Answers

1 (a) Letter to Josette Brown

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Dear Ms Brown

Following our meeting, we hereunder provide you with our comments on your general liability to tax in Malta, the Maltese tax treatment of the interest paid to you by WHM and the rental income derived by WHM.

(i) Personal liability to tax in Malta

An individual's Maltese tax liability is based on their personal connections with Malta, namely residence and domicile. From the information you have provided to us, it appears that you have never had a Maltese domicile. Since you did not reside in Malta for more than 183 days during 2017, you were in Malta for a temporary purpose only and as you do not intend to establish your residence in Malta, you will not be considered to be tax resident in Malta. As a non-resident person, you will be taxable in Malta only on your Malta source income.

In the remote possibility that Malta would consider you to be tax resident, the tie breaker rules in the tax treaty between Malta and Canada would need to be invoked. Since you do not have a permanent home in either Malta or Canada and therefore your centre of vital interests is not relevant, it would be necessary to consider the location of your habitual abode, which is clearly Canada. Therefore in terms of the tax treaty, you will be considered to be tax resident only in Canada.

Tutorial note: *The centre of vital interests test would have been relevant only if Josette had a permanent home in both Malta and Canada.*

(ii) Tax treatment of the interest paid to you by WHM and the rental income derived by WHM

You granted a €2 million loan at 6% per annum interest to WHM to finance the acquisition and development of a factory which was then rented out by WHM to Winter Trading Limited (WT).

Interest paid to a non-resident person is exempt from Maltese tax, as long as (1) the interest is not connected with a Maltese permanent establishment; and (2) the non-resident is neither owned and controlled, nor acts on behalf of an individual who is ordinarily resident and domiciled in Malta. Since you are not resident in Malta, the interest paid to you by WHM will be exempt from any Malta withholding tax.

The rental income derived by WHM from the lease of the factory to WT is treated as income of a passive nature and therefore the available deductions are limited to any rent, ground rent or similar burden payable on the immovable property, plus a further deduction of 20%. However, the interest paid by WHM to you, which would in other circumstances be allowed as a deduction, will not be deductible for tax purposes because:

- the loan is used for the acquisition and development of an immovable property in Malta;
- as a non-resident person, you will be exempt from tax in Malta on the interest income received; and
- given that your shareholding in WHM exceeds 10%, you are deemed to be related to WHM.

Moreover, WHM is not allowed to opt for the flat 15% final tax on the gross rent charged to WT, since WHM owns and controls more than 25% of WT and therefore the two companies are considered to be related. Accordingly, the rental income received will be taxable at the standard tax rate of 35% and allocated to WHM's immovable property account.

I trust that the above addresses the issues raised to your satisfaction. Please do not hesitate to contact me if you need any further clarifications.

Yours sincerely

Tax consultant

(b) Draft paragraphs on the tax treatment of the dividends received by WHM and the profits arising on the disposal of its investment in HK IP

During 2017, WHM held three investments, two of which generated dividend income and the third a gain on disposal. For WHM to benefit from the participation exemption on such income, the investment holding must first be an equity holding. An equity holding is a holding of share capital in a company which is not a property company, where the shareholding entitles the shareholder to at least two of the following rights:

– a right to vote;
– a right to profits available for distribution to shareholders; and
– a right to assets available for distribution on a winding up of the company.

In the absence of any information to the contrary, it is presumed that WHM's shareholding in HK IP and Spain Cloth Limited (SCL) will entitle WHM to all these equity holding rights, which normally attach to holdings of ordinary shares. As regards WHM's investment in the Lux Fund (LF), the Income Tax Act allows the Commissioner to determine that an equity holding exists even where the holding is not a holding of the share capital of a company, as long as it can be shown that in substance there is an entitlement to at least two of the three equity holding rights. In the case of LF, WHM is entitled to both profits (it received a dividend during the year) and the right to vote, meaning that this investment will also be deemed to be an equity holding.

In order to claim the participation exemption on the income derived from its three investments, WHM's shareholding therein must also qualify as a participating holding in that the holding satisfies at least one of the following conditions:

– it entitles WHM to at least 10% of any two of the equity holding rights; or

– its market value at the date of acquisition was at least €1·164 million; or

– it confers a level of control, such as the ability to appoint a director, or the right to acquire the balance of other investees' equity shares; or

– it is held to further the Maltese investor's business and not held as a trading stock.

In addition, for dividend income to qualify for the participation exemption, the entity in which the participating holding is held must also satisfy one of the following anti-abuse conditions:

– be incorporated in the European Union (EU); or
– be subject to any foreign tax at the rate of at least 15%; or
– have not more than 50% of its income derived from passive interest or royalties.

The above mentioned anti-abuse provisions do not need to be satisfied in the case of the disposal of a participating holding.

Therefore WHM will be able to claim the participation exemption on the dividend received from LF (20% holding and incorporated in the EU) and on the gain on the disposal of its 30% holding in HK IP; and both these amounts will be allocated to the final tax account.

WHM holds less than 10% of the equity share capital of SCL, is not entitled to appoint a director to its board and, although it acquired its shareholding for more than €1·164 million, the investment had not been held for an uninterrupted period of 183 days as at the date of receipt of the dividend (WHM's shareholding was only acquired in August 2017). Therefore, in the absence of any information indicating that any of the other conditions relating to a participating holding is satisfied, it would appear that WHM will not be able to benefit from the participation exemption in respect of the dividend received from SCL. Therefore the dividend income WHM derived from SCL in 2017 will be allocated to the foreign income account (FIA) and WHM and you as a shareholder can then apply any of the following three ways:

(1) Apply the flat rate foreign tax credit (FRFTC) provisions, which allow for a notional foreign tax credit of 25%. Since WHM does not have any expenses deductible against this dividend, this will result in an effective tax rate of 18·75% of the net dividend received in Malta. Under this option, upon a distribution of the dividend income by WHM, you may claim a 2/3rds tax refund, thereby reducing the effective Malta tax rate to 6·25% of the net dividend received in Malta.

(2) Tax the dividend income received at 35%, in which case, upon a distribution of the dividend income by WHM, you may claim a 6/7ths tax refund, thereby reducing the effective Malta tax rate on the dividend received to 5%.

(3) Claim treaty/unilateral tax relief for the 8% withholding tax suffered in Spain. In such a case, upon a distribution of the dividend income by WHM, you would only be able to claim the 2/3rds tax refund (not a 6/7ths refund), but the 2/3rds refund is determined by taking into account the tax charge, i.e. the tax prior to accounting for the relief for double taxation (i.e. 2/3rds of 35% = 23·33%). Given that WHM would also claim double tax relief of 8%, the effective tax rate resulting from the operation of the 2/3rds refund would be 3·67% (35% – 8% = 27% – the 23·33% tax refund).

(c) Computation of the tax payable and allocation of income to tax accounts

Winter Trading Limited (WT)

	€	€
Chargeable income		1,000,000
Tax at 35%	350,000	
Investment tax credit	(35,000)	
Tax due		(315,000)
After tax amount to be allocated to tax accounts		685,000

	Malta taxed account (MTA)	Immovable property account (IPA)
	€	€
Primary allocation		
Investment tax credit (€35,000/35%)	100,000	
Primary allocation taxed at 35% (€1 million – 315,000 – 100,000)	585,000	
	685,000	
Secondary allocation (working 1)	(100,000)	100,000
Tax accounts after secondary allocations	585,000	100,000

Working 1

	€
Rent charged by WHM	150,000
Annual market rent (1,000 m^2 x €250)	250,000
AMR required	100,000

Tutorial note: *The reallocation of profits from the MTA to the IPA is made out of the profits relieved by the tax credit so that WHM can maximise the refunds which can be claimed.*

Winter Holdings Limited

	Final tax account (FTA)	Maltese taxed account (MTA)	Immovable property account (IPA)	Untaxed account (UA)	Foreign income account (FIA)
	€	€	€	€	€
Primary allocations					
Profit on sale of shares in HK IP	250,000				
Dividend paid by LF	220,000				
WT:					
Net dividend subject to tax paid out of MTA		585,000			
Tax refund thereon (€315,000 x 6/7ths)				270,000	
Net dividend paid out of IPA			100,000		
Rental income (Working 1)			78,000		
Disallowed interest (Working 1)				(120,000)	
20% Further deduction				30,000	
Net of tax profit from online clothes trading (€800,000 x (1 – 35%))		520,000			
Dividend paid by SCL (Working 2)					325,000
	470,000	1,105,000	178,000	180,000	325,000
Secondary allocation		(450,000)	450,000		
Tax accounts after secondary allocations	470,000	655,000	628,000	180,000	325,000

Working 1

	€
Gross rental income	150,000
20% deduction (UA)	(30,000)
Taxable rental income	120,000
Tax at 35%	(42,000)
IPA allocation	78,000
Disallowed interest (UA)	120,000

Working 2

	€
Dividend received from SCL	500,000
Malta tax payable at 35% net of DTR (€500,000 x (35% – 8%))	(135,000)
Double tax relief (€500,00 x 8%)	(40,000)
Primary FIA allocation	325,000
Annual market rent of warehouse (€250 x 1,800 m^2)	450,000

2 Everydaysports Limited

(a) Income tax and duty on documents and transfers (DDT) implications arising on the conversion of ordinary shares into preference shares

A conversion of ordinary shares into preference shares with a fixed rate of return (and whose value for tax purposes is their nominal value) constitutes a change in the issued share capital of the company. Should the conversion lead to a reduction in the value of the shares appertaining to a particular shareholder, which value is shifted in favour of another shareholder or shareholders, then the change will result in the value shifting anti-abuse provisions (VSP) being triggered.

There are exceptions to the VSP as follows:

(1) When the change to the issued share capital or voting rights is made in a proportionate manner such that the change does not produce any change in the beneficial owners of the company and in the proportion of the issued share capital and voting rights held by each beneficial owner. Such exception is not applicable in the case of Everydaysports Limited (ES) since Mark will be reducing the value of his shares in favour of his daughter and brother.

(2) When the company is not a property company. Again this is not applicable in the case of ES, as ES owns immovable property situated in Malta and is, thus, a property company.

Tutorial note: *The proviso to the definition of a property company is not applicable in the case of a value shift and, in any case, would still be irrelevant because the value of ES's property constitutes more than 50% of its assets.*

(3) When the shift in value is made in favour of a related person, then the transfer is exempt from any tax on the deemed capital gain made, but is still subject to DDT. For the purposes of the exemption, related person is defined as: a spouse, descendants and ascendants in the direct line and their relative spouses, or in the absence of descendants, brothers or sisters and their descendants.

Through the conversion of his ordinary shares into preference shares, Mark is transferring the value of his shares equally to:

– Alessia, his daughter, who is a related person for the purposes of the exemption from tax on any capital gain deemed to have been made; and

– Joseph, his brother, who will not be considered to be a related person for the purposes of this capital gains exemption since Mark has at least one descendant (Alessia).

Therefore, the transfer to Alessia will only be subject to DDT, whereas the transfer to Joseph will be subject to both tax on capital gains and DDT.

As the transfer will trigger the VSP, the value transferred is computed by comparing the market value of the shares held by each shareholder prior to the change with the market value of their shares after the change. Such market value is computed by adjusting the net asset value of the company derived from two balance sheets showing the position of the company immediately before and immediately after the change. In ES's case, market value for tax purposes will be arrived at by making the following adjustments to the statement of financial position net asset value: (1) adding goodwill based on two years' average profits for the last five years; (2) replacing the book value of the immovable property with its market value as derived from the architect's valuation; and (3) deducting the book value of any preference shares (unless resulting from a capitalisation of reserves, other than the capital redemption reserve and retained earnings).

The company may produce a market valuation prepared by an independent expert and the Commissioner for Revenue can, at his discretion, accept this valuation in lieu of the statutory valuation if it entails a difference in the resulting capital gain of at least 10% **and** of at least €30,000.

In arriving at the capital gain to be taxed, a deduction is allowed for a proportion of the cost of acquisition. This is arrived at by dividing the decrease in the value of the shareholding suffered by the transferor by the market value of the shares before the change. The capital gain is taxed at the progressive tax rate applicable to the transferor.

For DDT purposes, the real value of the company is computed by adding to the market value computed for capital gains purposes, the excess of any liabilities (other than bank loans and other loans registered at the Public Registry within three months from the acquisition of the immovable property to which they relate) over the value of all assets other than immovable property. In the case of ES, it appears that all the liabilities will be of a disallowed nature since there are no bank loans or any other loans registered with the Public Registry. Moreover, for the purposes of this add back, preference shares having a fixed rate of return which resulted from the capitalisation of tainted debt are to be treated as a liability. Therefore, the €4,000 preference shares already belonging to Mark will also be treated as a disallowed liability.

When the VSP are triggered, DDT is computed on the real value of the value transferred without any deduction. In the case of ES, the market value of its immovable property is €550,000 out of total non-current assets of €600,000 (€550,000 + €50,000). As the value of its immovable property constitutes 75% or more of ES's non-current assets (€550,000/€600,000 = 92%), the applicable rate of DDT will be €5 for every €100 of value transferred or part thereof.

(b) Tax and DDT applicable to the proposed conversion

Market value of ES for capital gains purposes

	Before	After
	€	€
Net asset value	130,000	130,000
Goodwill (–50,000 + 20,000 + 80,000 + 150,000 + 100,000)*2/5	120,000	120,000
Less Book value of immovable property	(350,000)	(350,000)
Add Market value of immovable property	550,000	550,000
Less Book value preference shares	(4,000)	(6,000)
Market value	446,000	444,000

Market value shift calculation

	% holding before	MV before	% holding after	MV after	Total value shift	Value shift to Joseph (50% of total)	Cost of acquisition (50% of total)	Capital gain	Tax at 35%
Mark	33·33%	€148,667	0·00%	€0	€148,667	€74,334	1,000	€73,334	€25,667

Real value of ES for DDT purposes

	Before	After
	€	€
Market value for capital gains purposes (as above)	446,000	444,000
Total liabilities	370,000	370,000
Preference shares (capitalised shareholder loan)	4,000	4,000
Assets other than immovable property (€50,000 + €100,000)	(150,000)	(150,000)
Market value	670,000	668,000

Tutorial note: *The newly issued preference shares are not treated as a liability as they originated from equity and not from a disallowed liability.*

Real value shift calculation

	% holding before	MV before	% holding after	MV after	Value shift	Duty at €5 per €100
		€		€	€	€
Alessia	33·33%	223,333	50%	334,000	110,667	5,535
Joseph	33·33%	223,333	50%	334,000	110,667	5,535
				668,000		

(c) Effect of converting Mark's equity shares into non-voting equity shares

The suggested alternative of converting Mark's ordinary shares into non-voting ordinary shares will also be deemed to constitute a value shift for the purposes of Maltese tax laws, with the value shift being calculated based on the percentage of the voting rights held by the respective shareholders before and after the change. However, if the transfer of value from Mark to his daughter, Alessia (as a descendant), is done through a change in voting rights, the share value shift would qualify for an exemption from both tax on the capital gain and from DDT. This would result in a saving of the DDT otherwise payable by Alessia of €5,535.

The tax consequences arising on the change in voting rights from Mark to his brother, Joseph, would be identical to those arising on the conversion of the ordinary shares to preference shares.

3 6G GmbH (6G)

(a) Malta income tax on business profits from the sale of mobile phones to Malta customers

6G is a company which is neither resident nor domiciled in Malta, and therefore is taxable in Malta only on any Malta source income it may derive. In the case of the business income derived by 6G, Malta would be able to impose tax on 6G's profits only if they arise from trading in Malta, either through a business operation physically carried out in Malta or through a dependent agent. If 6G's operations are merely limited to trading with Malta without the necessary connection with Malta, then Malta will be unable to exert its source jurisdiction to tax such business profits. Furthermore, the treaty between Germany and Malta only allows Malta to tax the business profits derived by 6G if such profits are attributable to a permanent establishment (PE) which 6G has in Malta through either a fixed place of business through which the business of 6G is partly or wholly carried out, or through a dependent agent.

In the case of Option A, 6G will have no real activity, or any place of business or agent in Malta. Moreover, the server which hosts the website used to sell the mobile phones in Malta is situated outside Malta. Therefore 6G will not be subject to tax in Malta on its business profits under this option.

Tutorial note: *Even if the server hosting the website were situated in Malta, it would be necessary to question whether the website and the server constitute the real business of 6G or are only of a preparatory and auxiliary nature to 6G's business model.*

Under Option B, 6G will have a fixed place of business at its disposal in Malta. However, such space will be used exclusively for advertising and viewing purposes and all sales will still be processed through the German website. In this respect, the treaty provides that a PE is not deemed to exist where the fixed place of business and the maintenance of stock in the state is used exclusively for displaying products, that is, for activities which are merely preparatory and auxiliary. Again, 6G will not be subject to tax in Malta on its business profits if its activities in Malta are limited to those listed in Option B.

In the case of Option C, however, 6G will rent a space in the shopping complex in Valletta which will be used to sell and distribute its range of imported mobile phones. Therefore, 6G as a non-resident company will have a fixed (a specific location in Malta which will be held for some time and will not change all the time) place (identifiable location) of business (the space will be used to carry out a retail activity) through which it will carry out its Maltese business. Under these circumstances, the treaty permits Malta to tax any profits arising from the sales carried out through the retail outlet in the shopping complex but it would still be unable to tax the profits from any sales happening through 6G's German website.

Under Option D, the retail space in the shopping complex will be rented, and the mobile phones imported and sold in Malta, by a Maltese subsidiary company, 6G Malta (6G-M), in its own name. 6G-M will be the subsidiary of 6G which is resident and domiciled in Malta and as such taxable in Malta on its worldwide income. The German company 6G would not be taxed on any of the activities carried out in Malta by its subsidiary, 6G-M, unless the subsidiary acts as a dependent agent of 6G, which does not appear to be the case here.

The position in the case of Options E or F depends on whether the activities carried out in Malta by MOBL would, in terms of the treaty, lead MOBL to be considered as a dependent agent or as an independent agent of 6G.

Under Option E, MOBL will act as a reseller acting in its own name and in the ordinary course of its business when selling 6G's products. Moreover, 6G will have no control or ownership relationship in MOBL, which will continue to be permitted to sell competitors' products. 6G would also not be restricted from having other independent distributors in Malta. Therefore, MOBL will be considered as an independent agent of 6G, so no Maltese PE will arise and 6G will not be subject to tax in Malta.

Contrast with Option F, where MOBL will be acting for and on behalf of 6G, will have the right to contract on behalf of 6G and will be required to terminate its sales of all competing products. Here, in terms of the treaty, MOBL will be considered to be a dependent agent of 6G and as such 6G will be considered to have a PE in Malta and all of its income derived from the intended operations will be deemed as Malta source income and taxed as such. Furthermore, Maltese tax legislation provides that, where a non-resident carries on business with a resident person and there is a close connection leading to substantial control being exercised by the non-resident (6G) over the Maltese resident agent (MOBL), then the non-resident person (6G) can be assessed and charged to tax in the name of the resident person (MOBL) which is a dependent agent of the non-resident person (Article 5(6) ITMA).

Finally, since 6G will be servicing and repairing all mobile phones outside Malta, any charge imposed for such services cannot be considered to be effectively connected to any Maltese PE and therefore Malta will be precluded from taxing such profits in terms of the tax treaty.

(b) Value added tax (VAT) treatment of distance sales of mobile phones

Supplies of goods with transport are deemed to take place where the goods are when the transport begins, in this case in Germany. However, when a taxable person not established in Malta (such as 6G) supplies goods with transport to persons in Malta who are not treated for Maltese VAT purposes as taxable persons, and therefore are not registered in terms of Articles 10 or 12 of the VAT Act, the place of supply will depend on the following factors:

(1) Where the total value of the sales of goods transported to Malta during the year (or during the previous year, if the seller is already registered for VAT purposes in Malta) exceeds €35,000, then the place of supply is deemed to be in Malta. If this is the case for 6G, then it will be required to register for VAT purposes in terms of Article 10 and charge VAT at 18% on its sales to Malta customers from the moment the threshold is exceeded.

(2) Where the €35,000 threshold is not exceeded, the place of supply will remain at the point where transport starts, i.e. Germany, and German VAT will apply unless 6G voluntarily decides to register for VAT in Malta and impose Maltese VAT on its sales to its Malta customers.

(c) VAT treatment of sales of mobile phones by 6G to MOBL

Mobile phone sales by 6G, a German taxable person, to MOBL, a Maltese taxable person registered for VAT purposes in terms of Article 10, are considered to be intra community sales as long as the goods are transported to Malta by 6G or by MOBL on behalf of 6G. In this case, the liability to account for and pay VAT in Malta will shift from 6G to MOBL; 6G will not be required to obtain a Maltese VAT identification and MOBL will account for the Maltese VAT using the reverse charge mechanism.

4 Sophia Borg

(a) Advice on the tax treatment of income derived in 2017

Sophia is both ordinarily resident and domiciled in Malta and therefore is taxable in Malta on a worldwide basis. This is the case even though in any particular year she spends most of her time outside Malta, since Malta remains her country of ordinary residence.

Although the Income Tax Act provides for an optional preferential tax rate of 15% applicable on foreign source employment income when the employment contract requires the employee to perform their duties mainly or wholly outside Malta, this preferential treatment is not available to employees of the Government of Malta. Therefore Sophia's employment income from the Ministry of Foreign Affairs will be taxable at the normal income tax rates, which will be the parent progressive tax rates because Sophia maintains (through child maintenance) a child who is still a minor. The alimony payments Sophia pays to her estranged spouse are a personal expense which is allowed as a deduction against the taxable income derived by Sophia, but no deduction is available for the child maintenance payments in respect of her daughter.

Capital gains made on the sale of shares listed on the Malta Stock Exchange are exempt from tax. Capital disposals of bonds at a gain are outside the scope of tax as they carry a fixed rate of return and therefore are not considered to be securities for the purposes of the capital gains rules. However, Sophia is trading very frequently in both bonds and stocks and keeps such investments for very short periods of time, which indicates that it is her intention to derive a short-term profit from these activities, meaning that the transactions will be considered to be of a trading nature. This being the case, Sophia will be unable to claim the exemption from tax on capital gains contemplated by the ITA and the profits from the sales of both the shares and the bonds will be taxed as income at the progressive tax rates.

As the interest on the bonds has already been subject to the 15% final withholding tax, it does not need to be declared in Sophia's tax return and no further tax will be due thereon. Sophia made the right choice to opt for the 15% final withholding tax at source as this will avoid her paying 35% tax on the interest income through her tax return.

The disposal of the units in both collective investment schemes constitutes a one-off disposal of a life-time investment, so both are to be considered transactions of a capital nature. Any gain on the sale of the units in the prescribed fund is exempt from tax since this fund is listed on the Malta Stock Exchange. On the other hand, on the disposal of the units in the non-prescribed fund which will cancel, liquidate or redeem such units, Sophia has the option of either having the 15% final withholding tax charged at source on the gain, or receiving the gain gross and declaring it in her tax return. Since Sophia's marginal rate of tax is higher than 15%, the 15% final tax at source will be the better option.

The dividend income Sophia received from Farland is taxable in Malta. However, since she has been provided with the supporting evidence of the tax withheld, she will be able to claim unilateral tax relief for the overseas tax suffered. The claim for double tax relief will be limited to the lower of actual foreign tax paid of 30% and the Malta effective tax on the dividend, which is derived by dividing the total tax charge in Malta by the total income taxed through the tax return, and multiplying the result by the foreign dividend received on which tax was withheld.

With regards to the rental income derived during the year, Sophia again has a choice of treatment between a 15% final tax on the gross rental income received without any deductions whatsoever, which is payable by 30 June of the year following the year when the rental income is derived, through a special form separate from the tax return; or to be taxed at the progressive rates on the net rental income after the deduction of the interest paid on the loan used to acquire the property and a further deduction, amounting to 20% of the gross rent received.

When considering the rental income on its own, the 15% final tax would result in the lower amount of tax, given that Sophia's marginal rate of tax is higher than 15%. However, while opting for the alternative of declaring the net rental income after deductions in her tax return will result in a higher amount of total income taxable at progressive rates, this in turn will result in the amount of double tax relief claimable on the foreign dividend income being higher. As shown in the computation in part (b), this increased credit will exceed the additional tax payable on the rental income, therefore, taking double tax relief on the Farland dividend income into account, declaring the rental income through her tax return results in a tax saving overall.

(b) Tax computation for the year of assessment 2018

	15% final tax on gross rent option €	Progressive rates on net rents option €
Income/expense type		
Salary	60,000	60,000
Alimony payment (€500 x 12)	(6,000)	(6,000)
MSE trading	5,000	5,000
Interest on bonds (FWT)	0	0
Collective investment gains (exempt/FWT)	0	0
Farland foreign dividend	15,000	15,000
Income taxable at progressive rates excluding rental income	74,000	74,000
Rental income (FWT/(€12,000 – €4,200 – (20% x €12,000))	0	5,400
Total income taxable at progressive rates	74,000	79,400
Tax thereon at parent progressive rates	16,850	18,740
Effective tax rate on income (22·77%/23·60%)		
Double tax relief (limited to Malta tax payable)	(3,416)	(3,540)
Tax payable on tax return after DTR	13,434	15,200
Final tax on income payable at 15% rate		
Rental income (€12,000 x 15%) (final tax option)	1,800	0
Bond interest (€400 x 15%)	60	60
Gain on disposal of non-prescribed CIS units (€5,000 x 15%)	750	750
Total tax payable for the year including final taxes	16,044	16,010

Minimum tax payable is €16,010.

5 (a) Valletta Food Distributors Limited (VFD)

(i) Value added tax (VAT) treatment in 2017 compared to previous years

Up to 2016, VFD's operations related exclusively to the supply of foodstuffs, which are treated as taxable (either at the rates of 18% or 5%) or exempt with credit supplies for Maltese VAT purposes, meaning that the company was entitled to a 100% credit for any input VAT incurred (unless specifically blocked). The lease of an immovable property by a company to another person is subject to VAT (at 18%) only when the lessee will use such premises in the course of their economic activity and the lessee is registered for VAT purposes in terms of Article 10 of the VAT Act. The latter condition is not satisfied in the case of the insurance company, so the lease of the building will be treated as the supply of an exempt without credit service.

(ii) Adjustments required under the capital goods scheme

VFD claimed the input VAT on the refurbishment of the building in full in 2004, since it had the intention of utilising the premises exclusively for the retailing of foodstuffs (supplies subject to VAT). Whenever a taxable person incurs capital expenditure, there is an obligation for that taxable person to make sure that the capital asset is used for taxable activities for the whole of the 20-year adjustment period for immovable property established under the capital goods scheme, and in particular, that there is no change in the proportion of entitlement to input VAT in respect of the asset on which the input VAT was claimed. This adjustment period is deemed to commence when the asset is first put into use, which in the case of VFD's building occurred during 2005.

During February 2017, VFD changed the use of the premises from the supply of goods on which it was entitled to claim input VAT, to a lease which will not give the lessor the right to claim input VAT. Therefore, the input VAT claimed on the 2004 refurbishment should be adjusted for in 2017. The lease of the premises is for 25 years, which is longer than the 20-year adjustment period, so VFD will be required to make a full adjustment for the remaining years of the adjustment period. The building has been used for 12 years (2005 to 2016), therefore VFD should make an adjustment for eight years out of the 20 years in favour of the Commissioner of VAT, on the VAT claimed initially. This adjustment will, therefore, be €7,200 (€100,000 x 18% x 8/20).

(iii) Application of partial attribution rules from 2017

From February 2017, VFD will not be able to claim credit for input VAT which relates to acquisitions which are directly related to the exempt without credit lease of the building. Moreover, the introduction of exempt without credit supplies will require VFD to start applying the partial attribution rules. With effect from calendar year 2017, in respect of input VAT which cannot be directly allocated to taxable supplies versus exempt without credit supplies, input VAT credit should be claimed as follows:

(1) Until the end of calendar year 2016, VFD exclusively provided taxable supplies, so during 2017, VFD will be able to provisionally claim 100% of the input VAT not directly attributable to any type of supply.

(2) At the end of 2017, VFD will be required to establish what is the total value of the supplies which grant it a right to claim back input VAT (i.e. its foodstuff sales) and the total value of supplies in respect of which no claim for input VAT may be made (i.e. the lease to the insurance company).

(3) The total value of the supplies which grant VFD a right to claim input VAT must be divided by the total sales for 2017 to arrive at the definitive ratio for 2017.

(4) Since the provisional ratio for 2016 was 100% and during 2017 VFD introduced exempt supplies, the definitive ratio for 2017 will be lower than the provisional ratio, so an adjustment in favour of the Commissioner will need to be accounted for in VFD's VAT return for the first period ending in 2018.

(5) During 2018, VFD will use the 2017 definitive ratio as the provisional ratio for that year, with a subsequent adjustment being required should this differ from the definitive ratio for 2018 once it is calculated (as in steps 2 to 4 above).

(iv) Time of supply of the lease

VFD received a full year's rent in advance from the insurance company in February 2017. The VAT Act provides that in the case of the provision of a service, the date when a supply is deemed to take place for VAT purposes (the chargeable event) is the date when the service is performed. However, in the case of a continuous service, the date of the chargeable event is the last day of the period for which a statement is issued or a payment is made, up to the amount covered by the statement or payment. Therefore, as the rent is payable to VFD annually, the supply is deemed to be made by VFD at the end of each year for which a payment is made.

(b) Dome Malta Insurance Limited (DMI)

(i) Place of supply of insurance services

DMI carries out four different supplies of insurance services, which for value added tax (VAT) purposes are deemed to take place as follows:

(1) Supplies of insurance services to taxable persons established within the EU are deemed to take place where the customer is established, in terms of the general B2B place of supply rule.

(2) Supplies of insurance services to taxable persons established outside the EU are also deemed to take place where the customer is established, in terms of the general B2B place of supply rule.

(3) Supplies of insurance services to non-taxable persons established within the EU are deemed to take place where the supplier is established, in terms of the general B2C place of supply rule, which in DMI's case is in Malta.

(4) Supplies of insurance services to non-taxable persons established outside the EU are deemed to take place where the customer is established, in terms of an exception to the general B2C place of supply rule.

(ii) Ability to claim credit for input VAT

The supply of insurance services is generally deemed to be exempt without credit thereby resulting in the insurance provider being unable to claim any credit for input VAT. However, where insurance services are provided to customers established outside the EU, such a supply grants a right to claim a credit for input VAT. Therefore, DMI will be entitled to claim a credit for the input VAT which is directly related to and partially attributable to the B2B and B2C supplies of insurance services provided to customers outside the EU.

				Available	*Maximum*
1	**(a)**	**(i)**	**Personal liability to tax in Malta**		
			Not resident: <183 days, in Malta for a temporary purpose, no intention of residing	2·0	
			Tie breaker rule:		
			Ignore centre of vital interests since no permanent home in either country	1·0	
			Deciding factor location of habitual abode, tax resident in Canada	1·5	
			Taxed in Malta on a source basis	0·5	
				5·0	4
		(ii)	**Tax treatment of interest paid by WHM and rental income derived by WHM**		
			Interest exempt, paid to a non-resident person, not connected with a PE and non-resident not owned and controlled or acts for an individual ordinarily resident and domiciled	2·0	
			Rental income treated as passive	0·5	
			Restricted deductions plus 20% maintenance allowance	1·0	
			Interest disallowed as a deduction as paid on a loan to finance acquisition and development of immovable property in Malta and payer and recipient connected to the extent of >10% holding	2·0	
			15% final tax on gross rental income not available since WHM holds >25%	1·0	
			Taxable at standard rate of 35%	0·5	
				7·0	6
	(b)		**Dividends received from and profits arising on the disposal of investments**		
			Equity holding definition; not a property company, 2 of 3 rights	1·5	
			Application to HK IP and SCL	0·5	
			Application to holding in collective income schemes and thereof to holding in LF	1·5	
			Participating holding definition (4 x 0·5)	2·0	
			Anti-abuse provisions (3 x 0·5)	1·5	
			No need to meet anti-abuse provision for disposal of a participating holding/HK IP gain	1·0	
			Application to LF dividend	1·0	
			Application to SCL, not a participating holding, <10% holding, no right to appoint a director, >€1·164m investment but held for less than 183 days	2·5	
			Analysis of options available re SCL dividend: FRFTC with 2/3rds refund, 6/7ths refund no DTR, and 2/3rds refund with underlying tax relief	3·0	
				14·5	12
	(c)		**Computations**		
			Winter Trading Limited (WT):		
			Taxed at 35% on €1 million	0·5	
			Investment tax credit adjustment	0·5	
			Primary allocation (2 x 0·5)	1·0	
			Annual market rent re-allocation	1·0	
			Final allocation to MTA and IPA after secondary allocations (2 x 0·5)	1·0	
			Winter Holdings Limited:		
			FTA allocation of gain on sale of HK IP shares and of dividend paid by LF (2 x 0·5)	1·0	
			WT dividend allocation to MTA and IPA	0·5	
			6/7ths tax refund calculation and allocation to UA	1·0	
			Rental income calculation and allocation to IPA	1·0	
			Disallowed interest calculation and allocation to UA	1·0	
			Online sale of clothes net allocation to MTA	0·5	
			SCL dividend calculation and allocation to FIA	1·0	
			Secondary allocation to IPA	1·0	
				11·0	9
			Presentation:		
			Appropriate format of letter	1·0	
			Logical development	1·0	
			Effectiveness of communication	2·0	4
					35

			Available	*Maximum*
2	**(a)**	**Tax and DDT implications on the conversion of ordinary shares to preference shares**		
		Conversion triggers value shifting provisions	1·0	
		Exception 1: Proportionate change and why not applicable	1·5	
		Exception 2: Not a property company, so not applicable	1·5	
		Exception 3: Transfer of value to a related person, including definition of RP	1·5	
		Not applicable for transfer of value to brother as has descendants	1·0	
		Only applicable for tax on capital gains not for DDT	1·0	
		Basis of computation of value shift (Y = A – B)	1·0	
		Market value calculation:		
		Based on balance sheet for net asset value before and after	0·5	
		Goodwill adjustment, ignoring profits post last financial year end	0·5	
		Immovable property value adjustment	0·5	
		Preference shares deduction	0·5	
		Company may produce an independent valuation, 10%/€30,000 differential, at Commissioner's discretion	1·5	
		Available deduction Z = (A – B)/A x E	1·0	
		DDT calculation requires addition of disallowed liabilities to market value	0·5	
		Definition of excess liabilities	1·0	
		Application to ES, preference shares resulting from debt treated as a liability	1·0	
		€5 duty rate applies, immovable property >75% total non-current assets	1·0	
			16·5	13
	(b)	**Calculation of the tax and DDT on the proposed conversion**		
		Market value before and after:		
		Net asset value	0·5	
		Goodwill adjustment	0·5	
		Immovable property value adjustment	0·5	
		Preference shares deduction, including increase to €6,000 through the change	1·0	
		Computation of value transferred (Y) by Mark	1·0	
		Computation of capital gain on transfer to Joseph and tax payable	1·5	
		Real value before and after:		
		Disallowed liabilities calculation	0·5	
		Existing preference shares treated as a liability	1·0	
		Newly converted preference shares not treated as a liability	1·0	
		Assets other than immovable property deducted	0·5	
		Calculation of value shift to Joseph and Alessia	1·5	
		DDT at €5 per €100 including part thereof	0·5	
			10·0	9
	(c)	**Change in voting rights**		
		Still triggers VSP	1·0	
		Transfer of value to Alessia (a descendant) is exempt from DDT as well as tax on capital gain	1·0	
		Tax saving of €5,535 identified	0·5	
		No difference in relation to transfer of value to Joseph	0·5	3
				25

			Available	*Maximum*
3	**(a)**	**Malta tax income on business profits from sales to Malta customers**		
		Malta only able to tax on a source basis	0·5	
		Trading in versus trading with Malta	1·0	
		Treaty requires PE via a fixed place of business or dependent agent	1·0	
		Option A: Not taxable in Malta	0·5	
		No fixed place of business or dependent agent	0·5	
		Website and server outside Malta	0·5	
		Option B: not taxable in Malta	0·5	
		Activities in Malta limited to preparatory and auxiliary activities	1·0	
		Option C: fixed place of business, through which the business is carried out	1·0	
		Retail sales through PE are taxable but not sales via the website	1·0	
		Option D: 6G-M is a subsidiary not a PE	0·5	
		Subsidiary not 6G taxable on sales in Malta	0·5	
		Option E: MOBL an independent agent, no PE	1·0	
		Selling in own name and in the ordinary course of business, has the ability to sell other products	1·0	
		Option F: MOBL a dependent agent acting for and on behalf of principal, PE exists	1·0	
		Ability to contract on behalf of 6G and sells 6G's products exclusively	1·0	
		Art 5(6) ITMA:		
		– close connection between resident and non-resident	0·5	
		– substantial control	0·5	
		– non-resident taxed in the name of the dependent agent	0·5	
		Servicing and repairs: non-Malta source income	1·0	
			15·0	13
	(b)	**VAT treatment of distance sales**		
		General place of supply of goods rule with transport	1·0	
		German VAT applies without distance sales rules	0·5	
		Distance sales to persons not registered under Art 10 or 12	0·5	
		Annual sales threshold of €35,000	1·0	
		Applicable if threshold exceeded in previous year	0·5	
		Register under Art 10 and charge 18% VAT on sales	1·0	
		If threshold not exceeded general rule continues to apply, German VAT	0·5	
		Option to register voluntarily and charge Malta VAT	1·0	
			6·0	5
	(c)	**VAT treatment of sales by 6G to MOBL**		
		Intra community sale, between taxable persons in different MS	1·0	
		MOBL liable to account for VAT – reverse charge mechanism	1·0	2
				20

			Available	*Maximum*
4	**(a)**	**Tax treatment of income derived in 2017**		
		Ordinarily resident and domiciled, worldwide basis of taxation	0·5	
		Optional 15% flat rate foreign employment, activity mainly/wholly outside Malta	1·0	
		Not applicable to services for the Government of Malta	0·5	
		Parent rates applicable	0·5	
		Alimony payments deductible	0·5	
		Child maintenance not deductible	0·5	
		Capital gains on transfer of shares listed on MSE – exempt	0·5	
		Capital transfers of bonds outside the scope of capital gains rules	0·5	
		But trading in shares and bonds due to short-term nature, so taxable	1·5	
		15% FWT deducted from interest on bonds, so not subject to further tax through return	1·0	
		Gain on sale of units in prescribed fund listed on MSE – exempt	0·5	
		Gain on sale of units in non-prescribed fund – taxable	0·5	
		Option for 15% FWT (better option) or progressive rates	1·0	
		Farland dividend taxable	0·5	
		Unilateral double tax relief available for WHT, as supported by evidence	1·0	
		Limited to lower of actual foreign tax paid and effective Malta tax on foreign income	1·0	
		Optional 15% final tax on gross rent no deductions	1·0	
		Optional 20% maintenance allowance and interest deduction taxed at progressive rates	1·0	
		Consideration of effect of opting for final tax on double tax relief	1·5	
			15·0	12
	(b)	**Calculation of tax due**		
		Two options compared and minimum overall tax identified	1·0	
		Items taxed/allowed at progressive rates under both options: salary, alimony payment, MSE trading, Farland dividend (4 x 0·5)	2·0	
		Exclude bond interest and CIS gains (FWT/exempt)	1·0	
		Rental income net of 20% maintenance allowance and interest included in non-final tax computation	1·0	
		Calculation of tax at progressive tax rates	0·5	
		Calculation of effective tax rate and limited double tax relief	1·0	
		Calculation of final tax on: rental income, bond interest and capital gain on sale of non-prescribed fund (3 x 0·5)	1·5	8
				20

			Available	*Maximum*
5	**(a)**	**VAT Advice on VFD's rental income**		
	(i)	Full right to input VAT on sale of foodstuff and full right to claim input VAT on capital costs	1·0	
		Art 12 lessee – lease exempt without credit supply	1·0	2
	(ii)	Application of capital goods scheme required when claiming input VAT on capital goods	1·0	
		20-year adjustment period	1·0	
		Commitment to lease exempt without credit for remaining adjustment period – full adjustment in year lease starts	1·0	
		8 years adjustment required	0·5	
		Calculation of adjustment in favour of the Commissioner	1·0	
			4·5	4
	(iii)	No longer able to claim input VAT on expenses directly related to the lease (exempt without credit supply)	1·0	
		Partial attribution required for general overheads/non-directly related costs	1·0	
		Partial attribution methodology:		
		– 100% as definitive ratio since 2016 sales grant full right to input VAT	1·0	
		– end of 2017 establish total sales, taxable sales and exempt without credit sales	1·0	
		– establish definitive ratio 2017	0·5	
		– compare definitive ratio with provisional ratio – adjustment in favour of Commissioner in 2018	1·0	
		– 2017 definitive ratio used as provisional ratio for 2018	0·5	
			6·0	5
	(iv)	General rule re supply of services	0·5	
		But lease is a continuous service	0·5	
		Last day of the period for which a statement is issued or a payment is made, up to the amount covered by the statement or payment	1·0	2
	(b)	**Place of supply of insurance services**		
	(i)	B2B EU general rule – customer	1·0	
		B2B Non-EU general rule – customer	1·0	
		B2C EU general rule – supplier	1·5	
		B2C Non-EU exception to the general rule – customer	1·5	5
	(ii)	General rule exempt without credit	1·0	
		Exception non-EU customers both B2B and B2C	1·0	
		Both directly related and partial attribution input VAT	0·5	
			2·5	2
				20