Professional Level – Options Module

Advanced Taxation (Malta)

Thursday 7 June 2018

P6 MLA MIA

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 – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–5

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Paper P6 (MLA)

Think Ahead

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 2017 (year of assessment 2018) 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	700	0%
701	3,100	20%
3,101	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%

Value added tax (VAT)

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

Car fringe benefit

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

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) x 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

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

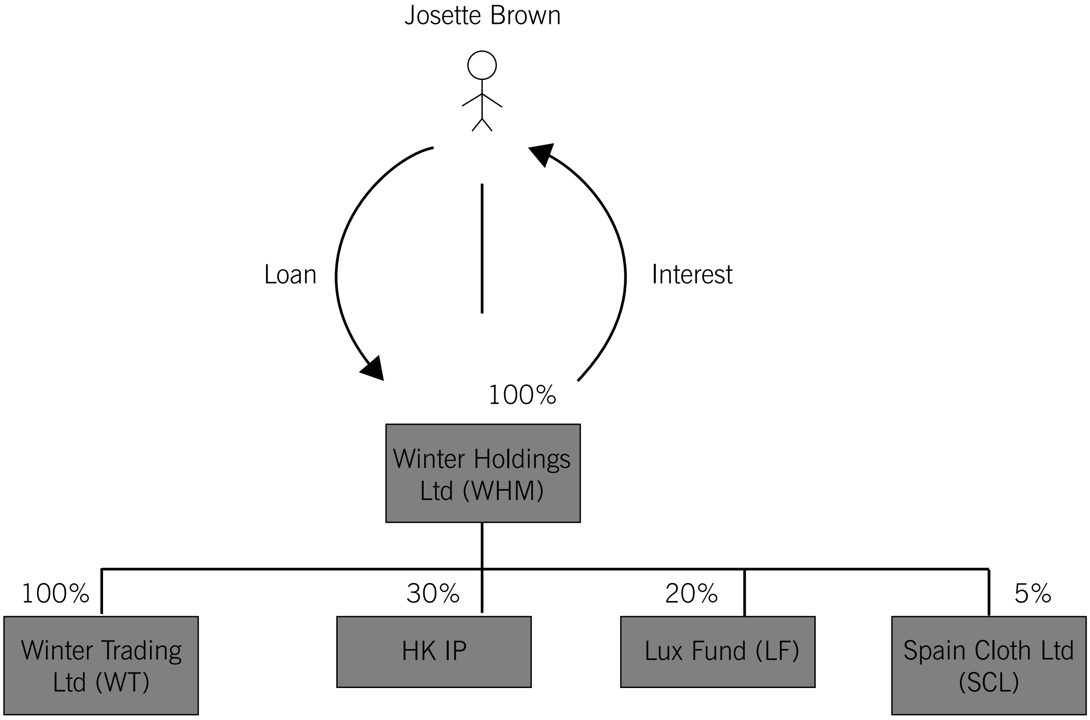
Standard rate	€2 for every €100 in value or part thereof
Property companies (as defined)	€5 for every €100 in value or part thereof

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



Josette Brown (JB), is an unmarried individual, born in Canada in 1960, of Canadian resident and domiciled parents. JB regularly visits her adult son and close friends in Canada but does not own or rent any house or other place in Canada since, due to her lifestyle, she prefers staying in different hotels and luxury apartments rather than maintaining a place of her own. She stays in Canada whenever she can and has a profitable business venture in Canada.

JB's father retired to Malta in 2014. In 2017 JB spent 40 days in Malta, living in a rented apartment, in order to take care of her ailing father. JB's only other visit to Malta was for a short holiday in 2003. During 2017 JB spent around 200 days in Canada spread over ten separate visits; this is consistent with the usual number of days she has spent in Canada for the last ten years. Canada considers JB to be tax resident therein, but she is concerned that Malta may also consider her to be tax resident in Malta during 2017 due to her 40-day visit and because her father lives in Malta. Malta and Canada are contracting states to a tax treaty which is based on the OECD Model Convention.

During 2017 JB set up the Winter Holdings group. JB is the 100% shareholder of Winter Holdings Limited (WHM), a company incorporated, managed and controlled in Malta. WHM's board of directors is independent and autonomous of JB, who is not involved in any way in the management and control of the company. During 2017 JB granted WHM a €2 million loan, subject to an interest rate of 6% per annum, to acquire and develop a 1,000 m^2 factory in Malta. Once completed, the factory was rented out by WHM to its fully owned subsidiary, Winter Trading Limited (WT), which is also resident and domiciled in Malta, for €150,000 per annum. The rental income for 2017 was received in full in January 2017. WHM does not have any other expenses which potentially could be available as a deduction against this rental income.

WT uses the factory it rents from WHM to manufacture solar panels for export. In 2017, WT generated a chargeable income before tax (after deducting the rent paid to WHM) of €1 million. In view of the nature of its activities, WT was granted an investment tax credit of €35,000 by Malta Enterprise in 2017. WT distributed all of its after tax profits to WHM as a dividend on 31 December 2017.

In addition to its rental income, WHM derives trading income from the online sale of clothes and from various investments.

WHM's online selling activity uses a 1,800 m^2 warehouse in Malta, which it acquired through equity injected by JB. In 2017 WHM derived a chargeable income before tax amounting to €800,000 from this trading activity.

During 2017 WHM held three investments:

(1) A 30% holding in HK IP, a company incorporated, managed and controlled in Hong Kong, which WHM acquired during September 2017 and disposed of in December 2017 for a profit of €250,000. All of HK IP's income is derived from passive royalties which are taxed in Hong Kong at a reduced tax rate of 3%.

(2) A 20% holding in Lux Fund (LF), a collective investment scheme incorporated, managed and controlled in Luxembourg. This investment grants WHM the right to appoint a director and vote in general meetings. LF's income is derived entirely from interest, which is exempt from tax in Luxembourg. LF paid WHM a dividend of €220,000 in 2017.

(3) A 5% holding in Spain Cloth Limited (SCL), a company incorporated, managed and controlled in Spain, which was acquired by WHM during August 2017 for €2 million. WHM's shareholding in SCL does not entitle it to appoint a director. SCL operates various fashion outlets in Spain. In the year 2017, SCL paid WHM a gross dividend of €500,000 out of its after tax trading profits. Withholding tax at the rate of 8% (evidence available) was imposed on this dividend payment by Spain. WHM does not have any expenses directly related to this dividend income.

Required:

(a) Draft a letter to Josette Brown advising her on:

(i) Her general liability to tax in Malta in terms of the Maltese tax legislation as potentially limited by the provisions of the tax treaty between Malta and Canada. (4 marks)

(ii) The tax treatment of the interest paid to her by Winter Holdings Limited (WHM) and of the rental income derived by WHM from the factory leased to Winter Trading Limited (WT), including an analysis of any available options. (6 marks)

(b) Further to your advice in part (a), JB obtained reassurances from the Maltese tax authorities that they will not consider her to be more than a temporary resident in Malta and, therefore, that the withholding tax obligations in terms of the Investment Income Provisions and the deemed dividend distributions orders will NOT be applicable to any profits distributed or attributable to her, to any tax refunds paid to her, nor to her share of any profits benefiting from the participation exemption.

Required:

Draft paragraphs for a second letter to Josette Brown advising her on the applicability or otherwise of the participation exemption to the dividend income and profit on the disposal of the HK IP holding derived by WHM in 2017, including a review of any alternative tax refunds should the preferred option of the participation exemption NOT be available. (12 marks)

(c) Prepare calculations illustrating the allocation of the various sources of income of WT and WHM to the applicable tax accounts, clearly identifying any tax refunds receivable by WHM and the secondary allocations required to the immovable property account by both companies.

Note: You are NOT required to support your calculations with any narrative analysis. (9 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 You should assume that today's date is 1 April 2018.

Everydaysports Limited (ES) is a company incorporated in Malta in 2013 and managed and controlled in Malta. ES has a total ordinary share capital of 6,000 shares of €1 each, which since its incorporation has been owned equally by three shareholders, Joseph and Mark (who are brothers) and Mark's daughter, Alessia, who each subscribed for 2,000 ordinary shares. All of ES's ordinary shares carry the same voting rights.

ES operates in the sportswear distribution industry. ES owns one retail outlet in the north of Malta, which it acquired during 2013 for €350,000. ES's profits/(loss) before tax since its incorporation are as follows:

2013	(€50,000) loss
2014	€20,000
2015	€80,000
2016	€150,000
2017	€100,000

The following is an extract from ES's statement of final position for the year ended 31 December 2017:

	€	€
Immovable property: Retail outlet in the north of Malta	350,000	
Other (movable) non-current assets	50,000	
Total non-current assets		400,000
Current assets		100,000
Total assets		500,000
Trade creditors	120,000	
Shareholders' loan	250,000	
Total liabilities		370,000
Ordinary share capital	6,000	
Preference share capital	4,000	
Retained earnings	120,000	
Total equity		130,000
Total liabilities and equity		500,000

Additional information:

(1) The 4,000 preference shares of €1 all belong to Mark, and resulted from the conversion of a shareholders' loan during 2016. The preference shares are non-participating shares and carry a 4% fixed rate of return.

(2) None of the shareholders' loans, past and present, have been registered with the Public Registry in Malta

(3) ES does not own any immovable property in Malta other than the retail outlet nor does it have any investments in other companies.

On 1 April 2018, the three shareholders reached an agreement for Mark to have a more passive role in the company, whilst still remaining entitled to a return from his investment. Consequently, the three shareholders have approached your firm as their tax adviser, to discuss the income tax and duty on documents and transfers implications should they convert Mark's ordinary shares into non-participating preference shares of €1 each, carrying a 4% fixed rate of return.

They have also informed you that:

(i) The conversion is to take place on 15 April 2018.

(ii) The market value of the immovable property (retail outlet) as per a recent architect's valuation is €550,000.

(iii) The net asset value of ES as at the date of the conversion is expected to be equal to that on 31 December 2017.

(iv) The profit before tax generated in the period 1 January to 15 April 2018 is expected to be €15,000.

(v) Any further income derived by Mark will be taxed at the rate of 35%.

Required:

(a) **Explain the income tax and duty on documents and transfers (DDT) implications arising on the proposed conversion of Mark's ordinary shares into preference shares, including how any income tax and DDT must be computed. Identify any possible exceptions and exemptions provided for by the Income Tax Act and the Duty on Documents and Transfers Act, together with their applicability in this case.** (13 marks)

(b) **Calculate the tax and DDT (if any) which would arise on the proposed conversion.** (9 marks)

(c) As an alternative to the conversion of the ordinary shares into preference shares, it has been suggested that the ordinary share capital is split into two classes whereby, with effect from 15 April 2018, Mark's shares would no longer carry any voting rights and as a result, all the voting rights would become vested equally in the ordinary shares held by his brother, Joseph, and his daughter, Alessia.

Required:

State, with reasons, whether this alternative proposal would result in different tax and DDT implications and, if so, identify the potential tax saving or additional tax leakage which would occur. (3 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 You should assume that today's date is 1 February 2018.

6G GmbH (6G) is a company based in Germany which manufactures and distributes mobile phones, mainly for the European market. Prior to 2018, 6G did not ship any of its products to Malta and did not have any physical presence or agent of any type in Malta. 6G intends introducing its products to the Maltese market during 2018, and is considering the following six options, A to F, to achieve this.

Option A – 6G will start shipping mobile phones to Malta. Customers (exclusively end users) will be able to place orders on the company's website, which is hosted on German servers, and pay in advance for the products ordered. The goods will then be shipped directly to the customer's personal address in Malta.

Option B – In addition to the online sales of mobile phones to Maltese customers in Option A, 6G will rent a fixed place of business in a prominent shopping complex in Valletta, where customers will be able to view and test the mobile phones. However, customers would still be required to effect any purchases online through 6G's website, as no sales will be carried out from the rented space, which will act purely as a location for advertising and viewing the mobile phone range.

Option C – As an alternative to renting the advertising and viewing space in Option B, 6G will rent 100 m^2 of retail, display and storage space in the Valletta shopping complex. 6G will import its range of mobile phones into Malta and sell and distribute them through this retail outlet. All the sales will be made in the name of 6G. Online sales to Malta customers through the website will also continue.

Option D – 6G will set up a fully owned subsidiary, 6G Malta Limited (6G-M) in Malta and this Maltese subsidiary company (not 6G) will rent the 100 m^2 retail display and storage space referred to in Option C, and import, sell and distribute 6G's range of mobile phones. Under this option, all sales made from the shopping centre retail outlet will be made in the name of 6G-M.

Option E – 6G will ship its range of mobile phones from Germany to MOBL, a Maltese resident company specialising in the distribution of innovative products, and MOBL will carry out the distribution of the mobile phones in Malta as a reseller, purchasing and reselling the products in its own name. 6G will have no control of or ownership relationship in MOBL, which will be acting in the ordinary course of its business when selling 6G's products. MOBL will not be restricted from selling any competing products and 6G will be able to appoint other independent distributors in Malta. MOBL is registered for value added tax (VAT) in Malta in terms of Article 10 of the VAT Act.

Option F – 6G and MOBL will enter into an agreement through which MOBL will be the exclusive distributor of 6G's range of mobile phones in Malta, on condition that MOBL will terminate all sales and servicing of any competing products and concentrate its resources on selling 6G's products only. MOBL will sell the mobile phones on behalf of 6G and will be able to contract on behalf of 6G in Malta.

Under all options A to F, 6G will carry out all the mobile servicing and repairs required through its repair centre in Berlin, Germany. Any outside warranty repair charges will be issued to customers directly by this German repair centre.

Malta and Germany are parties to a double tax treaty which is similar in all relevant respects to the OECD Model Tax Convention.

Required:

(a) Advise 6G GmbH (6G) on whether and to what extent Malta will be entitled to tax the business profits arising from the distribution of its products in Malta under each of the options A to F, and the profits arising from the servicing and repairs to the mobile phones physically carried out in Germany. You should refer to both the Maltese income tax source rules and the provisions of the double taxation treaty between Germany and Malta. (13 marks)

(b) In the case of Option A, advise on the value added tax (VAT) place of supply of the mobile phones by 6G to the Maltese final customers (B2C sales), and whether a Maltese VAT registration will be required or registration can be opted for voluntarily by 6G. (5 marks)

(c) In the case of Option E, advise on the place of supply of the mobile phones by 6G to MOBL. (2 marks)

(20 marks)

4 Sophia Borg is ordinarily resident and domiciled in Malta. She is separated, and under the terms of her public deed of separation she is required to pay her estranged husband child maintenance amounting to €1,000 a month for their five-year-old daughter, Amy, plus a further €500 per month in alimony payments.

The following information is relevant to Sophia's sources of income in the year 2017:

(1) She is employed as an international liaison officer with the Ministry of Foreign Affairs, a Ministry of the Government of Malta. Her employment contract requires her to carry out her main employment activities outside Malta. During the year 2017, Sophia spent 205 working days outside Malta in fulfilment of her employment duties. For her services, Sophia is remunerated with a gross salary package of €60,000 per annum inclusive of taxable fringe benefits. No other jurisdiction exerts any right to tax Sophia's salary package as she rarely spends more than 15 days in any particular country, other than Malta.

(2) In her free time Sophia likes to deal in shares and bonds listed on the Malta Stock Exchange. In general, she holds such instruments for very short periods of time, sometimes not even a week, with an average of five transactions per month. For the calendar year 2017 her net results from such trades amounted to a gain of €5,000. In addition, Sophia received €400 in interest on the bonds, from which she instructed the payors to withhold the 15% final withholding tax.

(3) During 2017, Sophia disposed of her life-time savings in two collective investment schemes (CIS), a prescribed fund and a non-prescribed fund, both of which are listed on the Malta Stock Exchange. Sophia realised a capital gain of €6,000 on the sale of the units in the prescribed fund and a further €5,000 gain on the sale of the units in the non-prescribed fund. In both cases, the units were sold back to the issuer of the units which cancelled them.

(4) In 2017, Sophia derived foreign source dividend income of €15,000 from Farland on which withholding tax of 30% was deducted at source; Sophia has been provided with all the supporting evidence for the tax withheld. Malta and Farland have never entered into any treaty for the relief of double taxation.

(5) Sophia has rented out her apartment in Swieqi to a Spanish couple for three years, for a rental of €1,000 per month. The interest payable on the loan taken out to purchase the apartment amounts to €4,200 per annum.

Required:

(a) Advise Sophia Borg on the tax treatment of each of her items of income arising in 2017, including any deductions and options which may be available to mitigate her personal tax liability within the parameters of the Income Tax Act, clearly indicating any conditions which apply. (12 marks)

(b) Calculate the minimum amount of total tax (including final taxes) payable by Sophia for the year of assessment 2018 based on your recommendations in part (a). (8 marks)

(20 marks)

5 **(a)** Valletta Food Distributions Limited (VFD), a company established in Malta in 2004, is engaged in the importation and distribution of food stuffs in the Maltese market. During 2004, VFD bought an old shop in Valletta with the intention of opening a retail outlet to sell exclusively its own products. The building was refurbished during 2004 for a total cost of €100,000, excluding value added tax (VAT). VFD claimed the input VAT on all of the capital cost incurred. The shop was officially opened during January 2005 and commenced making sales immediately. The shop continued to be used for such sales activity up to January 2017.

On 1 February 2017, VFD decided to lease out the shop building for 25 years to an insurance company for a rent of €90,000 per annum (excluding any applicable VAT), payable annually in advance. The insurance company is registered for VAT in Malta in terms of Article 12 of the VAT Act. VFD will continue the importation and distribution of food stuffs through other premises owned by the company.

Required:

(i) **Explain the value added tax (VAT) treatment of the lease to the insurance company as compared with the VAT treatment of the usual trading operations of Valletta Foods Distributions Limited (VFD).** (2 marks)

(ii) **Explain the adjustments required to the input VAT previously claimed by VFD on the capital refurbishment of the shop building, and calculate the amount of such adjustment(s).** (4 marks)

(iii) **Explain why it will be necessary for VFD to apply the partial attribution rules in 2017 and subsequent years and the manner in which the partial attribution is to be calculated.**

Note: You are NOT required to calculate the amount of any partial attribution adjustment. (5 marks)

(iv) **State, with reasons, the time of supply of the lease to the insurance company for VAT purposes.** (2 marks)

(b) Dome Malta Insurance Limited is a company registered in Malta and licensed by the Malta Financial Services Authority (MFSA) to provide insurance services. The company provides insurance services to final customers and to other taxable persons, both in the EU and outside the EU.

Required:

(i) **State the place of supply of each of the types of supply carried out by Dome Malta Insurance Limited (DMI), clearly distinguishing between B2B and B2C supplies and between supplies made to persons in the EU and persons outside the EU.** (5 marks)

(ii) **State whether any of DMI's supplies will entitle it to claim a credit for any of the input VAT it has suffered.** (2 marks)

(20 marks)

End of Question Paper