Strategic Professional – Options

Advanced Taxation – Malta (ATX – MLA)

Tuesday 2 June 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.

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)

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
2019	900 (assumed)

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.

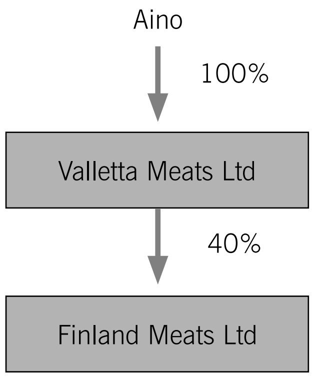
Duty on documents and transfers

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

This is a blank page.
Question 1 begins on page 8.

Section A – BOTH questions are compulsory and MUST be attempted

1 Aino Pennanen (Aino) is resident and domiciled in Finland. She owns all the shares and voting rights in Valletta Meats Limited (VML), which is incorporated, managed and controlled in Malta. VML owns 40% of the ordinary shares in Finland Meats Limited (FML), which is a company incorporated, managed and controlled in Finland. All ordinary shares in FML have equal voting and profit participation rights. FML is not considered to be a controlled foreign company (CFC) in relation to VML in terms of Malta's tax law. Finland is a member state of the European Union (EU). Aino is registered with the Commissioner for Revenue in Malta for the purpose of Maltese tax refunds.



VML is in the business of importing and distributing meat products within Southern Europe. It does not have any permanent establishment in any country outside Malta. VML owns three warehouses in Malta which provide it with 8,000m^2 of refrigerated storage space for meat products. FML carries on a similar business in Finland and during 2020 is expected to pay a dividend of €10 million to VML, and this is included in VML's forecast statement of profit or loss for the year ending 31 December 2020, as shown below:

	Notes	€millions	€millions
Turnover			500
Cost of sales			(200)
Gross profit			300
Finance income	1	2	
Finance costs	2	(75)	
Net finance cost			(73)
Dividend income from FML			10
Administration expenses	3		(134)
Net profit for the year			103

Notes:

1. Finance income is interest payable by FML to VML. This is not subjected to any withholding tax in Finland under the terms of the Interest and Royalties Directive.
2. Finance costs include a €12 million interest payment on a loan taken out during 2015. All other finance costs relate to loans taken out during 2019. All finance costs incurred by VML relate exclusively to VML's trading operations.
3. Administration expenses include the following expenses:

	€millions
Unrealised exchange losses	26
Depreciation and amortisation (Note 4)	20

   All VML's administrative expenses are related exclusively to trading operations and none are related to the generation of the interest and dividend income.
4. The tax adjusted depreciation and amortisation for the year amount to €15 million.
5. VML will distribute all the profits for the 2020 financial year to Aino.
6. VML intends to claim the participation exemption if the prescribed conditions are satisfied.

7. VML is not required to, and does not, prepare group consolidated financial statements.

Required:

Draft a letter addressed to Aino Pennanen in which you:

(a) Explain the Maltese tax treatment of the different types of income derived by Valletta Meats Limited (VML) including:

- **trading income and interest received from Finland Meats Limited (FML);**
- **the conditions which must be met for the participation exemption to be available for the dividend income from FML;**
- **how income should be allocated to tax accounts; and**
- **the implications of these allocations for any refunds which may be available to Aino if profits are fully distributed as dividends to her.** (9 marks)

(b) Explain how the interest limitation rule introduced by the implementation of the Anti-Tax Avoidance Directive (ATAD) will affect VML's forecast chargeable income for the year of assessment 2021, including any potential exemptions from the interest limitation rule, which may be available.

Note: Assume all tax rules in force for year of assessment 2020 will continue to apply for future years. (9 marks)

(c) Calculate the expected adjustment to the chargeable income of VML as a result of the interest limitation rule. You are required to show your workings to the nearest million. (4 marks)

(d) Calculate the expected chargeable income, tax charges and tax account allocations for VML for the year of assessment 2021. You are required to show all tax allocations to the nearest million euros, except for the foreign income account allocation which is to be shown to the nearest thousand euros. (7 marks)

(e) Calculate the tax refunds which Aino should expect to receive in respect of dividends which VML may pay out of its Maltese taxed account. You are not required to calculate the tax refunds available upon a distribution from any other tax accounts. You are required to show your workings to the nearest million euros. (2 marks)

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

Note: You are not required to consider the provisions of the consolidated group rules or the notional interest deduction rules.

(35 marks)

2 (a) Peter Borg (Peter) is an individual who is resident and domiciled in Malta. Peter married Cherise in 2017 but the couple have lived separately since January 2018 and they are going through proceedings for a personal separation. The deed of separation is expected to be published in 2020.

Peter owns a number of immovable properties situated both in Malta and abroad. Peter plans to spend his retirement years in California, USA and he would like to acquire a mansion there. Now that he is approaching his retirement age, Peter would like to establish the Maltese tax treatment if he decides to dispose of the following properties in the second half of 2020:

(1) A house in Marsascala which he acquired for €120,000 during 2001 and rented out since then. Peter expects the house will fetch €1,200,000 if sold in 2020.

(2) A villa in Madliena which he inherited from his mother in 2004. It was valued by an architect at €200,000 in the declaration *causa mortis* at that time. Duty on documents paid on the transfer *causa mortis* amounted to €10,000. The villa is vacant and is expected to fetch €2,000,000 on disposal.

(3) Four remaining apartments in 'The Valley' project which are currently rented to tenants. 'The Valley' is a large project situated in St Julians which has a special designated area status. It is fully owned by Peter and he originally acquired it as a large plot of undeveloped land in 2007. The first five housing units were sold in 2014. Peter elected at that time to have the development treated as a project for income tax purposes and thus opted out of the final tax system. Peter now expects to realise a total of €1,600,000 from the sale of the four apartments in November 2020, and he mentioned that these properties had cost €500,000 to build.

(4) His personal residence in Manikata. The property was purchased during mid 2016 for €1,000,000. The house has a large garden adjacent to it, which is typical of houses in the area. Within a month of the acquisition of this property, Peter acquired two adjacent plots of land (one on each side of the house) to ensure that the house remained well separated from his neighbours. Both plots have been used to park his sailing boats and remain undeveloped. Peter has a potential buyer in mind, and he anticipates that both side plots will be sold with the house during January 2021, all to the same buyer. By this date, Peter will have lived in this house for four and a half years and he expects to vacate the house just before its disposal. The expected receipts from the sale amount to €2,000,000 for the house and garden, and €700,000 in total for the two side plots.

(5) A farmhouse in Sicily, which he acquired in 2010 for €50,000 and which he expects to sell for €120,000 in July 2020. Peter has been informed that the transfer would not create any liability to taxes in Italy.

(6) A shop in Sliema, which Peter has owned for more than 20 years. The shop forms part of the assets of a business which he operates as a sole trader. Peter plans to set up a new company, to be fully owned by him, and he wants to transfer the business as a going concern, including the shop, to the company in exchange for shares. The market value of the property amounts to €800,000, plus a further €200,000 for the value of the business goodwill and the company will issue 1,000,000 shares of €1 each to Peter upon incorporation. Peter intends to appoint his son as the day-to-day administrator and sole director of the company when he moves to California.

(7) A bungalow in Bugibba, which he purchased jointly with his wife Cherise in January 2017 just after their marriage, for €200,000. As part of the separation process, Peter will transfer his 50% share in this property to Cherise through a public deed of separation to be concluded by the end of June 2020. For these purposes, the half-share to be transferred to Cherise is agreed to be valued at €175,000.

You should assume:

– All the immovable properties which Peter plans to transfer or sell, apart from the Sicilian farmhouse, are situated in Malta.

– Any further income derived by Peter in 2020 will be taxed at 35%.

– The inflation index will be 900 for calendar year 2019 and will increase by 50 points each year thereafter. Any property transfers will happen in 2020, unless otherwise indicated, and you should assume that all tax rates in force in 2020 will continue to apply in the future where relevant.

Required:

Advise Peter Borg of the relevant Maltese tax treatment under the Income Tax Act for each of the seven potential property disposals, calculating the tax due on each transfer.

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

The default property transfer tax:	1 mark
Marsascala property:	2 marks
Madliena property:	2 marks
The Valley property:	2 marks
Manikata property:	5 marks
Sicily property:	4 marks
Sliema property:	3 marks
Bugibba property:	1 mark

(20 marks)

(b) Maria Attard, an individual who is resident and domiciled in Malta, divorced from her ex-husband during 2019. During the court proceedings, Maria was awarded the half-share of a bungalow in Swieqi from her ex-husband and which formed part of the community of acquests, so she now owns the bungalow in her sole name. This is where she has been living since January 2018. She has declared this property as her sole ordinary residence in Malta. Maria's ex-husband never resided with her in the bungalow. Maria is planning to sell the bungalow by December 2021 for €400,000. Maria also owns an apartment in Ta' Xbiex (used as a summer residence) since 2010 and she plans to move there after she sells the Swieqi bungalow.

Required:

Advise Maria Attard of the tax issues raised by her plans to sell the bungalow in Swieqi by December 2021, indicating any tax which will be payable on the transfer. (5 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 (a) Mint Sundae (Mint) is a renowned Canadian tax resident singer who will be on tour in Europe during the summer of 2020. During this tour, Mint will be spending five days in Malta and she will give a concert in Mdina. All aspects of this concert are being arranged by Boom Productions Ltd (Boom), and Boom will receive the proceeds of all ticket sales. Boom will pay Mint a fee for her services. Boom is tax resident in Malta and the company is registered for value added tax (VAT) under Article 10 of the VAT Act.

Mint has no previous connection of any kind to Malta and she is neither tax resident, domiciled nor VAT registered in Malta.

Malta and Canada are signatories to a double tax treaty whose substantive provisions are identical to the OECD Model Tax Convention.

Required:

(i) Advise Mint Sundae on the Maltese income tax treatment of her performance fee, and explain how she may be affected by the Malta–Canada double tax treaty. (4 marks)

(ii) Explain the VAT treatment of the performance fee for the supply of Mint Sundae's services to Boom Productions Ltd, including whether she needs to apply to be registered for VAT in Malta. (3 marks)

(iii) During her stay in Malta, Mint is planning to organise a second concert. Boom Productions Ltd will not be involved with this event. Mint will sell the tickets directly to her fans for this event, and will pay all costs associated with the venue setup and organisation. As well as selling tickets to the general public, the attendees will include a group of 50 individuals resident in Italy (EU). They are employees of a company which is registered in Italy for Italian VAT purposes. Admission tickets for the employees will be sold to the Italian company, which will then give the tickets to the employees by way of a performance bonus.

Required:

Advise Mint Sundae on the value added tax (VAT) implications of her second concert in Malta.
(4 marks)

(b) Ricasoli Development Limited (RDL) is a company which is domiciled and resident in Malta. RDL will be constructing a 30-floor tower block of flats in the south of Malta and has engaged an Italian (EU) company, Construct Spa (CS), to assist in the two-year project. The Italian company has registered a branch in Malta and will charge RDL a substantial fee for the immovable property construction services to be rendered. The branch is recognised as a Maltese permanent establishment by both Malta and Italy in terms of the tax treaty between Malta and Italy.

Required:

(i) Advise Ricasoli Development Limited (RDL) of its income tax compliance obligations with respect to the payments made to the Italian company, and explain the penalties imposed in the event of non-compliance. (5 marks)

(ii) Both CS and RDL are VAT registered in Malta under Article 10 of the VAT Act. CS will charge 18% Maltese VAT on all its supplies. The directors of RDL are considering two mutually exclusive alternative approaches. RDL will EITHER sell all the flats in the tower; OR it will obtain a Malta Tourism Authority licence for the whole block and instead rent out ALL of the flats to tourists for short-term lets (not more than 30 days).

Required:

Advise RDL on its right to claim input VAT on the construction costs charged to it by CS under the two mutually exclusive options. (4 marks)

(20 marks)

4 **(a)** Black Eyed Peas Ltd (BEP) is a 100% subsidiary of Chickpeas Limited. Chickpeas Limited also holds 100% of the share capital in Lentils Limited (LL). All companies in the Chickpeas Group are incorporated and tax resident in Malta and owned or beneficially owned by individuals who are resident and domiciled in Malta. The group directors have decided that on 30 June 2020, BEP will transfer all of its assets, as listed below, to LL.

LL will continue running the business acquired from BEP as a going concern. The consideration due in respect of the transfer will be as follows:

Business	€2,000,000
Trade name	€4,000,000
Intellectual property	€3,000,000

BEP has never claimed any tax depreciation or amortisation on any of the above-mentioned assets. All the intangible assets were developed in Malta, and are situated in Malta. The business actives of all the companies in the Chickpeas Group consist of the development of genetically modified crops. All companies in the Chickpeas Group are registered for VAT in Malta under Article 10 of the VAT Act.

Required:

Explain the value added tax, income tax and duty on documents implications of the proposed transfer of assets from Black Eye Peas Ltd to Lentils Limited. You are required to ignore the provisions of the Consolidated Group Rules. (9 marks)

(b) John is a divorced individual who was born in Ireland (EU). For the last five years he has been residing in Malta, in a rented villa in Swieqi. Before moving to Malta, John had always resided in Ireland. He does not exclude that one day he may move back to Ireland. He has asked for advice about the following four items which he received or paid during 2019:

(1) Income of €20,000, received in his Irish bank account, which derives from consultancy services he has provided to clients in the EU. These services are not attributable to any permanent establishment outside Malta and are provided from John's home in Swieqi.

(2) A dividend of €1,800, net of 10% Irish withholding tax, received from an Irish company which was credited to his bank account in Malta.

(3) €450,000 (net of 10% Irish withholding tax) from the sale of an apartment in Dublin, Ireland which he had bought in 2010 for €200,000. The proceeds were credited to his Maltese bank account.

(4) John paid €4,000 in alimony payments to his ex-wife. John does not have any children.

John did not derive any other income in 2019 other than that listed above.

Required:

(i) Advise John of his liability to tax in Malta in general and on the Maltese tax treatment of the four transactions above. (6 marks)

(ii) Calculate John's tax liability for year of assessment 2020. (5 marks)

(20 marks)

End of Question Paper