty on documents legislation. Part (a), which carried 27 marks was based on the income tax implications of the restructuring of interests in Y Ltd. Part (b) which carried 4 marks was based on the same fact pattern but required candidates to consider the stamp duty implications of the envisioned transfer to Mrs Z.

Part (a) (i) (carrying 20 marks) required candidates to advise AB Ltd, the current shareholders in Y Ltd, on the income tax implications in relation to the envisioned sale of its interest in Y Ltd to Mrs Z, including the effect previous transfers may have on the envisioned sale. In fact, given that a restructuring of the holding in X Ltd was carried out in 2011, without suffering any tax charge, the planned sale to Mrs Z would not only give rise to tax



implications for the vendors, but the 2011 transaction would be chargeable to tax in the hands of Y Ltd in terms of the de-grouping provisions.

Most candidates performed well on this part of the question, identifying that there would be a transfer of a controlling interest, that the previous transaction was exempt from tax and that the de-grouping charge would apply should AB Ltd transfer 15% of its holding to Mrs Z. However, while the main areas of the question were identified, candidates appeared not to have a deep understanding of the de-grouping provisions, few explained how they would be applicable in the case at hand, and what the repercussions would be. Candidates were expected to explain that since the transfer would mean that Y Ltd and AB Ltd would no longer satisfy the conditions through which they benefitted from the intra-group exemption, as well as explain why they do not satisfy the said conditions. This is either because candidates believed that this was obvious, or because the intricacies of the de-grouping provisions are not completely clear to them. In any case this is not a determination that markers can make, and unless candidates give reasons for their answers they cannot score precious marks. Candidates need to learn how to apply their knowledge to the case at hand.

Part (a)(ii) required candidates to provide supporting calculations on the income tax payable. Candidates' performance in this was mixed, but in general the main points were understood.

Professional marks were mainly awarded to candidates as the structure of their answer and format was of good level.

Part (b) carrying 4 marks required candidates to comment on the stamp duty payable by Mrs Z on the purchase of shares in Y Ltd. Candidates generally performed well on this question albeit the vast majority of candidates simply explained the general principles without considering how these applied to the facts of the case. By way of example, while candidates correctly pointed out that the only liabilities that are accepted as a deduction against the net asset value of the company are bank loans and debts registered in the public registry within 3 months, they failed to identify that in the case at hand the shareholders' loans are not deductible as they were not registered in the public registry.

## Question Two

This 25-mark question covered the topics of tax refunds and exemptions. The Deluxe Group has a number of activities in Malta and candidates were asked to comment on the tax implications thereof.

In Part (a) for 17 marks candidates were asked to comment on the income tax implications of the income derived by Luxe MT Ltd, South East Dreams MT Ltd and Stone MT. This part contained two issues which may have put students on the wrong track, and therefore when marking, the markers were instructed not to penalise students if they were misled and therefore award the marks if their analysis is technically correct based on the assumptions taken. The issues which led a minority of candidates to consider a different tax treatment to what the answer provided were (i) whether Luxe MT Ltd had a permanent establishment outside Malta and (ii) the tax residence of SED Cam Ltd, SED Vie Ltd and SED Thai Ltd. In the first case the model answer assumed that Luxe MT did not have a permanent establishment outside Malta and therefore profits were allocated to the Malta taxed account, however, a minority of candidates made an assumption that there was a permanent establishment outside Malta and that therefore such income was exempt from tax in Malta. Where students provided this alternative answer the same marks were allocated. With respect to the tax residence of the three subsidiaries, a handful of candidates answered the question based on the assumption that they were resident in Malta. Where reference was made to the imputation system, marks were allocated for this part.

The performance of the majority of candidates was encouraging, however, the technical knowledge of the refund system and participation exemption is still quite superficial. The mistakes are recurring mistakes from exam to exam: (i) the participation exemption may still apply where a Maltese company holds shares in a company that

owns immovable property situated outside Malta; (ii) the participation exemption may still apply where the subsidiary is not situated in an EU country; and (iii) just because the source of income derived by a Maltese company is outside Malta does not mean that such income is allocated to the foreign income account. Another common mistake is that candidates do not consider whether the company has equity holding rights in its subsidiaries. Candidates are expected to explain the conditions in order to benefit from the participation exemption.

Part (a) also required candidates to comment on the deductions available on income derived from the rental of immovable property, however, only a handful of students identified the issue. On the other hand the majority of candidates identified the indirect allocation of profits from the Malta taxed account or foreign income account to the immovable property account where immovable property is owned and used by a company or where a company rents immovable property from a related company and the rental income is less than market value and less than 250 per square metre, which is very encouraging.

Part (b) for eight marks required candidates to carry out the tax computation of this scenario. Candidates performed modestly well on this. A number of candidates unfortunately left this part out. A very common mistake was that students failed to highlight that the tax refund is allocated to the untaxed account of the recipient of the refund.

### Question Three

This 20-mark question related to the application of the Malta Retirement Programme Rules to Ms Egli, a national of Switzerland.

Part (a)(i) for nine marks required candidates to comment on the conditions for taking up the Malta Retirement Programme. Whereas candidates generally performed well on this part, the main issue which required more analytical thinking was only picked up by a few candidates. This related to the value of Ms Egli's farmhouse in Gozo and the concession available in terms of the Rules with respect to property acquired prior to 1 January 2011. Candidates' performance in this question was however significantly better than expected as the different programmes available were not generally mixed up, which was a recurring theme in the past.

Part (a)(ii) for seven marks required candidates to consider the tax treatment of the pension and interest income derived by Ms Egli once she has taken up residence in Malta and benefits from the Malta Retirement Programme Rules. Candidates generally performed well in this question albeit few considered the application of the treaty.

Part (b) for 4 marks required candidates to consider whether it was possible for Ms Egli to act as a non-executive director of companies resident in Malta, and her partner to operate a small cafe in Malta. Most candidates performed very well on this part, identifying most of the main issues.

### Question Four

Part 4(a) for 13 marks required candidates to consider the fringe benefit issues of standard conditions to be included in the employment contract of Fringe Limited, as well as additional benefits to be provided to its CEO. Candidates generally performed well in this part as they identified the fringe benefit issues in most of the conditions to be provided in the standard contract, however, the majority of candidates failed to provide the main conditions applicable to the reduction in benefit with relation to the car allowance as well as the intricacies of the taxation of share options. Candidates were expected to go beyond the mere fact that a maximum deduction of €1,170 is allowed from the car allowance, explaining what the main conditions are for such deduction, i.e. that the car cash allowance is in terms of a contract of employment, that the employees are not in a controlling position and that the employees are not entitled to another car owned or held under a title of lease by the employer. With respect to the taxation of share options, candidates were expected to go beyond that the fringe

benefit arises when the option is exercised and determine what the value of the benefit is. Candidates were expected to comment on the tax implications of assigning or renouncing the share option, as well the means of determining the gain should the shares be transferred after the option is exercised.

Part 4(b) for seven marks required candidates to advise Mr van Dijk on the tax implications of his secondment to Malta. Candidates were required to comment on how to solve Mr van Dijk's dual residence issue in terms of the double tax treaty as well as determine whether Malta will be restricted from taxing Mr van Dijk in terms of the Treaty. Candidates' performance on this question varied. In general it appears that candidates are not very comfortable with questions relating to double tax treaties, however, the conditions for the application of the tie breaker rule were explained well in general.

### **Question Five**

This 20-mark question required candidates to consider the value added tax issues of two scenarios. Approximately 25% of candidates opted to answer this question which evidences that candidates do not feel comfortable answering questions relating to value added tax.

Part (a) for 13 marks required candidates to consider the value added tax implications of letting of immovable property, as well as registration requirements. Candidates were required to consider three different scenarios thus giving candidates ample chance to score precious marks, however, unfortunately candidates did not perform too well on this part as they failed to even mention the general value added tax principles relating to the letting of immovable property. Candidates were expected to comment on the difference between Article 10 and Article 11 registration, however this was an issue which few candidates spotted.

Part (b) for 7 marks required candidates to consider the value added tax implications of Swiss Design Co selling furniture to persons resident in Malta. The question required candidates to consider the different value added tax implications based on whether the goods are transported or not, as well as if the furniture is assembled in Malta. This part also required candidates to consider the different value added tax implications applicable depending on whether the customer is registered for value added tax in Malta or not. Same as in part (a) the majority of candidates failed to consider the general value added tax rules as well as properly consider the value added tax registration requirements.