Strategic Professional – Options

Advanced Taxation – Malta (ATX – MLA)

Tuesday 3 December 2019

ATX MLA MIA EN

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

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 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

€	
0 to 5,900	0%
Remainder	15%

Others

€	
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 = $\dfrac{29{\cdot}75\%}{70{\cdot}25\%} = 42{\cdot}349\%$

Notional interest deduction (NID)

Y = A x 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 proceeding 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.

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Section A – BOTH questions are compulsory and MUST be attempted

1 Canned Fruit Ltd (CF), a company incorporated in Malta, is owned equally by two sisters, Sanja and Maja Maric. CF is managed and controlled from Malta, and both Sanja and Maja are neither resident nor domiciled in Malta.

On 1 June 2014, CF acquired a factory in Hal Far, Malta, for €400,000 and it has always used the factory for its tinned food manufacturing activity. During January 2017, at a cost of €100,000 (net of value added tax (VAT)), CF carried out a major refurbishment of the factory to expand its production capabilities. Since CF carries out taxable economic activity for Maltese VAT purposes, it claimed full credit for the 18% input VAT suffered. The company was also eligible for, and claimed, a 35% investment tax credit on the refurbishment improvements. Since its inception, and for the foreseeable future, CF qualifies as a small undertaking for the purposes of the Malta Enterprise legislation.

Due to the success and constant expansion in CF's business, the Hal Far factory is no longer keeping up with the company's production demand. Accordingly, Sanja and Maja have decided to move operations to a larger factory in Mriehel, Malta. The company will finance the new factory cost of €800,000 from the sale of the Hal Far factory to a third party, for €600,000, and from raising a shareholders' loan for the balance. The purchase of the Mriehel factory and the sale of the Hal Far factory are both planned to occur on 5 December 2019.

The value of the Hal Far factory represents at least 80% of the current value of the total assets held by CF, and so will the replacement factory in Mriehel.

Sanja and Maja have indicated that their longer term plans could include the following:

1. CF may sell the Mriehel factory at some point in the future, but there are currently no definite plans to do so, OR,
2. Alternatively, Sanja and Maja may sell all their shares in CF, at a time when the company still owns the Mriehel factory.

Required:

Draft a letter addressed to Sanja and Maja Maric, advising on the following points:

(a) The implications arising out of the Income Tax Act on the sale of the Hal Far factory by Canned Fruit Ltd (CF).

Note: You should identify any potential exemption or tax deferral possibilities, and include a calculation of the expected tax consequences arising from the proposed sale, taking into account any recommendations which you include in your advice. (7 marks)

(b) The value added tax (VAT) consequences arising on the sale of the Hal Far factory by CF, calculating any VAT adjustment which the sale may give rise to. (4 marks)

(c) Any income tax adjustment which would be required on the sale of the Hal Far factory due to the investment tax credit claimed in January 2017, including comments on any potential tax planning opportunities available to mitigate any negative tax consequences. (3 marks)

(d) The income tax consequences which would arise if CF were to sell the Mriehel factory under each of the following three mutually exclusive scenarios:

(i) In June 2020, for €1,000,000, without replacement;
(ii) In June 2022, for €1,200,000, without replacement;
(iii) In June 2024, for €1,800,000, and within six months acquire a smaller factory for €500,000.

Notes:
1. You are required to provide a high-level summary of the general rules, apply such rules to the three scenarios and calculate the expected income tax and/or property transfer tax due under each scenario.
2. For the purpose of your calculations, you should ignore any stamp duty on the cost of acquisition of the immovable property and assume the inflation index for the future years will be as follows:

2019	950
2020	1000
2021	1050
2022	1100
2023	1150
2024	1200

The following mark allocation is provided as guidance:

General comments	2 marks
Scenario (i)	3 marks
Scenario (ii)	4 marks
Scenario (iii)	4 marks

(13 marks)

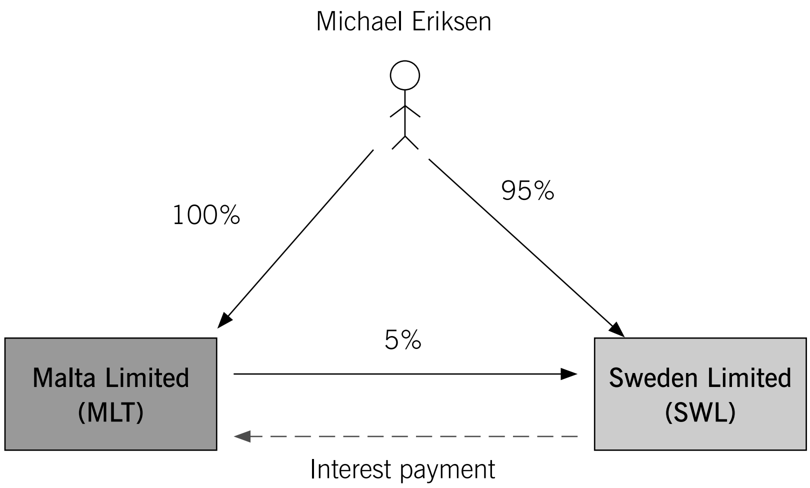
(e) Whether a sale of shares in CF by Sanja and Maja in June 2021 would qualify for any exemption from tax, and whether it would have any impact on any tax exemption and/or deferral opportunity previously identified.

Note: You are NOT required to provide any computations or comment on the tax treatment should there be no available exemptions. (4 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 Michael Eriksen, an individual resident and domiciled outside Malta, owns all the shares in Malta Limited (MLT) and 95% of the shares carrying voting rights in Sweden Limited (SWL). The remaining 5% shares in SWL are held by MLT. MLT is a company incorporated, managed and controlled in Malta. SWL is incorporated, managed and controlled in Sweden, European Union (EU).



MLT provides internet marketing services to businesses established outside Malta, it owns and uses an office in Malta for the purpose of its trading activity and does not have any permanent establishment outside Malta. During 2018, it suffered withholding tax on payments received from Thailand related to its marketing service, but was not provided with any documentary proof of the amount of withholding tax. There is no double tax treaty between Malta and Thailand.

SWL provides specialised consultancy services in the field of search engine optimisation. Sweden's domestic tax law imposes 30% withholding tax on the payment of dividends, but SWL has not paid any dividends for the last seven years and has accumulated reserves amounting to €20 million.

During 2018, Michael Eriksen granted a €2 million loan to MLT at an interest rate of 5%. This loan was hived down to SWL at the same interest rate. Sweden imposes a 10% withholding tax rate on all outgoing interest payments and this is in line with Article 11 of the double tax treaty which Sweden has with Malta.

Michael Eriksen has decided to restructure his shareholding in SWL in December 2019 such that SWL becomes a 100% subsidiary of MLT. This will be achieved by transferring his shares in SWL to MLT in exchange for a new issue of 20 million €1 shares in MLT, at par. Once the share-for-share exchange is concluded, SWL will distribute all its reserves by way of a dividend to MLT, at the end of December 2019.

Michael Eriksen is registered with the Commissioner of Inland Revenue to be eligible for refunds of tax on dividend distributions. He is seeking your assistance in order to assess the Maltese and foreign tax implications of the planned transactions. Your advice should be limited to those tax implications arising from the EU Interest and Royalties Directive, and the EU Parent-Subsidiary Directive, disregarding any provisions of foreign domestic law other than those already referred to.

Required:

Advise Michael Eriksen on:

(a) The Maltese income tax treatment (including double taxation relief considerations) of:

(i) The profits generated by Malta Limited (MLT) from the company's trading activities.
(ii) The dividend income to be received by MLT following the proposed restructuring.

Notes:

1. In both cases, comment on the Maltese tax treatment of any dividends which may be payable by MLT from these income sources to Michael Eriksen.
2. You are NOT required to comment on the Maltese income tax treatment of the interest income derived by MLT.
3. You are NOT required to comment on the notional interest deduction (NID) in this part. (10 marks)

(b) Whether, in terms of the EU Interest and Royalties Directive, Sweden is entitled to impose any withholding tax on the interest payment to MLT both before, and after, the restructuring.

Note: You are NOT required to comment on the Maltese income tax treatment of the interest income derived by MLT. (6 marks)

(c) Whether, in terms of the EU Parent-Subsidiary Directive, Sweden is entitled to impose any withholding tax on the dividend payable to MLT subsequent to the restructuring. (6 marks)

(d) Whether MLT will be able to claim a NID on the increase in share capital effected during the restructuring exercise. (3 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 **(a)** Mobili Srl (Mobili), a company set up and registered for value added tax (VAT) purposes in Italy, European Union (EU), is a furniture wholesaler and retailer.

During 2020, the company is considering supplying furniture occasionally to various clients in Malta as follows:

(1) Supply of office furniture with transport but WITHOUT installation to Accountancy Ltd, a company registered for VAT purposes in terms of Article 10 of the VAT Act.

(2) Supply of office furniture with transport and WITH installation to Architects Ltd, a company registered for VAT purposes in terms of Article 10 of the VAT Act.

(3) Supply of bedroom furniture with transport but WITHOUT installation to Chris and his fiancée, Martina, two individuals who reside in Malta.

(4) Supply of bedroom furniture with transport and WITH installation to Mark, an individual who resides in Malta.

If the supplies take place, Mobili is considering engaging a Maltese firm, Joiners Ltd, to carry out the assembly of the furniture in Malta. Joiners Ltd is registered for VAT purposes in Malta in terms of Article 10 of the VAT Act. Joiners Ltd also occasionally assembles furniture for Mobili's Maltese customers who have bought the furniture from Mobili without their assembly service.

You are informed that Mobili will NOT exceed Malta's distance sales threshold during 2020, or in any other year, and will not take the option to have its distance sales treated as taking place in Malta.

Required:

(i) For each of the four furniture supplies Mobili Srl (Mobili) is considering making to customers located in Malta, advise Mobili on:

- **the general rules for determining the place of supply of goods for VAT purposes and any relevant exceptions,**
- **whether any of the supplies would require Mobili to obtain a Maltese VAT registration, and**
- **whether there is a need to charge Maltese VAT on any of the supplies.**

Note: You are requested to treat each supply independently such that if a VAT registration is required under one of the options, this should not have any impact on your advice for the other scenarios. (11 marks)

(ii) Explain whether Maltese VAT should be charged by Joiners Ltd on its invoices for assembly services provided to Mobili, and directly to Mobili's customers based in Malta. (3 marks)

(b) Pretty & Cool Ltd (P&C) is a limited liability company set up in Malta in 2019 and is registered for VAT purposes in terms of Article 10 of the VAT Act. P&C provides digital marketing campaigns to both taxable and non-taxable persons established outside Malta for VAT purposes, both within the European Union (EU) and outside the EU. P&C is unsure of the place of supply of its services and whether Maltese VAT should be charged on its services. However, you are informed that due to the significant human intervention required from P&C, their supplies cannot be considered to be electronically supplied services for VAT purposes.

Required:

Advise Pretty & Cool Ltd (P&C) on the place of supply of their digital marketing services, and whether Maltese VAT should be charged on the supply of its services to both taxable and non-taxable persons established in the other EU Member States and outside the EU. (6 marks)

(20 marks)

4 Gianni Baggio (Gianni) is an individual who, until the end of the calendar year 2018, has always been an Italian, European Union (EU) tax resident. Gianni is single, divorced, aged 60 years old, has one daughter in her thirties, and his parents have always been resident and domiciled in Italy. Gianni has been employed by Banca del Lago di Garda (BLG) for the last 30 years and up to 2018 he was the company's chief financial officer (CFO). BLG is a company incorporated and tax resident in Italy which operates in the banking sector.

In December 2018, BLG set up a subsidiary in Malta (BLGM) to act as a credit institution and is licensed to carry out banking activities in Malta by the Malta Financial Services Authority. As Gianni had already planned to start his retirement in Malta on 1 January 2020, he requested a transfer to work as BLGM's CFO during his last year of employment from 1 January 2019. After spending a few years in Malta, Gianni later intends to move to Indonesia.

During 2019, Gianni will receive a salary of €120,000 for his employment in Malta, plus an additional fixed annual €10,000 rental income from a property situated in Italy on which Italy will impose 10% withholding tax. Gianni will have carried out all his employment activities from Malta and will have resided in Malta for more than 300 days in 2019. Subsequent to his retirement at the age of 60, Gianni will receive an annual pension of €50,000 from BLG from Italy, in addition to his rental income.

You are informed that the Italian tax authorities will NOT consider Gianni as an Italian tax resident after his departure from Italy. Malta and Italy are signatories of a tax treaty with substantive provisions in line with the provisions of the OECD Model Tax Convention. Gianni intends to remit any foreign source income he may derive to Malta.

Required:

(a) Advise Gianni Baggio (Gianni) on his tax status in Malta and Italy in 2019 and the countries' respective rights to tax him on his current sources of income and pension income in 2020. (5 marks)

(b) Advise Gianni on the options granted by Maltese tax law in respect of his employment with BLGM in 2019, pension income in 2020, and rental income in both years.

Note: You should explain any conditions he will be required to satisfy in order to benefit from any options you suggest and support your recommendation with calculations comparing the tax due in Malta under the various options. (15 marks)

(20 marks)

End of Question Paper