Professional Level – Options Module

Advanced Taxation (Malta)

Friday 6 December 2013

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–5

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

Paper P6 (MLA)

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 Euro
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 2013 are to be used in answering the questions.

Individual income tax rates

Resident individual tax rates

Married couples – joint computation €		Other individuals €	
0 – 11,900	0%	0 – 8,500	0%
Next 9,300	15%	Next 6,000	15%
Next 7,500	25%	Next 5,000	25%
Remainder	35%	Remainder	35%

Parent rates

€	
0 – 9,300	0%
Next 6,500	15%
Next 5,400	25%
Remainder	35%

Non-resident individuals

€	
0 – 700	0%
Next 2,400	20%
Next 4,700	30%
Remainder	35%

Returned migrants

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

Capital allowances – Income Tax Act rates

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

Capital allowances – Business Promotion Act rates

Investment allowances

Industrial buildings and structures	20%
Plant and machinery	50%

Corporate income tax

Standard rate	35%

Value added tax (VAT)

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

Car fringe benefit calculation and 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

Applicability of increase for inflation

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

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

Transfer of value

Y = (A – B) + C – D

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

Cost of acquisition of shares in the transfer of value

$Z = ((A - B)/A) \times E$

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

Business Promotion Act Incentives

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 €40 million or total assets not exceeding €27 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 not exceeding €7 million or total assets not exceeding €5 million; and
– is to be treated as being independent.

Stamp duty

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

Annual market rent (tax accounting)

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

Section A – BOTH questions are compulsory and MUST be attempted

1 (a) Alfa Ltd, a company incorporated in Malta, was set up in 1995 as a consultancy firm with an issued share capital of 100,000 shares of €1 each. Each share has equal voting and profit participating rights.

The shares in the company are held as follows:

– A holds 60%
– B holds 25%
– C holds 10%
– D holds 5%

The four shareholders all acquired their shares at par on the incorporation of Alfa Ltd, are resident in Malta and are not related to one another.

In 1998 Alfa Ltd acquired a large office block in Tas-Sliema for €500,000. The office block was recently valued by an architect as having a market value of €1,000,000.

The company's profits before tax over the last five years were as follows:

2008	€750,000
2009	€800,000
2010	€950,000
2011	€800,000
2012	€1,200,000

The financial statements of Alfa Ltd as at 31 December 2012 record the net asset value of the company as €2,150,000.

C has recently informed the other shareholders that she wishes to sell them her shares in the company. A, B and D believe this is the perfect time to rebrand and restructure the shareholding of the company. The shareholding of A is also to be reduced.

The plan is for the amended shareholding to be as follows:

– A to hold 50%
– B to hold 35%
– D to hold 15%

The shareholders are considering two options for effecting this reorganisation:

Option A: A to transfer one-sixth of his shareholding (that is, 10% of the total share capital) to B, and C to transfer her 10% shareholding to D. The consideration payable has been agreed at €300,000 for each of these two transfers.

Option B: A new company, Beta Ltd, to be incorporated in Malta by A, B and D holding 50%, 35% and 15% of the shares respectively (all the shares having equal rights). Alfa Ltd to transfer all its business, as well as the office block, to Beta Ltd and following the transfer of the business and office block, Alfa Ltd to be placed in liquidation.

The reorganisation is to take place by the end of the year 2013.

Required:

Draft a letter to Alfa Ltd explaining the income tax, duty on documents and transfers and value added tax (VAT) implications of Option A and Option B. Support your explanations with calculations of the income tax, stamp duty and VAT payable, if any, and advise Alfa Ltd on which option is the better alternative from a tax perspective. (24 marks)

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

(b) Mr Zammit, a widower, lives in a house in Lija which he shares with his only daughter, Jacqueline, who is 25 years old. Mr Zammit acquired the house 12 years ago, and has since been living in the house with his daughter as their own residence for the last 12 years. The house was acquired in a dilapidated state for €400,000 and a further €150,000 has been spent converting the property to its current state. Due to the parking problems in his area, Mr Zammit also acquired a 60 square metre garage which is 50 metres away from the house for a further €30,000. Mr Zammit is the sole owner of the house and the garage.

The house has been valued at €1,200,000 and the garage at a further €50,000.

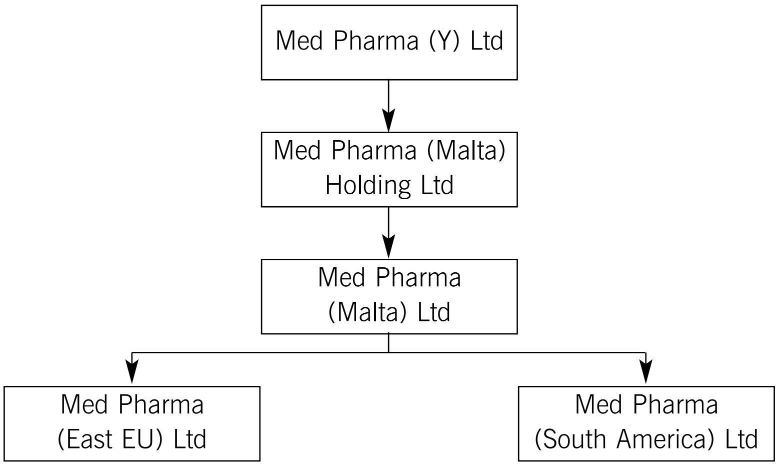
Required:

(i) Examine the income tax implications and calculate the tax payable if Mr Zammit transfers the house and the garage to a third party; (4 marks)

(ii) Comment upon the stamp duty implications and calculate the duty arising if the house and the garage are inherited by Jacqueline upon her father's death, assuming that the value of the property remains the same and that she will still be residing in the house at the time of the inheritance. (3 marks)

(35 marks)

2



Med Pharma (Malta) Ltd, a company incorporated in Malta, is the 100% subsidiary of Med Pharma (Malta) Holding Ltd, a company also incorporated in Malta. Med Pharma (Malta) Holding Ltd is fully owned by Med Pharma (Y) Ltd, a company incorporated in Country Y, which is fully owned by individuals who are neither resident nor domiciled in Malta.

A double taxation agreement, based on the OECD Model Convention, is in force between Malta and Country Y. The double taxation agreement provides that where a resident of Country Y holds shares in a company incorporated in Malta which qualifies for tax incentives in Malta, the tax chargeable in Malta on the dividends paid by that company to the Country Y shareholders shall not exceed 15%.

Med Pharma (Malta) Ltd has a manufacturing and research and development plant in Malta. The company develops generic medicines and sells them to related companies in the Mediterranean and Sub Saharan region. In 2012, it derived profits of €2,000,000 from the manufacture and sale of generic medicines.

Med Pharma (Malta) Ltd owns all the intellectual property developed in Malta, and receives royalties from its patents from other group companies. In 2012, it derived royalties of €500,000 from these patents.

Med Pharma (Malta) Ltd is also the 100% holding company of two other manufacturing companies which also develop generic medicines, Med Pharma (East EU) Ltd, a company incorporated in another European Union (EU) country, and Med Pharma (South America) Ltd, a company incorporated in South America. In 2012, Med Pharma (Malta) Ltd derived dividends from these subsidiaries of €1,250,000 and €785,000 respectively.

Med Pharma (Malta) Ltd qualifies for investment tax credits as a medium sized enterprise under the Investment Aid Regulations, and in 2012 it made a qualifying investment of €450,000. The company rents a factory and offices of 1,000 square metres from third parties.

All the profits generated by Med Pharma (Malta) Ltd in 2012 were distributed to Med Pharma (Malta) Holding Ltd.

Required:

(a) Advise Med Pharma (Malta) Ltd:

(i) on the Maltese income tax treatment of its income, identifying any tax benefits which are relevant to it in the light of the circumstances described above, and setting out the conditions to be satisfied to qualify for those benefits, and

(ii) on the tax implications for Med Pharma (Malta) Holding Ltd arising from the distribution of profits by Med Pharma (Malta) Ltd.

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

(i) 17 marks
(ii) 5 marks

(22 marks)

(b) Prepare tax computations for Med Pharma (Malta) Ltd assuming that it qualifies for all tax benefits identified in your answer to part (a) of this question, and determine the tax refund available to Med Pharma (Malta) Holding Ltd, if any. (3 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 Mr Fribau, who is a national of a European Union (EU) member state, has been employed in London as a qualified professional in the fund management industry for the last five years. He has now been offered the post of CEO with a fund management company, which holds an investment services licence issued under the Investment Services Act [Article 6]. His contract of employment in his new post, which is still being drafted, will be governed by Maltese law. Mr Fribau will be posted to Malta and his emoluments, including the value of any fringe benefits, will be in the region of €120,000 per annum. His salary is to be deposited in a Maltese bank account from which he will derive interest income.

Mr Fribau is a divorced person. He will be moving to Malta to take up his new employment, together with his two children who are aged four and five years. He has never resided in Malta before. Mr Fribau has made arrangements for his children to be enrolled in a Maltese school and he intends to stay in Malta for at least 12 years in order to avoid disrupting his children's education. He does not intend to acquire Maltese domicile.

Mr Fribau holds a number of directorships in companies which are unrelated to his new employer and which are incorporated, managed and controlled outside Malta. He earns €85,000 per annum in director's fees from these offices.

Mr Fribau has provided the following breakdown of his expected expenses in Malta:

– He will rent a villa for which he will be paying €2,500 a month.
– His children will be enrolled at a local international school, where the fees are €7,000 per child per annum.
– He will retain his medical insurance policy, for which he pays €1,500 per annum.
– He will lease a car for €500 per month.
– He plans to have regular holidays abroad with his children.
– He will continue to pay alimony of €25,000 a year to his ex-wife. The alimony payments were determined in the divorce decision delivered by a French court.

Mr Fribau is enquiring about any tax benefits which may be available to him in Malta once he takes up his new employment, as he wishes to ensure that the emoluments received under his employment contract are structured in the most tax efficient manner.

Required:

Advise Mr Fribau on the benefits available under:

(a) the Highly Qualified Persons Rules, and
(b) the Income Tax Act (Article 6) relating to Investment Services Expatriates,

explaining the conditions which he would be required to satisfy to qualify for the benefits under these two rules. Your advice should identify the extent, if at all, to which the benefits you have identified could depend on the manner in which the emoluments in his employment contract are structured.

Note: The total marks will be split equally between each part.

(20 marks)

4 **(a)** Mrs Camilleri, a non-taxable person resident in Malta, acquired a car in November 2013 for €30,000 from Auto Dealers UK, a second hand car dealer registered for value added tax (VAT) purposes in the United Kingdom. Mrs Camilleri was introduced to Auto Dealers UK by a friend, who is also a non-taxable person resident in Malta and who had bought a used car from Auto Dealers UK for €28,000 in September 2013. In both cases, the cars had a mileage of just under 20,000 kilometres and had been on the road for 12 months in the UK. Both cars were shipped by Auto Dealers UK direct to the purchaser in Malta.

Required:

State, giving reasons, where the sale to Mrs Camilleri is deemed to take place for value added tax (VAT) purposes and where any VAT will be paid.

Note: You are to assume that Auto Dealers UK has not applied the margin scheme for second hand goods to its sales. (6 marks)

(b) HTI Finland Ltd, a company registered in Finland for value added tax (VAT) purposes, is the trading company of HTI Global, a group of companies engaged in the manufacture, distribution and sale of household appliances. The goods are manufactured in Poland by HTI Poland, a company registered for VAT purposes in Poland, and sold to HTI Finland for resale both to HTI-related companies and to third parties around the world.

HTI Finland has secured the sale of a consignment of microwaves to Talo Ltd, a company registered for VAT purposes in Malta under the VAT Act [Article 10], which operates a household store. The goods are to be sold by HTI Poland to HTI Finland, and then by HTI Finland to Talo Ltd. The goods will be transported directly from Poland to Malta by HTI Poland.

HTI Finland has no place of business in Poland or Malta and is not VAT registered in either of those countries.

Poland, Finland and Malta are all members of the European Union (EU) and for the purposes of this scenario, the VAT laws in all three countries comply with the VAT Directive in all material respects.

Required:

Explain the value added tax (VAT) treatment of the chain of transactions resulting in the sale of the microwaves to Talo Ltd. (7 marks)

(c) Mr Grima, a non-taxable person, is a football enthusiast and is a registered member of Sports24–7. Sports24–7 is a website registered outside the European Union (EU) with no fixed establishment or place of business in the EU, which gives registered users access to the online version of various sports newspapers around the world. Registration is subject to a nominal yearly fee.

Required:

State, giving reasons, where the supply by Sports24–7 to Mr Grima will be deemed to take place for value added tax (VAT) purposes and where any VAT will be paid. (3 marks)

(d) True Insurance, an insurance company licensed in Malta under the Insurance Business Act, only insures risks situated in Malta. In 2013 True Insurance explored the possibility of setting up a branch in France and obtained advice about this from TGV Legal, a French law firm, which charged True Insurance €12,000 for its services.

Required:

Explain the value added tax (VAT) treatment of True Insurance's activities in Malta, and the VAT implications of the services obtained by True Insurance from TGV Legal. (4 marks)

(20 marks)

5 Fresh Ltd, a company incorporated in State E, holds 20% of Fresh Living Ltd, a company incorporated in State U which is in the manufacturing industry. The other 80% of Fresh Living Ltd is held by Fresh Living Holding Ltd, a company incorporated in State X, which also holds 100% of Fresh Ltd.

Fresh Ltd owns the intellectual property of the Fresh brand and in 2012 charged Fresh Living Ltd a royalty of €150,000.

In 2012 Fresh Living Ltd distributed a dividend of €1,000,000.

The tax rates in the jurisdictions of State E and State U, respectively, are as follows:

– State E imposes a tax of 10% on all income, but no withholding tax on dividend distributions, interest or royalty payments to non-residents.

– State U imposes a tax rate of 30% on all income, and a withholding tax of 15% on dividend distributions, interest and royalty payments to non-residents.

Tax treaties which are similar to the OECD Model Tax Convention are in force between State E and State U, State E and State X, and State U and State X, with the exception of the dividend article. The relevant article reads as follows:

Article 10 – Dividends

(1) Dividends paid by a company which is a resident of a contracting State to a resident of the other contracting State may be taxed in that other State.

(2) Dividends paid by a company which is a resident of a contracting State to a resident of the other contracting State may also be taxed in the contracting State, but, if the recipient is the beneficial owner of the dividends, the tax so charged shall not exceed:

(a) 0% of the gross amount of the dividends if the recipient is a company which holds directly at least 25% of the capital of the company paying the dividends; or
(b) 15% of the gross amount of the dividends, in all other cases.

State E and State U are both member states of the European Union (EU), while State X is not a member of the EU.

Required:

Determine the tax treatment of the dividend distributions and royalty payment made by Fresh Living Ltd in State E and State U respectively, explaining the application of the relevant EU Directives and the double tax treaties which are in place.

(20 marks)

End of Question Paper