Strategic Professional – Options

Advanced Taxation – Malta (ATX – MLA)

Tuesday 8 December 2020

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.

Please note that you are not expected to make any reference to Covid 19 or the global economic crisis as a result of this pandemic in your exams. None of the temporary financial or legislative measures implemented as a result of Covid are examinable.

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 2019 (year of assessment 2020) are to be used in answering the questions.

Individual tax rates

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

$$\text{FRFTC Optimisation Formula} = \frac{29{\cdot}75\%}{70{\cdot}25\%} = 42{\cdot}349\%$$

Notional interest deduction (NID) calculation

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 preceding the year of assessment less any risk capital that is not employed by the undertaking in producing any income or is employed in producing income which is exempt from tax.

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

Annual market rent (tax accounting)

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

Value added tax (VAT)

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

VAT small undertaking (Article 11) thresholds

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

Car fringe benefit rates

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

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

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

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

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

Capital gains

Index of inflation

1988	439·62
1989	443·39
1990	456·61
1991	468·21
1992	475·89
1993	495·60
1994	516·06
1995	536·61
1996	549·95
1997	567·95
1998	580·61
1999	593·00
2000	607·07
2001	624·85
2002	638·54
2003	646·84
2004	664·88
2005	684·88
2006	703·88
2007	712·68
2008	743·05
2009	758·58
2010	770·07
2011	791·02
2012	810·16
2013	821·34
2014	823·89
2015	832·95
2016	838·29
2017	849·77
2018	859·63
2019	873·73

Applicability of increase for inflation

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

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

Investment aid regulations

Definition of a medium sized enterprise

An enterprise which is not a small enterprise and:

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

Definition of a small enterprise

An enterprise which:

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

Duty on documents and transfers

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

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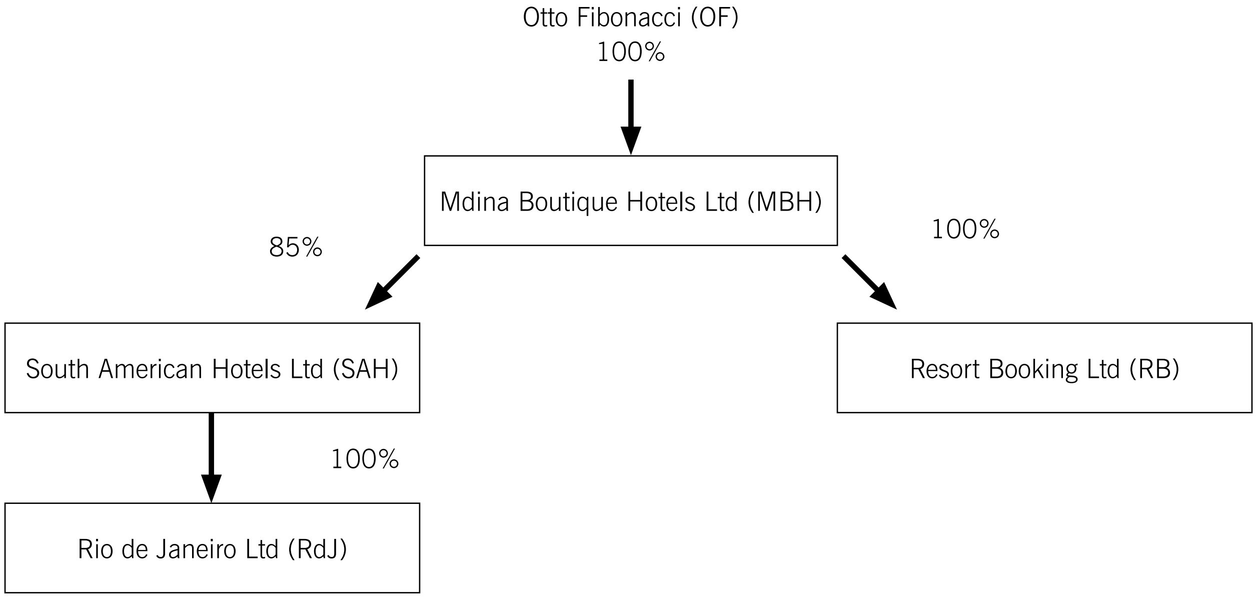
Question 1 begins on page 8.

Section A – BOTH questions are compulsory and MUST be attempted

1 Otto Fibonacci (OF), an individual who is neither resident nor domiciled in Malta, is a client of your firm and has asked for some advice about the new Controlled Foreign Company Rules, the Consolidated Group Rules and eligibility to tax refunds on dividend distributions. OF owns 100% of Mdina Boutique Hotels Ltd (MBH). MBH owns all the share capital and voting rights in Resort Booking Ltd (RB) and 85% of the share capital and voting rights in South American Hotels Ltd (SAH). MBH, RB and SAH are companies incorporated in Malta and effectively managed and controlled in Malta. SAH owns all the issued share capital (carrying equal voting rights) in Rio de Janeiro Ltd (RdJ), a company incorporated and tax resident in Brazil. MBH is registered with the Commissioner for Revenue in Malta for the purpose of Maltese tax refunds.



All of the companies have a 31 December year-end.

During 2019 the companies derived the following income:

– RdJ derived trading profits which were taxed at a 25% rate of tax in Brazil. RdJ employs 40 individuals in Brazil who are indispensable for its day-to-day operations. RdJ derives no passive income. In 2019, it distributed all its profits for the year by way of a dividend to SAH. The dividend was subject to 10% withholding tax.

– SAH's sole income consisted of its dividend from RdJ. This amounted to €140,000 net of Brazilian withholding tax. SAH distributed all its profits for the year to MBH.

– RB operates a hotel booking portal and is in the business of deriving commission income from hotel bookings. During the year, the company derived taxable income of €1 million from such commissions, which related exclusively to bookings in hotels outside of Malta. RB's income is not connected to any permanent establishment situated outside of Malta. It distributed all its profits for the year by way of a dividend to MBH.

– MBH received as a dividend all of the profits derived by SAH and RB during 2019. In addition, MBH derived taxable income of €2 million from estate agency fees and commissions on the rental and transfer of immovable property situated in Malta.

– MBH paid a gross dividend of €2 million, comprising its taxable income in respect of its estate agency fees and commission on the rental and transfer of immovable property situated in Malta to its shareholder, OF.

Required:

Prepare a set of short notes for your tax manager's meeting with Otto Fibonacci (OF) which covers the following issues:

(a) An analysis of the impact of the Controlled Foreign Company (CFC) Rules (introduced into Maltese law by the European Union Anti Tax Avoidance Directive (ATAD) implementing regulations) on the chargeable income derived by South American Hotels Ltd (SAH) during 2019 with respect to Rio de Janeiro Limited (RdJ). Your analysis should refer to the tax rate paid by RdJ, RdJ's activities conducted in Brazil, and RdJ's dividend policy.

Note: For the purposes of this part of the question, you should assume that the CFC anti-abuse provisions are applicable with effect from 1 January 2019. (8 marks)

(b) In relation to the Consolidated Group Rules:

(i) Advice as to whether Mdina Boutique Hotels Ltd (MBH) will be able to create a fiscal unit with SAH and/or Resort Booking Ltd (RB). (4 marks)

(ii) A brief explanation of the tax implications arising upon the creation of the fiscal unit with specific respect to:

- **transactions between companies forming part of the fiscal unit;**
- **how the fiscal unit's chargeable income is computed; and**
- **any tax balances belonging to a subsidiary before joining the fiscal unit.** (5 marks)

(c) Assuming that the relevant companies will opt to form a fiscal unit so far as this is possible under the relevant tax rules, a description of the expected Maltese tax treatment of the income derived by SAH, MBH, RB and OF, and their eligibility for tax refunds. Your analysis should include a calculation of the expected tax to be paid for the year ended 31 December 2019 by any fiscal unit you recommend, including a clear allocation of the income to the relevant tax accounts.

The following mark allocation is provided as guidance for this requirement:

Analysis of the expected Maltese tax treatment	10 marks
Calculation of the tax due	4 marks

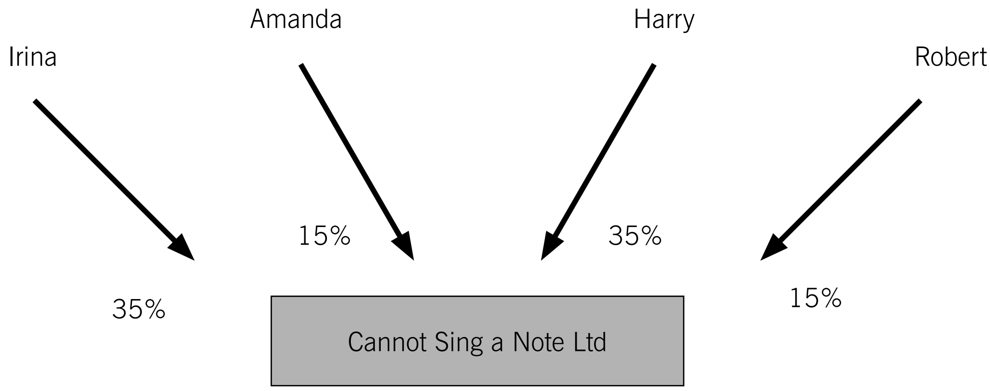
(14 marks)

Professional marks will be awarded for the format and presentation of the notes (including the supporting calculations) and the effective communication of the information. (4 marks)

(35 marks)

2 Irina, Amanda, Harry and Robert are four unrelated individuals who are resident and domiciled in Malta. All of the shareholders are subject to tax at the marginal tax rate of 35%.

During March 2015, the four individuals set up Cannot Sing a Note Ltd (CSNL) in Malta, and subscribed for the share capital in the company, for €1 per share, as follows:



Irina	35,000 shares
Amanda	15,000 shares
Harry	35,000 shares
Robert	15,000 shares

All the shares in the company carry the same voting rights and rights to profits. In terms of CSNL's Articles of Association only shareholders holding 33% or more of the share capital can appoint a new director.

In April 2015, CSNL acquired a studio in St. Julians, Malta, for €400,000. The studio has been used by the company to provide vocal training and its acquisition was financed through a shareholders' loan which is still unpaid. CSNL does not own any other non-current assets apart from this studio which has a market value of €700,000 as determined through a recent architect's valuation. CSNL is in a net current liability position.

Due to disagreements with respect to the future strategy that the company should take, the shareholders have decided that Amanda and Robert will leave the company and the four shareholders are considering two mutually exclusive options (Option A and Option B) to achieve the exit of Amanda and Robert. Whether Option A or Option B is pursued, Robert and Amanda wish to leave the company on 20 December 2020.

Option A

Amanda and Robert will each transfer their 15% shareholding to Irina and Harry, respectively, for a price of €5 per share, thereby increasing Irina's and Harry's shareholding in CSNL to 50% each; **or**

Option B

Step 1: Irina and Harry will set up a new company (Newco) which will be owned 50% by each of them.
Step 2: CSNL will transfer to Newco the studio for €600,000 and CSNL's business and goodwill for €150,000.
Step 3: CSNL will then be liquidated and all reserves distributed. This distribution will take place prior to the exit and the reserves to be distributed will result only from the transactions required for Robert and Amanda's exit (i.e. Steps 1 and 2, above).

Required:

(a) Advise Cannot Sing a Note Ltd's shareholders of the income tax, property transfer tax (where applicable) and duty on documents implications of Option A and Steps 1 and 2 of Option B being contemplated for Robert's and Amanda's exit from the company. (20 marks)

(b) Indicate the expected income tax due by Robert and Amanda under Option A and the timelines for the payment of such tax.

Note: You are NOT required to calculate the duty on documents due on the transfer. (2 marks)

(c) Indicate the tax consequences of any distribution of profits arising from Robert's and Amanda's exit under Step 3 of Option B, including a calculation of any tax due. (3 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 Freya Abela (FA), an individual who is tax resident in Malta, was employed as a financial controller with a large company. FA is not currently registered for value added tax (VAT).

FA intends to start a new business venture in the property development industry sector in Malta. During a recent meeting at your offices, FA expressed her intention to acquire a terraced house in Msida, Malta, demolish it and build on the plot of land an office plus three residential apartments. The property will be acquired and developed in her own name. FA has resigned from her position of employment to focus on this new venture which will be her only economic activity.

FA is confident that the construction and finishing costs involved in developing the three apartments and office will be capable of being directly and separately allocated to each unit being developed.

FA's current intention is to utilise the apartments as follows. However, she has indicated that her plans may change in the future depending on the performance of the local rental market:

a) Sell one apartment (Apartment 1) for €400,000;

b) Rent out another apartment (Apartment 2) to tourists visiting Malta for short stays, of not more than two weeks. This activity is expected to generate a turnover of €32,000 per annum; and

c) Retain the last apartment (the penthouse) to be her main and sole residence in Malta.

FA intends to rent the office to either a real estate agency registered for VAT purposes under Article 10 of the VAT Act, or to a financial institution registered for VAT purposes under Article 12 of the VAT Act.

FA has also indicated that in the long term (after she has lived in the apartment for a minimum of ten years) she may consider selling the penthouse.

Required:

Advise Freya Abela (FA) on:

(a) The value added tax (VAT) treatment of the sale of Apartment 1, the lease of the office (indicating the difference in VAT treatment, if any, depending on the party to whom the office is leased) and the rental of Apartment 2. (4 marks)

(b) Her obligation to register for VAT in Malta. (2 marks)

(c) Assuming that she registers for VAT in Malta, her right to claim a credit for input VAT on:

(i) the construction and finishing costs of each of the three apartments and the office; and

(ii) the general overheads of the building project that are not directly related to any of the apartments or the office being developed.

Note: Your answer should specifically consider any VAT implications if FA's use of the relevant buildings changes during her period of ownership. (11 marks)

(d) Advise FA of the income tax implications if she decides to sell her penthouse after ten years. (3 marks)

(20 marks)

4 Paolo Speranza (PS), a 30 year-old individual, was born and domiciled in Nearland and until 2020 had always resided there. During 2018, PS acquired his own apartment in Nearland and moved out of his parents' home so that he could live closer to the university where he is a genetics professor. PS also owns 14% of the issued share capital in GEN, a company set up in Farland, located outside of the European Union (EU), which carries out genetics research. PS acquired his shareholding in GEN during 2016 for €250,000.

During September 2020, PS travelled to Malta for a four day trip to lecture at the University of Malta. During his Malta stay he met Maria Sultana (MS) and ever since, has spent five days a week in Nearland and the weekend in Malta with MS. Whenever he is in Malta, PS stays at MS' apartment in Sliema, Malta.

As a result of meeting MS in September 2020, PS intends to move to Malta in January 2021 when he will commence lecturing at the University of Malta under a contract of employment. PS will still lecture for one day a week in Nearland (and his salary will be remitted to a Maltese bank account) and will retain his apartment there for this reason. Sometime during 2021, PS plans to sell his shares in GEN for an estimated value of €800,000 and intends to transfer the funds to Malta. Notwithstanding the above, PS is not excluding the possibility of eventually retiring in Nearland.

PS informs you that his estimated income for 2020 and 2021 is as follows:

	2020 (€)	2021 (€)
Salary from university in Nearland	80,000	20,000
Malta lecturing services (not in employment)	1,000	
Salary from University of Malta		45,000
Gain from sale of shares in GEN		800,000

You are informed that Malta and Nearland are signatories to a double tax treaty which is based in all material aspects on the OECD Model Tax Convention and that Nearland will consider PS to be tax resident there during both 2020 and 2021. The Nearland tax authorities will impose a 15% tax on the Nearland source employment income, irrespective of PS' residence status. Both Malta and Nearland are member states of the EU.

PS and MS plan to get married on 1 February 2022. The couple plan to start a family and to have their first child in 2023. MS is deemed to be resident and domiciled in Malta and derives Malta source employment income in addition to dividends from an overseas company which are kept in a overseas bank account and never remitted to Malta. Following the birth of their first child, MS hopes to return to work for the same employer. Neither PS nor MS have any other children and PS will be appointed as the responsible spouse for tax purposes.

Required:

(a) Advise Paolo Speranza (PS) on his liability to income tax in Malta for 2020 and 2021 (years of assessment 2021 and 2022), in terms of both Maltese tax legislation and the double tax treaty between Malta and Nearland. Your answer should indicate the tax due by PS for both years and comment on Nearland's right to tax the employment income from the university in Nearland in both years. (16 marks)

(b) Other than the joint computation basis, explain the impact the marriage will have on the couple's Maltese taxation basis. (2 marks)

(c) Advise the couple on any applicable fiscal incentives that are available should Maria return to employment in March 2024 after the birth of her first child. (2 marks)

(20 marks)

End of Question Paper