Strategic Professional – Options

Advanced Taxation – Malta (ATX – MLA)

Tuesday 4 December 2018

ATX MLA MIA

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 – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–5

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

ACCA

MIA

SCIENTIA VIGILANTIA

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 2017 (year of assessment 2018) are to be used in answering the questions.

Individual income tax

Resident individual tax rates

Married couples – joint computation				Other individuals			
€	€	Rate	Subtract – €	€	€	Rate	Subtract – €
0	to 12,700	0%	0	0	to 9,100	0%	0
12,701	to 21,200	15%	1,905	9,101	to 14,500	15%	1,365
21,201	to 28,700	25%	4,025	14,501	to 19,500	25%	2,815
28,701	to 60,000	25%	3,905	19,501	to 60,000	25%	2,725
60,001 and over		35%	9,905	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	700	0%
701	3,100	20%
3,101	7,800	30%
7,801 and over		35%

Returned migrants

Married couples		Others	
€		€	
0 to 5,900	0%	0 to 4,200	0%
Remainder	15%	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%

Value added tax (VAT)

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

Car fringe benefit

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

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.

Transfer of value

$Y = (A - B) + C - D$

Where:
- 'Y' represents the value transferred or acquired by a person
- 'A' is the market value of the shares held in the company immediately before the change
- 'B' is the market value of the shares held in the company immediately after the change
- 'C' is the consideration paid by the person for the acquisition of shares or additional shares issued by the company, where the change consists of an issue of share capital for consideration
- 'D' is the amount paid by the company in respect of a cancellation of shares held by the person, where the change consists of a reduction of share capital

Cost of acquisition of shares in the transfer of value

Z = ((A – B)/A) x E

Where:
'Z' represents the amount to be determined
'A' is the market value of the shares held by the transferor immediately before the change
'B' is the market value of the shares held by the transferor immediately after the change
'E' is the cost of acquisition of the shares held by the transferor immediately before the change

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

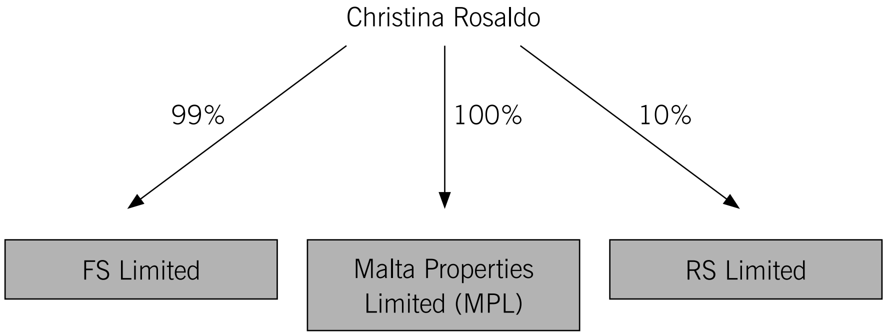
Annual market rent (tax accounting)

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.

Section A – BOTH questions are compulsory and MUST be attempted

1 You should assume that today's date is 7 October 2018.

Christina Rosaldo, an individual resident and domiciled in Portugal, has the following investments:



Malta Properties Limited (MPL) is a limited liability company, incorporated in Malta in 1995 and effectively managed and controlled in Malta. MPL is fully owned by Christina, who also owns 99% of the share capital in FS Limited (FSL) and 10% of the share capital in RS Limited (RSL). FSL and RSL are also companies incorporated in Malta.

Upon incorporation, MPL acquired a portfolio of immovable properties in Malta for their rental potential. All of the properties currently owned by MPL have been owned for more than 15 years and, with exception of the Bugibba residential property, are leased on a long-term basis. All of the properties are held as capital assets in MPL's books.

Rental income from these properties is MPL's only source of income. The rental income derived and the related expenses incurred by MPL on these properties during year of assessment 2018 are as follows:

Rent type	Location	Lessee	VAT registration lessee	Rental income €	Bank interest paid on related loan €	Ground rent payable €	Other directly related expenses (Note 2) €
Commercial	Gozo	Unrelated company	Article 10	40,000	3,000	–	12,000
Commercial	Sliema	RSL	Article 11	72,000	20,000	7,000	19,000
Commercial	Valletta	FSL	Article 10	80,000	5,000	6,000	5,100
Residential	Gzira	Employee of a gaming company	Not applicable	14,000	2,000	–	2,500
Residential	Birkirkara	Maltese resident family	Not applicable	8,000	–	1,000	1,400
Residential	Bugibba	Tourists (maximum 1 week let at a time)	Not applicable	17,000	5,500	4,000	12,500

Note:

(1) All amounts shown in the table above are exclusive of VAT (where applicable).

(2) 'Other directly related expenses' are subject to the standard VAT rate of 18% and are not blocked for VAT purposes.

(3) In addition to the expenses which are directly allocated against the specific immovable property in note (2) above, MPL incurred €100,000 (net of VAT) on general overheads which cannot be attributed directly to any specific immovable property revenues. The general overheads are related exclusively to the long-term rental revenue and none are attributable to the rental revenue received from short-term lets of the Bugibba residential property.

(4) For the purposes of VAT partial attribution calculations, the definitive ratio for 2016 (prior year) was 40%.

(5) MPL is registered for VAT purposes in terms of Article 10 of the VAT Act.

Required:

Draft a letter to Christina Rosaldo advising her on the following matters:

(a) The income tax treatment of the rental income derived by Malta Properties Limited (MPL) during year of assessment 2018.

(i) Explain the methods of assessment available for each property. (4 marks)

(ii) Evaluate the total amount of tax due for year of assessment 2018 with supporting calculations, and advise on the most tax efficient method of assessment. (8 marks)

(b) The VAT treatment of the rental receipts derived by MPL during the calendar year 2017, including:

(i) Explain which property leases are to be treated as subject to VAT, and the VAT rate to apply, where relevant. (3 marks)

(ii) Analyse MPL's right to claim back input VAT.

Note: You are NOT required to consider the Capital Goods Scheme for this part. (3 marks)

(iii) Calculate the VAT due for the calendar year after taking into consideration any partial attribution rules adjustments. (5 marks)

(c) During 2018, Christina plans to transfer the Valletta commercial property out of MPL. MPL has rented the property to FSL for the past 22 years. Christina is considering one of the following options, which are mutually exclusive:

Option A – MPL to transfer the Valletta commercial property only into Christina Rosaldo's personal name.

Option B – MPL to transfer all of the immovable property except the Valletta commercial property to FSL. Thereafter, MPL to be liquidated, transferring the Valletta commercial property into Christina Rosaldo's personal name during the liquidation process.

Option C – MPL to transfer the Valletta commercial property only to FSL, and immediately convert FSL to a partnership *en nom collectif*.

Required:

Include in the letter, your advice on the property transfer tax and duty on documents implications of each of the three options for the transfer of the Valletta commercial property out of MPL during 2018, and identify the most tax efficient option.

Note:
You are NOT required to prepare calculations for this part.
You are NOT required to comment on the VAT implications for this part. (8 marks)

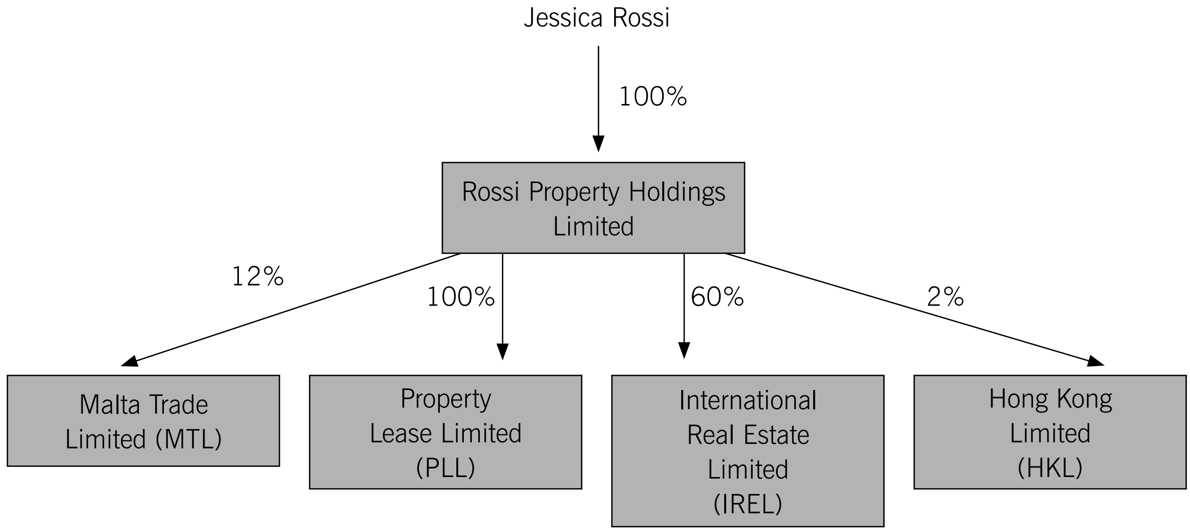
Professional marks will be awarded for the format and presentation of the letter and the effective communication of the information. (4 marks)

(35 marks)

2 You should assume that today's date is 7 December 2018.

Jessica Rossi is an individual who is neither resident nor domiciled in Malta. She is the sole shareholder of Rossi Property Holdings Limited (RPH), a company incorporated, managed and controlled in Malta.

The following diagram shows the investments held by Jessica and RPH:



- 12% of Malta Trade Limited (MTL), a company incorporated, managed and controlled in Malta. It manufactures chocolate at a factory in Malta. The factory was acquired in 2017 for its current market value of €1,000,000, and has a floor area of 500m^2. The total value of the assets of MTL is €1,500,000.
- 100% of Property Lease Limited (PLL), a company incorporated, managed and controlled in Dubai. It owns an office block situated in Valletta and leases it out to unrelated parties.
- 60% of International Real Estate Limited (IREL), a company incorporated, managed and controlled in Malta. It derives income from the provision of short-term accommodation through a hostel situated in Ireland. The hostel is the only asset owned by the company. Ireland considers the income to be attributable to an Irish permanent establishment and taxes the income at a rate of 12%.
- 2% of Hong Kong Limited (HKL), a company incorporated, managed and controlled in Hong Kong. It derives interest from a loan to a related company. The interest is taxed at a flat tax rate of 4% in Hong Kong. RPH has the right to appoint a director to HKL's board of directors. However, RPH is considering setting up an intermediary 100% owned holding company in Hong Kong to hold the 2% shareholding in HKL. RPH would still be entitled to appoint a director to the new holding company's board of directors.

Jessica Rossi and RPH are registered for tax refunds with the Commissioner for Revenue in Malta.

Required:

(a) Explain the Maltese tax treatment of the income derived by Malta Trade Limited, Property Lease Limited and International Real Estate Limited, analyse how the allocation of the profits to the tax accounts should be made, and describe the implications of these allocations for any refunds which may be available if the profits are fully distributed as dividends to Rossi Property Holdings Limited. (10 marks)

(b) Advise on whether the participation exemption is available for any dividends paid by Hong Kong Limited to Rossi Property Holdings Limited (RPH), explain the tax treatment which would apply if the participation exemption is not available to RPH, and assess whether setting up an intermediary Hong Kong holding company would have an impact on RPH's right to claim the participation exemption. (7 marks)

(c) Advise on whether the participation exemption is available if Rossi Property Holdings Limited disposes of its investments in Malta Trade Limited, Property Lease Limited, International Real Estate and Hong Kong Limited, and examine whether setting up an intermediary Hong Kong holding company would have an impact on RPH's right to claim the participation exemption on the disposal of the shares in Hong Kong Limited.

Note: You are NOT required to explain the tax treatment which would apply if the participation exemption is not available to RPH for this part. (8 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 You should assume that today's date is 15 October 2018.

Malta Distribution Limited (MDL), a company incorporated in Malta in October 2018, was set up to import detergents into Malta from other EU member states and countries outside the EU. It was registered for VAT purposes under Article 10 of the VAT Act.

The expected turnover and expenses for its first VAT return covering the quarter from October to December 2018 are as follows (all amounts are stated net of VAT):

		€
Purchases of goods from outside the EU		70,000
Transport costs to Malta on non-EU imports		20,000
Import duties imposed by Maltese customs on non-EU imports		10,000
Purchases of goods with transport from other EU countries		75,000
Transport charges imposed by EU service providers		25,000
Malta sales to retailers	(Note 1)	300,000
Deposit on returnable containers	(Note 2)	13,000
Penalties and interest charged to clients for late payment not included in the sales figures above		22,000
Sales with transport to taxable persons in other EU countries		80,000
Sales with transport to taxable persons outside the EU		24,000
Sales to non-VAT registered customers in Italy	(Note 3)	30,000

Notes:

(1) Malta sales to retailers are shown before deducting €15,000 early payment discounts and €35,000 quantity discounts.

(2) MDL will adopt an eco-friendly policy whereby Maltese customers are entitled to a refund if they return the detergent packaging to designated collection centres.

(3) Italy's distance sales threshold is €35,000.

Required:

(a) Advise Malta Distribution Limited (MDL) of where the chargeable events are deemed to take place for VAT purposes and the appropriate VAT treatment and VAT accounting requirements for the following transactions:

(i) The importation of goods into Malta from outside the EU and from other EU member states;

(ii) The supply of its goods to Maltese retailers and to taxable persons outside Malta.

(6 marks)

(b) Advise MDL of the place of supply of its sales to non-VAT registered customers in Italy, clearly indicating the determining factor as to whether a VAT registration in Italy would be required. (3 marks)

(c) Define the term 'taxable value' under the Maltese VAT provisions and advise MDL of the taxable value of its imports of goods from outside the EU and its supplies of goods to Maltese retailers. (5 marks)

(d) Calculate the amount of VAT due by MDL on its first VAT return, assuming that the supplies of goods to the customers in Italy are subject to Maltese VAT. (6 marks)

(20 marks)

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Question 4 begins on page 12.

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4 Sunny Contractors Limited (SCL) and Sunny Property Limited (SPL) are companies incorporated, managed and controlled in Malta. SPL owns all of the share capital and voting rights in SCL, and SPL is owned by an individual who is resident and domiciled in Malta.

SCL provides property construction and finishing services exclusively in Malta to both SPL and non-related persons. SPL acquires land and other immovable properties which it develops through SCL's subcontracting activities, and it occasionally profits from the transfer of rights acquired on promise of sale agreements. Both companies have the same financial year.

SCL's statement of profit or loss for year of assessment 2018, analysed into the two key activities, is as follows:

		Construction and finishing services to SPL		Property development services provided to unrelated persons
	Note	€	Note	€
Turnover		2,000,000		500,000
Cost of sales	1	(1,900,000)	4	(400,000)
Gross profit		100,000		100,000
Administrative expenses	2	(280,000)	5	(95,000)
Distribution expenses	3	(150,000)		(25,000)
Loss before tax		(330,000)		(20,000)

Notes:

1. Closing inventory includes materials which are deteriorating fast. Accordingly, these materials are reported at their net realisable value of €4,000 (being lower than the actual cost of €5,000).

2. Administrative expenses related to the services provided to SPL include:

	€
Depreciation of plant and equipment (refer to additional information (i) below)	25,000
Advertising and promotion expenses	2,000
Unrealised currency exchange losses	2,000
Administrative penalty charged by the VAT Department for late filing of VAT returns	1,000
Interest charged by the VAT Department for late payment	2,200
Charitable donations	1,000
Casual labour not reported under the FSS rules	8,000

3. Distribution expenses related to the services provided to SPL include:

	€
Motor vehicle running expenses	12,000
Motor vehicle repair costs (SCL was provided with a document which is not a valid VAT invoice)	3,000
Non-commercial motor vehicle lease charges (list price of motor vehicle is €28,000)	8,000

4. The cost of sales attributable to the sales to unrelated persons includes a provision for obsolete inventory amounting to €1,500.

5. Administrative expenses related to services provided to non-related persons includes:

	€
Specific provision in respect of impaired debt	1,500
General provision for impaired debts (0·5% of unrelated receivables)	3,000
Irrecoverable debts	200

You are provided with the following additional information:

(i) For the purposes of calculating the claim for wear and tear allowances for the year:

	Cost	Tax WDV b/f	Years (Note)	Year of purchase
Commercial motor vehicles	€50,000	€30,000	5	2015
Computer equipment	€8,000	€2,000	4	2014
Plant	€100,000	€60,000	10	2013

Note: Years represents the number of years prescribed by the Deduction for Wear and Tear of Plant and Machinery Rules over which the asset is to be written off.

(ii) SCL does not have any tax losses or wear and tear allowances brought forward from previous years.

(iii) SPL's chargeable income for the year of assessment was as follows:

Transfers of immovable property situated in Malta which has already been subject to the final property transfer tax regime	€3,500,000
Transfers of rights acquired on promise of sale agreements relating to immovable property situated in Malta	€300,000 (before tax)
Capital gain arising on the disposal of an immovable investment property situated in Portugal (no tax has been paid on the gain in Portugal)	€25,000

Required:

(a) Advise Sunny Contractors Limited (SCL) and Sunny Property Limited (SPL) whether it is possible for SPL to utilise SCL's losses in order to offset or minimise the tax liability at SPL level under Maltese tax law.

Your advice should include comments on the following points:

(i) Whether SCL and SPL are a group of companies for the purposes of transferring group losses. (2 marks)

(ii) Whether the allocation of profits to tax accounts will have any impact on the possibility of offsetting SCL's losses against SPL's profits. (3 marks)

(iii) Any potential limitations imposed by the Income Tax Act with respect to the deductibility of charges made between related persons, clearly identifying when two persons are considered to be related for the purposes of such limitations.

Note: You are NOT required to comment on the deductibility of the individual items included in SCL's statement of profit or loss. (5 marks)

(b) Prepare SCL's computation of chargeable income for the year of assessment 2018, clearly identifying all claims and reliefs available and the amount of losses which may be transferred to SPL.

Note: You should include in the tax computation all of the items referred to in notes (1) to (5), indicating by the use of zero (0) any items for which no adjustment is required. (10 marks)

(20 marks)

5 Jack and Joyce Osprey are Australian (non-EU) nationals, currently resident and domiciled in Australia. They intend to retire in 2019 and are considering Malta as a retirement destination. Jack does not have any children of his own, but Joyce has adult children from a previous marriage who live in Malta and acquired Maltese residence status three years ago.

On retirement, Jack will be entitled to either a monthly pension of €7,000 per month or, alternatively, a one-off commutation of 25% of his pension plan amounting to €500,000, and thereafter to a monthly pension of €4,000 per month. In addition, Jack is expecting to receive a monthly gross rental income of €2,500 from the rent of a house (which is not his main residence) in Sydney, Australia. The rent will be subject to a 10% withholding tax in Australia. Jack will remit his annual pension and rental income to Malta.

Joyce will not have any sources of income.

Jack and Joyce do not wish to completely break their ties with Australia. They plan to visit Australia at least four times each year. The couple expect to spend around 200 days per annum in Malta and 150 days per annum in Australia, of which they will stay for around 120 days per annum in the apartment in Perth (Australia) which they will retain for the purpose of such visits.

You are informed that, due to the number of days spent in the country, Australia will still consider Jack and Joyce to be Australian tax residents for five years after their departure from Australia for the purposes of Australian tax law.

Jack and Joyce are considering acquiring Maltese citizenship in five years' time but do not intend to reside permanently in Malta. In the meantime they will acquire a property which will satisfy any conditions imposed by the residence programme. To fund the purchase of a house in Malta, Jack will be disposing of his business interest in Auz Limited, an Australian company in which he owns 30% of the share capital. He intends to continue to act as the president of 'Save the Tasman Sea', an Australian not for profit foundation, a position for which he is not remunerated.

You should assume that Jack and Joyce will be granted residence permits, if required by the Maltese authorities.

Required:

(a) Explain how Jack Osprey will be taxed on his pension and rental income and the respective taxing rights of Malta and Australia under the double tax treaty between Malta and Australia.

Note: You should assume that the double tax treaty between Malta and Australia is similar in all respects to the OECD Model Tax Convention. (5 marks)

(b) Discuss whether Jack should opt for a programme which would afford him special tax treatment, identifying which programme would best suit his circumstances, listing SIX main conditions he would need to satisfy in order to be eligible for such a programme, and carrying out calculations of Jack's Maltese tax liabilities to support your recommendation.

Note: For the purposes of your calculations you should assume that Jack would like to minimise his annual income tax liability. (13 marks)

(c) Outline the Maltese tax treatment of the pension commutation if this were to occur after he becomes tax resident in Malta. (1 mark)

(d) Evaluate the impact of becoming a Maltese national would have on your recommendation for the programme which would afford him special tax treatment. (1 mark)

(20 marks)

End of Question Paper