

Strategic Professional – Options

Advanced Taxation – Malta (ATX – MLA)

Tuesday 4 June 2019



Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and **MUST** be attempted

Section B – BOTH questions are compulsory and **MUST** be attempted

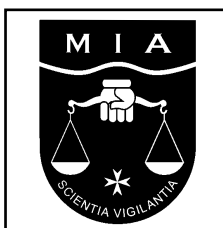
Tax rates and allowances are on pages 2–6

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

ATX – MLA

Think Ahead



The Association of Chartered
Certified Accountants

The Malta Institute of
Accountants

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 €
3. All apportionments should be made to the nearest month unless stated otherwise
4. All workings should be shown

TAX RATES AND ALLOWANCES

The following tax rates and allowances for 2018 (year of assessment 2019) are to be used in answering the questions.

Individual income tax

Resident individual tax rates

Married couples – joint computation

€	€	Rate	Subtract – €
0	to 12,700	0%	0
12,701	to 21,200	15%	1,905
21,201	to 28,700	25%	4,025
28,701	to 60,000	25%	3,905
60,001	and over	35%	9,905

Other individuals

€	€	Rate	Subtract – €
0	to 9,100	0%	0
9,101	to 14,500	15%	1,365
14,501	to 19,500	25%	2,815
19,501	to 60,000	25%	2,725
60,001	and over	35%	8,725

Parents maintaining a child/paying maintenance

€	€	Rate	Subtract – €
0	to 10,500	0%	0
10,501	to 15,800	15%	1,575
15,801	to 21,200	25%	3,155
21,201	to 60,000	25%	3,050
60,001	and over	35%	9,050

Non-resident individuals

€	€	Rate
0	to 700	0%
701	to 3,100	20%
3,101	to 7,800	30%
7,801	and over	35%

Returned migrants

Married couples

€	Rate
0 to 5,900	0%
Remainder	15%

Others

€	Rate
0 to 4,200	0%
Remainder	15%

Capital allowances – Income Tax Act

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

Corporate income tax

Standard rate 35%

Flat rate foreign tax credit (FRFTC) optimisation

FRFTC optimisation formula $\frac{29.75\%}{70.25\%} = 42.349\%$

Notional interest deduction (NID)

$$Y = A \times B$$

Where:

'Y' represents the interest on risk capital that an undertaking is entitled to claim in the relevant year of assessment;

'A' represents the reference rate;

'B' represents the risk capital of the undertaking for the accounting period ending in the year preceding the year of assessment less any risk capital that is not employed by the undertaking in producing any income or is employed in producing income which is exempt from tax.

For the purposes of the NID, the yield to maturity on Malta Government Stocks with a remaining term of 20 years is assumed to be 2%.

Annual market rent (tax accounting)

The annual market rent of immovable property situated in Malta owned and used by a company for the purpose of its activities (excluding property which is rented by the said company to other parties) is calculated by multiplying the aggregate surface area in square metres of all floors of such premises so owned and used by €250 per annum.

Value added tax (VAT)

Standard rate	18%
Reduced rate	5%
Reduced rate – accommodation	7%

VAT small undertaking (Article 11) thresholds

	Entry threshold €	Exit threshold €
Economic activities consisting principally in the supply of goods	35,000	28,000
Economic activities consisting principally in the supply of services with a relatively low value added	24,000	19,000
Other economic activities	20,000	17,000

Car fringe benefit rates

Annual value of benefit = (vehicle use + fuel value + maintenance value) x private use percentage

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 €28,000	3%
Vehicle value exceeding €28,000	5%

Maintenance value	% of vehicle value
Vehicle value not exceeding €28,000	3%
Vehicle value exceeding €28,000	5%

Car value	Private use percentage
Not exceeding €16,310	30%
Exceeding €16,310 but not €21,000	40%
Exceeding €21,000 but not €32,620	50%
Exceeding €32,620 but not €46,600	55%
Exceeding €46,600	60%

Capital gains

Index of inflation

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
2009	758.58
2010	770.07
2011	791.02
2012	810.16
2013	821.34
2014	823.89
2015	832.95
2016	838.29
2017	849.77
2018	859.63

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.

Investment aid regulations

Definition of a medium sized enterprise

An enterprise which is not a small enterprise and:

- has fewer than 250 employees; and
- has an annual turnover not exceeding €50 million and/or annual balance sheet total not exceeding €43 million; and
- is to be treated as being independent.

Definition of a small enterprise

An enterprise which:

- has fewer than 50 employees; and
- has an annual turnover and/or annual balance sheet total not exceeding €10 million; and
- is to be treated as being independent.

Duty on documents and transfers

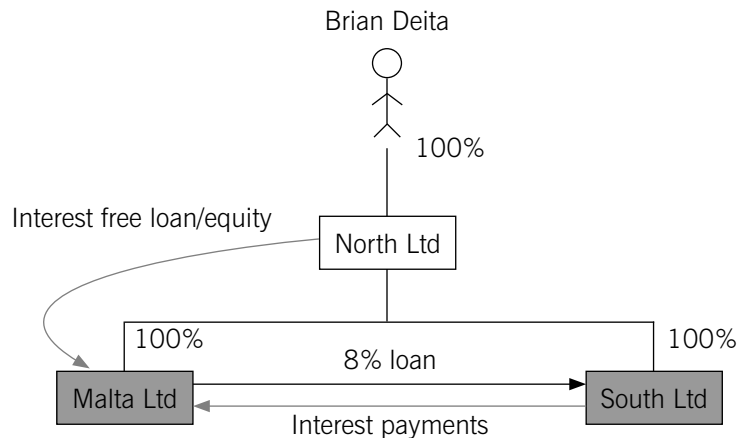
Standard rate	€2 for every €100 in value or part thereof
Property companies (as defined)	€5 for every €100 in value or part thereof

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Question 1 begins on page 8.**

Section A – BOTH questions are compulsory and MUST be attempted

- 1 Brian Deita, who is neither resident nor domiciled in Malta, owns 100% of North Ltd, which in turn owns 100% of Malta Ltd and South Ltd.

On 1 January 2019, North Ltd provided finance to Malta Ltd through a €6 million interest free loan and a €4 million equity injection. Malta Ltd used these funds to grant a €10 million loan with an annual interest rate of 8%, to South Ltd. South Ltd will use these funds to develop a hotel in Southland. The loan is being channelled through Malta Limited rather than North Limited lending directly to South Limited due to the maximum permissible annual interest rate being only 0.5% on loan funds provided in Northland.



Additional information:

1. North Ltd is incorporated, managed and controlled in Northland. Malta Ltd is incorporated, managed and controlled in Malta. South Ltd is incorporated, managed and controlled in Southland.
2. Malta, Northland and Southland are all member states of the European Union (EU).
3. In terms of its domestic law, Southland imposes withholding tax at the rate of 15% on interest payments made to non-residents. Evidence of the tax withheld will be available.
4. There is a double tax treaty between Malta and Southland, which is based on the OECD Model Convention.
5. Malta Ltd does not have any expenses in its statement of profit or loss which are deductible against the interest received from South Ltd, and has no income other than this interest received.
6. Malta Ltd will distribute all of its profits to North Ltd on the last day of its financial year.
7. North Ltd is registered with the Commissioner for Revenue in Malta for the purpose of receiving Maltese tax refunds.
8. Northland will not impose any tax on any tax refunds paid by the Maltese tax authorities.
9. Northland imposes tax on inbound dividend income at the rate of 10%. However, where the EU Parent–Subsidiary Directive (PSD) is applicable, Northland applies the exemption method to relieve any double taxation on dividend income received by companies incorporated therein. Northland will not impose any tax on any interest deemed to be received from Malta in terms of the Maltese notional interest deduction rule but will apply rules in line with the PSD to avoid double non-taxation.

Required:

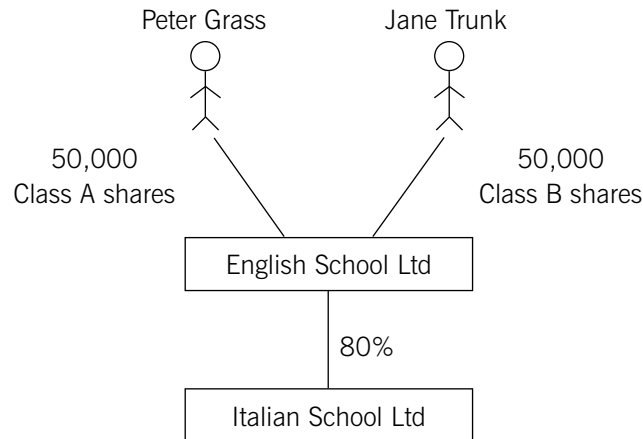
Draft a letter addressed to Brian Deita in which you:

- (i) Explain whether Southland will be able to impose any withholding tax on the interest paid to Malta Ltd, in terms of the double tax treaty between Southland and Malta and the EU Interest and Royalties Directive. (4 marks)
- (ii) Explain whether Northland will be allowed to impose any corporate tax on the dividend paid to North Ltd by Malta Ltd in terms of the EU Parent-Subsidiary Directive, taking into consideration the possibility that Malta Ltd may claim the notional interest deduction (NID). (8 marks)
- (iii) Summarise the main provisions of the NID rules, in terms of:
- the elements of risk capital on which the NID may be claimed;
 - the amount of the NID which may be claimed, including any limitations or restrictions;
 - the mechanism for making a NID claim; and
 - the implications of claiming the NID on the allocation of profits to the tax accounts. (7 marks)
- (iv) Assuming that Malta Ltd will claim the NID, provide calculations of the effective annual tax which would be payable in Malta and illustrate the allocation of profits to the applicable tax accounts, if Malta Ltd:
- (1) does NOT claim any form of double tax relief;
 - (2) claims double tax relief by way of the flat rate foreign tax credit (FRFTC) mechanism with the optimisation method; and
 - (3) claims double tax relief by way of the FRFTC mechanism without the optimisation method. (12 marks)

Professional marks will be awarded for the format and presentation of the letter and the effective communication of the information. (4 marks)

(35 marks)

2 You should assume today's date is 25 April 2019



English School Limited (ESL), a company incorporated and tax resident in Malta, was registered in Malta in January 2012 with an initial share capital of 100,000 shares of €1 each. This share capital is divided into two classes: Class A shares which carry two votes per share and Class B shares, which carry one vote per share. All of the shares carry equal rights to profits and have been held since incorporation by two individual shareholders as follows:

- Peter Grass: 50,000 Class A Shares of €1 each;
- Jane Trunk: 50,000 Class B Shares of €1 each.

Peter and Jane are neither resident nor domiciled in Malta and are not related to each other.

During November 2012, ESL acquired an immovable property for €1,000,000 to be used as a school. This acquisition was partially financed through a bank loan of €300,000 and the balance, of €700,000, through shareholder loans. The two shareholders did not register a hypothec or a privilege on the school acquisition with the Public Registry in Malta. As at 31 December 2018, €100,000 of the bank loan and €550,000 of the shareholder loans were still outstanding.

ESL's statement of financial position as at 31 December 2018 is as follows:

	€
Immovable property (school)	1,000,000
Investment in subsidiary (ISL)	200,000
Non-current assets – other than immovable property	200,000
Total non-current assets	1,400,000
Current assets	100,000
Total assets	1,500,000
Trade payables	350,000
Bank loans	100,000
Shareholder loans	550,000
Total liabilities	1,000,000
Equity	
Share capital	100,000
Retained earnings	400,000
Total equity	500,000
Total liabilities and equity	1,500,000

Although the school is still shown in ESL's books at its purchase price of €1,000,000, the school's current market value, as determined by an architect's valuation, is €2,000,000.

For the last five years, ESL's profits before tax have been as follows:

2014: €200,000

2015: €210,000

2016: €290,000

2017: €350,000

2018: €450,000

During 2015, ESL acquired 80% of the issued share capital of Italian School Limited (ISL), a company incorporated and effectively managed and controlled in Malta. All of the shares in ISL carry the same voting rights and the same rights to profits. ESL's investment in ISL is shown in its books at its cost of acquisition of €200,000. However, ISL has made losses in each year since its incorporation, and as at 31 December 2018, ISL's financial statements show a net asset value of €100,000. ISL does not own any immovable property, and does not have any investments in any other company.

On 25 April 2019, Peter and Jane received an offer from Joe Borg, an individual resident and domiciled in Malta, to acquire all of their shares in ESL, for €20 per share.

Peter and Jane will each be subject to tax on any capital gain arising from the disposal of their ESL shares at a marginal income tax rate of 35%.

Required:

With respect to the proposed sale of the English School Limited (ESL) shares by Peter Grass and Jane Trunk:

(a) Explain the income tax and duty on documents implications, evaluating any relevant exemptions which may be allowable on such a disposal. (12 marks)

(b) Calculate the income tax and duty on documents payable on the disposal by Peter and Jane. (13 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

- 3 (a)** Sarah Vella has recently obtained her legal warrant and intends to set up her own legal office in Malta. Her budgeted turnover for the first year is expected to be €15,000, with a targeted increase of €4,000 per annum in each of the subsequent three years.

Sarah will acquire a considerable amount of furniture from a French supplier (FF), a taxable person established and registered for value added tax (VAT) in France. The furniture will not be assembled by FF in Malta. FF is neither required to register nor will it voluntarily register for VAT purposes in Malta in terms of Malta's distance sales rules threshold.

Required:

- (i) Advise Sarah on whether she requires a value added tax (VAT) registration in Malta, and if so, whether she qualifies to be registered as a small undertaking, together with brief comments on the implications of such a registration with respect to charging output VAT and claiming input VAT.** (4 marks)

- (ii) Advise Sarah on whether it would be possible for her to choose to switch from an Article 10 to an Article 11 registration and vice versa in the future and the circumstances in which such a conversion is mandatory.**

Note: You are NOT required to comment on any consequences under the capital goods scheme.

(4 marks)

- (iii) Advise Sarah on the Maltese VAT consequences of acquiring the furniture from the French supplier (FF) in the case of both an Article 10 and an Article 11 VAT registration.**

Note: You are NOT required to comment on any consequences under the capital goods scheme.

(5 marks)

- (b)** High Street Limited (HSL), which owns a shopping complex in Gozo, is registered for value added tax (VAT) under Article 10. HSL leases various outlets and spaces within the complex to other taxable persons, all of whom are registered for VAT purposes under Article 10.

In addition to its existing activities, HSL intends to start selling multi-purpose vouchers (MPVs) to end consumers. The consumers are able to cash the MPVs in any of the outlets operating within the complex.

Required:

- (i) Advise High Street Limited (HSL) on the value added tax (VAT) treatment of the rental fees received for the outlet and space leases.** (3 marks)

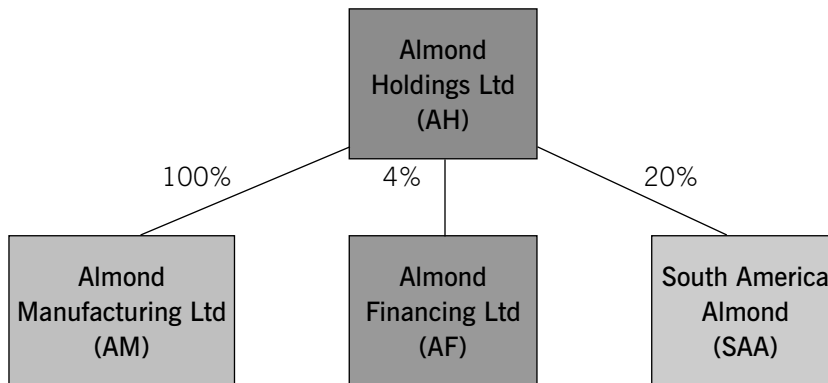
- (ii) Advise HSL on whether the sale of the multi-purpose vouchers (MPVs) to retail consumers constitutes a taxable event for VAT purposes and explain how the taxable value of the goods or services supplied by the various outlets, and paid for by the end customers through the use of the MPVs will be determined.**

(4 marks)

(20 marks)

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Question 4 begins on page 14.**

- 4 (a) Almond Holding Ltd (AH) is a company set up in Malta in 2018, owned by individuals who are neither resident nor domiciled in Malta. AH owns a number of investments in other companies as shown below:



Almond Manufacturing Ltd (AM) is a company set up in Ecuador which manufactures almond milk. AH acquired 100% of AM in June 2018 for €50,000.

Almond Financing (AF) is a company set up in Chile, whose only activity consists of the provision of a loan to AM of €20,000,000 with an interest rate of 5% per annum. Chile imposes tax at the rate of 8% on the interest income derived by AF and exempts from withholding tax all outward dividend payments. AH acquired its 4% holding in AF in April 2018 for €1,500,000. The remaining 96% shareholding in AF is held directly by the beneficial owners of AH.

South America Almond (SAA) is a limited liability partnership set up in Brazil in September 2018, which derives passive royalty income. Brazil imposes tax at the rate of 4% on the passive royalty income derived by SAA but does not impose any withholding tax on the payment of the share of profit by the partnership. AH acquired its 20% interest in the partnership for €200,000. This interest entitles AH to vote at all partnership meetings and to 20% of all voting rights but only to a 10% share of the profits generated by SAA.

Brazil, Chile and Ecuador are all non-EU countries.

On 31 December 2018, AM and AF paid a dividend to AH, and SAA paid AH its share of profits for that year.

Required:

- (i) **Set out the criteria for the application of the participation exemption in general, and advise on the applicability of the exemption to the dividends paid by Almond Manufacturing Ltd (AM) and Almond Financing Ltd (AF) to Almond Holdings Ltd (AH).** (9 marks)
- (ii) **Advise on the applicability of the participation exemption to the share of profit paid by South America Almond (SAA) to AH.** (3 marks)

Note: You are NOT required to comment on the tax treatment if the participation exemption is not available.

- (b) Maria is an individual, who is ordinarily resident and domiciled in Malta. On 1 January 2019, she took up employment with Magic GmbH (MG) for an agreed definite period of three years. MG is a company incorporated, managed and controlled in Germany, and the terms of Maria's engagement require her to perform her duties from the company's head office in Germany. However, Maria will regularly travel to Malta for eight days every month to visit her immediate family and friends. Maria expects to return to Malta on the expiry of her contract.

Maria's employment contract with MG provides that she will receive an annual salary of €90,000 plus reimbursement of her accommodation costs in Germany of €3,000 per month. Maria is not in receipt of any other taxable income.

A double tax agreement is in place between Malta and Germany based on the OECD Model Convention. Germany will impose a tax charge of €17,000 on Maria's German source employment income, but acknowledges that Maria is to be deemed tax resident in Malta throughout her stay in Germany since her centre of vital interests is in Malta.

Required:

Explain the extent to which Maria will be subject to income tax in Malta and in Germany respectively in the year 2019, and calculate her tax liability in Malta for that year. (8 marks)

(20 marks)

End of Question Paper