Professional Level – Options Module

Advanced Taxation (Malta)

Monday 7 December 2009

Paper P6 (MLA)

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 3–5.

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

The Malta Institute of Accountants

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The question paper begins on page 3.

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future
2. Calculations and workings need only be made to the nearest Euro
3. All apportionments should be made to the nearest month
4. All workings should be shown

TAX RATES AND ALLOWANCES

The following tax rates and allowances are to be used in answering the questions.

Individual income tax

Resident individual tax rates

Married couples – joint computation		Other individuals	
Euro		Euro	
0 to 11,400	0%	0 to 8,150	0%
Next 9,100	15%	Next 5,850	15%
Next 7,500	25%	Next 5,000	25%
Remainder	35%	Remainder	35%

Non-resident individuals

Euro	
0 to 700	0%
Next 2,400	20%
Next 4,700	30%
Remainder	35%

Residence permit holders (pre 1988) and returned migrants

Married persons		Others	
Euro		Euro	
0 – 5,900	0%	0 – 4,200	0%
Remainder	15%	Remainder	15%

Capital allowances – Income Tax Act rates

Industrial buildings and structures

Initial allowance	10%
Wear and tear allowance	2%

Plant and machinery

Wear and tear allowance as indicated in the question where applicable

Capital allowances – Business Promotion Act rates

Investment allowances

Industrial buildings and structures	20%
Plant and machinery	50%

Corporate income tax

Rate	35%

Value added tax (VAT)

Standard rate	18%
Reduced rate	5%

Car fringe benefit

Vehicle use	% of vehicle value
Vehicle not more than six years old	17%
Vehicle more than six years old	10%

Fuel value	% of vehicle value
Vehicle value not exceeding Euro28,000	3%
Vehicle value exceeding Euro28,000	5%

Maintenance value	% of vehicle value
Vehicle value not exceeding Euro28,000	3%
Vehicle value exceeding Euro28,000	5%

Car value	Private use percentage
Not exceeding Euro16,310	30%
Exceeding Euro16,310 but not Euro21,000	40%
Exceeding Euro21,000 but not Euro32,620	50%
Exceeding Euro32,620 but not Euro46,600	55%
Exceeding Euro46,600	60%

Capital gains – Index of inflation

1987	435·47
1988	439·62
1989	443·39
1990	456·61
1991	468·21
1992	475·89
1993	495·60
1994	516·06
1995	536·61
1996	549·95
1997	567·95
1998	580·61
1999	593·00
2000	607·07
2001	624·85
2002	638·54
2003	646·84
2004	664·88
2005	684.88
2006	703·88
2007	712·68
2008	743·05

Applicability of increase for inflation:

$$\frac{\text{Cost of acquisition/improvements}}{1} \times \frac{\text{index(yd)} - \text{index(ya)}}{\text{index(ya)}}$$

Where:
index(yd) is the index for the year immediately preceding that in which the transfer is made;
index(ya) is the index for the year immediately preceding that in which the property in question had been acquired or completed, whichever is the later, or, when it relates to improvements, for the year immediately preceding that in which the cost of carrying out the improvements was incurred.

Business Promotion Act incentives

Definition of a medium sized enterprise

An enterprise which is not a small enterprise and:

- has fewer than 250 employees; and
- has annual turnover not exceeding Euro 40 million or total assets not exceeding Euro 27 million; and
- it is to be treated as being independent

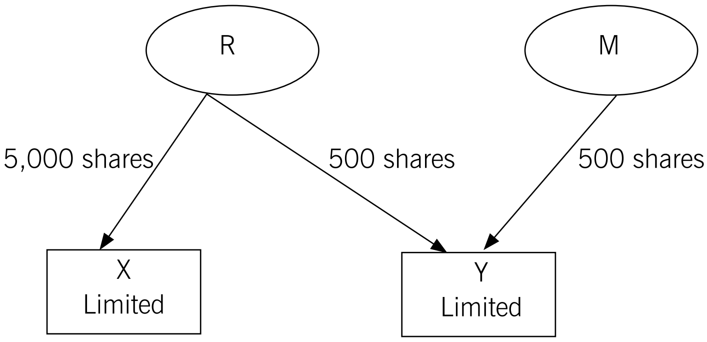
Definition of a small enterprise

An enterprise which:

- has fewer than 50 employees; and
- has annual turnover not exceeding Euro 7 million or total assets not exceeding Euro 5 million; and
- it is to be treated as being independent

Section A – BOTH questions are compulsory and MUST be attempted

1



X Limited and Y Limited are both limited liability companies incorporated in Malta and managed and controlled in Malta. The share capital of X Limited is divided into 5,000 shares and is all held by R. The share capital of Y Limited is divided into 1,000 shares and is held in equal proportions (500 shares each) by R and his brother M. All of the shares in each of X Limited and Y Limited are ordinary shares of an equal nominal value (Euro 1) and carry equal rights. Both R and M are domiciled and ordinarily resident in Malta.

R carries on a business in his own personal right as a tour operator. He organises packaged tours for incoming tourists visiting the Maltese islands. X Limited is also involved in the tour operator business. R had acquired the shares in X Limited in 2004 in order to capture a larger share of the local tour operator industry. R is the sole director of X Limited.

R operates his personal business from The Orange Building, which he acquired in 1999 for the equivalent of Euro 200,000. X Limited operates from The Green Building, which it acquired in 2003 for the equivalent of Euro 250,000.

Early in 2009, R made plans to organise all the tour operator business under one cap. Accordingly, he decided to conduct the combined business from the larger of the two premises, being The Orange Building, and so X Limited sold The Green Building on the open market for Euro 400,000 in July 2009.

R wishes to complete the merger of the two businesses and is considering two options for this purpose. Under the first option he will transfer his own tour operator business to X Limited. This will include the transfer of The Orange Building and all the other business assets. Alternatively, he will incorporate his personal business into a new company (NewCo), transferring all the assets including the property and X Limited will also transfer its business and assets to NewCo. Under both options, R will be transferring The Orange Building for its open market value of Euro 500,000 but no consideration will be charged by R or by X Limited for goodwill. All the transfers will be concluded before the end of 2009.

Y Limited was set up in January 2008. The issued share capital of 1,000 shares of Euro 1 each was originally allotted to N, who was the father of R and M. N passed away in January 2009 and his shares were inherited equally by R and M. R has agreed to sell his shares in Y Limited to M before the end of 2009 for the price of Euro 9 per share. This price represents the market value of the shares and is the value declared by R and M in the notice of the transmission *causa mortis* made for the purpose of the Duty on Documents and Transfers Act following the inheritance of the shares from their father. Y Limited does not own any immovable property.

Required:

(a) Prepare a report to R advising him on the income tax and stamp duty implications, including the availability or otherwise of any relief or exemption that you consider relevant of:

(i) The transfer of R's business and immovable property under each of the two alternatives being contemplated; (15 marks)

(ii) The transfer of R's shares in Y Limited to M. (4 marks)

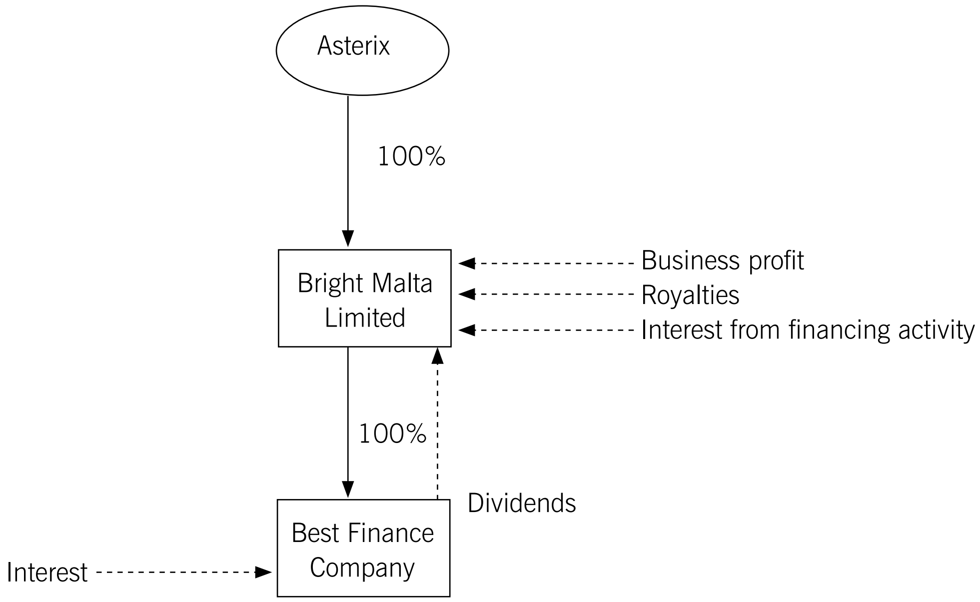
Support your advice with calculations of the income and stamp duty payable on the respective transfers.

Professional marks will be awarded in part (a) for the appropriateness of the format and presentation of the report and the effective communication of the information. (2 marks)

(b) Explain the tax consequences if following its transfer as part of R's business to (1) X Limited and (2) NewCo, The Orange Building were subsequently sold for Euro 500,000. (7 marks)

(28 marks)

2



Asterix, an individual residing outside Malta, holds all the shares in Bright Malta Limited. Bright Malta Limited was incorporated in Malta in June 2007 and is managed and controlled in Malta. Bright Malta Limited's income for 2008 consisted of business income, dividends, interest and royalties.

The business income was received from business activities in Country A, a country with which Malta has a treaty for the elimination of double taxation based on the OECD model. This income amounted to Euro 95,000 net of tax of Euro 5,000 withheld in Country A.

The dividends amounted to Euro 100,000 and were received from the 100% holding which Bright Malta Limited had acquired in Best Finance Company in January 2008. Best Finance Company, a company whose capital is divided into shares, is incorporated and resident in Country B, a jurisdiction that does not form part of the European Union (EU) and that imposes income tax at a flat corporate rate of 3%. Country B charges no tax on the payment of dividends to non-resident shareholders. Malta does not have a double taxation relief agreement with Country B. The income of Best Finance Company consists wholly of interest derived from a loan made to a resident of another jurisdiction, which is not directly or indirectly derived from a trade or business. No income tax is charged on the interest in that other jurisdiction.

Bright Malta Limited received the royalties from a company resident in Country C, a territory with which Malta has a treaty for the elimination of double taxation. The royalty income amounted to Euro 36,000, net of tax withheld at the rate of 10% in Country C.

Bright Malta Limited provides financing to other group entities, all of which are incorporated and managed and controlled outside Malta. Its interest income was derived from these activities and is treated as business income for Maltese tax purposes. This interest income was not derived through any permanent establishment situated outside Malta and was not subject to any foreign tax.

Asterix is registered with the Commissioner of Inland Revenue as a shareholder entitled to refunds of tax on dividend distributions.

Required:

(a) Draft a letter to Asterix:

(i) Outlining, briefly, the provisions of Maltese law relating to the refunds payable to shareholders on the distribution of company profits; (4 marks)

(ii) Advising him on the Maltese income tax treatment of each of Bright Malta Limited's items of income and on the tax implications arising from the distribution of the company's profits, indicating any options available to the company in the computation of its chargeable income to the extent that they can affect the calculation of the tax refunds. (16 marks)

Note: you should assume that Bright Malta Limited does not claim the flat rate foreign tax credit.

Professional marks will be awarded in part (a) for the appropriateness of the format and presentation of the letter and the effective communication of the information. (2 marks)

(b) Prepare computations of Bright Malta Limited's taxable income and tax liability for the year of assessment 2009 to determine whether the company should or should not claim relief for the foreign tax on its income by way of credit, if its main objective is the maximisation of the return to the company's shareholder, Asterix, including his right to tax refunds on the distribution of dividends.

Note: as in part (a), you should assume that Bright Malta Limited does not claim the flat rate foreign tax credit. (6 marks)

(28 marks)

Section B – TWO questions ONLY to be attempted

3 **(a)** Felix has been the holder of a residence permit issued in terms of Article 7 of the Immigration Act since 2003. The permit also covers his wife and his daughter as dependants. Felix intends to fulfil his obligation to remit income to Malta during 2009 in terms of his residence permit but his total remittances are not expected to exceed the required minimum.

In the same year that he obtained his residence permit, Felix bought an apartment in Malta for Euro 400,000. The apartment is the sole residence which Felix has ever had in Malta, and he lives in it when he visits Malta for holidays with his family. For the rest of the year Felix and his family generally reside in the house he owns in Mainland. Felix does not own other property in Malta and does not carry on any activity in Malta. His business interests are all situated in Mainland. A double taxation treaty based on the OECD Model Convention is in force between Malta and Mainland.

Felix has entered into negotiations for the sale of his Malta apartment for its current market value of Euro 650,000. His final decision as to whether or not to proceed with the sale will depend on the tax implications. He has been reliably informed that if he is treated for tax purposes as a resident of Mainland he will be taxed in Mainland at 15% on the gain that he derives from the disposal of the property in Malta.

Required:

(i) **Advise Felix on the tax considerations that he should take into account in order to assess the tax position that would arise if he sold his apartment in Malta in 2009. The advice should include a discussion on the applicability or otherwise of any exemption, the implications of the Malta-Mainland tax treaty and any other particular tax treatment that could be relevant in the circumstances outlined above;** (12 marks)

(ii) **Calculate the total tax payable by Felix in Malta for the calendar year 2009, if (1) he sells the property in 2009 and (2) he does not sell the property.** (4 marks)

(b) Pablo is a world-renowned singer who is domiciled and resident outside Malta. He visited Malta in June 2009 and performed in a number of concerts and entertainment venues throughout his 10-day stay. Pablo received Euro 75,000 for these performances and has calculated his expenses relating to these performances to amount to Euro 25,000.

Pablo is planning another 10-day visit to Malta. He expects to receive similar income as that of the June 2009 visit and anticipates the same expenditure. The planned visit can take place any time between 16 December 2009 and 15 January 2010. No further visits will be made to Malta by Pablo during 2010.

Pablo's profit on his other performances, all of which were made outside Malta, for the year 2009 is calculated at Euro 750,000.

Required:

Explain the Maltese tax treatment of Pablo's income and advise whether it would be beneficial in terms of his Maltese tax liability to undertake the planned second visit in December 2009 or postpone it until January 2010. (6 marks)

(22 marks)

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Question 4 begins on page 12.

4 ZZ Limited carries on the business of manufacturing concrete blocks and slabs, which is its sole trading activity. The company has had between 25 and 35 employees per annum on its books since its incorporation three years ago. The following is a summary of the income tax computations upon which tax returns have been filed for the company since incorporation.

Year of assessment	**2007**	**2008**	**2009**
	Euro	**Euro**	**Euro**
Turnover	900,000	1,000,000	1,250,000
Profit per accounts before depreciation	80,000	90,000	100,000
Initial allowance	34,000	0	0
Wear and tear allowances on buildings	6,800	6,800	6,800
Wear and tear allowances on plant and machinery	18,000	18,000	36,000
Wear and tear allowances on vehicles	16,800	16,800	22,800
Taxable income	4,400	48,400	34,400

Additional information:

(1) The profit for each of the three years includes rental income of Euro 20,000 per annum. This income was received in respect of the lease of one of the three warehouses owned by the company.

(2) ZZ Limited received a dividend from its subsidiary in 2007. The gross dividend was accounted for in the profit for that year. The following is an extract of the dividend warrant received:

	Final tax account	**Immovable property account**	**Maltese taxed account**
	Euro	**Euro**	**Euro**
Gross dividend	200	1,000	500
Malta tax	–	(350)	(175)
Net dividend	200	650	325

(3) The closing stock of materials, work-in-progress and finished goods were valued at cost with the exception of that for 2008 (year of assessment 2009), when the market price of certain materials that are used in the production of concrete slabs was drastically reduced such that the net realisable value was actually Euro 40,000 lower than the cost of these materials. The stock of these materials for the said year was therefore, valued at Euro 30,000, being this lower amount less an additional provision of 10% of the stock's original value of Euro 10,000.

(4) The profit for the year of assessment 2008 was arrived at after deducting the loss incurred by the company upon the disposal of some US dollar denominated bonds. The loss on the transfer of the bonds was Euro 2,000 and the transaction produced a further loss on the exchange rate between the US dollar and the Euro amounting to Euro 1,000.

(5) The profit for the year of assessment 2009 includes bank interest received of Euro 500 net, after accounting for withholding tax at the rate of 15%.

(6) The wear and tear allowance on buildings was calculated at 2% of cost and was claimed in respect of the factory (cost of construction Euro 150,000), three warehouses (cost Euro 40,000 each) and a showroom (cost Euro 70,000). The warehouses are all used for industrial purposes, and not for simple storage, but one of the warehouses is rented out and operated by the tenant (see (1) above). Initial allowance on all these buildings was calculated at 10% of the cost.

No depreciation was claimed on the cost of the land on which the factory was built. The land was acquired for Euro 140,000. The warehouses and the showroom were all acquired in a finished state in 2006.

The cost of acquisition of the company's plant and machinery, which was all acquired new, was Euro 180,000 in 2006 and Euro 180,000 in 2008.

The wear and tear allowance on motor vehicles has been calculated at 20% per annum on the following additions:

– delivery trucks – costing Euro 84,000 in 2006; and
– an executive car – costing Euro 30,000 in 2008.

There were no disposals of fixed assets during the three years in question.

Zak Zerafa, in his capacity of sole director of ZZ Limited, has been notified by the Commissioner of Inland Revenue that an enquiry is going to be held into the tax return of the company for the year of assessment 2007. Mr Zerafa wishes to review his company's tax returns and has asked for your assistance.

Required:

(a) Assuming that the tax returns of ZZ Limited contain omissions in respect of which additional tax may be imposed, state, giving reasons, whether it is advisable for the company to rectify those omissions before the Revenue enquiry commences or at a later stage. (2 marks)

(b) Identify the areas where the tax returns of ZZ Limited can be considered for tax purposes to contain omissions and explain what adjustments are required to rectify those omissions. (7 marks)

(c) Explain whether ZZ Limited is entitled to make other changes in its tax returns that would reduce its tax liability for the three years in question. (9 marks)

(d) Prepare revised computations of ZZ Limited's taxable income for each of the three years, taking into consideration the adjustments contemplated in (b) and (c) above, clearly identifying any unabsorbed or unutilised allowances and/or credits. (4 marks)

(22 marks)

5 (a) In the context of the Value Added Tax Act and the manner in which the taxable value of supplies is determined:

(i) Identify the items that are included and excluded from the taxable value of a supply; (4 marks)

(ii) Explain when a free supply is treated as a taxable supply and the manner in which the taxable value of free supplies is determined; (4 marks)

(iii) Explain the circumstances in which deductions may be claimed in respect of an adjustment to the taxable value of a supply occasioned by events that take place after the supply is made. (4 marks)

(b) In the context of the Duty on Documents and Transfers Act:

(i) Explain the meaning of 'group of companies' and the circumstances in which the existence of a group of companies is a basis for an exemption from duty; (4 marks)

(ii) Explain when the rate of duty on the transfer of marketable securities is 5% and the special rules relating to the determination of the dutiable value of the securities in cases where this rate is applicable; (4 marks)

(iii) State the rebate available in respect of the duty payable on the transmission *causa mortis* of immovable property, together with the conditions that must be satisfied for the rebate to be allowed. (2 marks)

(22 marks)

End of Question Paper