Suggested solution

Section A

Question 1

Maximum Marketing Limited (MML)

Notes for internal meeting of engagement team

Prospective client:	MML and David
Purpose:	Consideration of engagement of prospective client(s) and tax advice requested
Prepared by:	Tax senior
Date:	30 November 2027

(a) New client engagement procedures and provision of advice

We should clearly understand whether the engagement will be with David, MML or with both parties.

Prior to being in a position to advise David on the tax implications of MML's operations and the potential transfer of shares in the company, we are required to carry out mandatory anti-money laundering procedures on David, such as obtaining and recording evidence of David's identity and proof of residence, obtaining incorporation details in respect of MML and carrying out necessary background checks.

Moreover, we should have in place clearly defined engagement terms prior to commencing any work for either of the two parties (David and/or MML), so as to properly define scope, fees and other key aspects of the client relationship.

We should not be rushed by David to provide our advice within two days of the meeting without first ensuring the above procedures have been carried out. In this way we will ensure our firm is applying the principle of professional behaviour, which is one of the five fundamental principles included in ACCA's Code of Ethics and Conduct.

(b) Maltese income tax treatment of Maltese operations

MML, as a company incorporated in Malta, is deemed to be both tax resident and domiciled in Malta and therefore subject to tax in Malta on a worldwide basis. MML's trading profits from the digital marketing operations are subject to tax in Malta at the standard tax rate of 35% and are allocated to the Maltese taxed account (MTA). Despite MML's profits being derived from foreign clients, such profits are not to be allocated to the foreign income account (FIA) and are not eligible for the permanent establishment

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(PE) exemption, since the income generating activities are physically carried out from Malta and do not appear to be connected to a PE situated outside of Malta.

MML is not required to effect a secondary allocation from its MTA to the immovable property account, since the premises it uses in Sliema are owned by an unrelated party. Therefore, David is entitled to claim a 6/7ths tax refund of the income tax attributable to the trading profits once these are distributed by way of an MTA dividend.

Italy's and Malta's right to tax profits arising from the activities of Giovanni Rossi (GR) in Italy

On the basis that the tax treaty between Malta and Italy is based on the OECD Model Tax Convention, Italy is entitled to impose tax on business profits derived by MML, only if such profits are attributable to a PE which MML has in Italy.

Although it appears that MML does not have a fixed place of business in Italy through which it carries out a business activity, MML must analyse whether the activities conducted in Italy by GR could create a PE in terms of the dependent agent treaty definition.

In this respect, MML is likely to be considered as having an agency PE in Italy. This is because GR is acting in Italy on MML's behalf, and although he does not conclude contracts on behalf of MML, he habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by MML. Moreover, these contracts are in MML's name and in respect of the provision of services by MML. Accordingly, GR's activities in Italy appear to go beyond mere preparatory and auxiliary activities.

Therefore, Italy is entitled to tax MML's business profits attributable to GR's activity in Italy. Malta is also entitled to tax MML's profits attributable to the Italian PE, as long as Malta grants MML double tax relief for the tax paid in Italy. In this respect, MML is entitled to opt for any one of the following double taxation relief mechanisms:

- Claim a credit for the actual tax imposed by Italy on the PE, limited to the Malta tax on these profits (35%). The profits would be allocated to the FIA and upon a distribution of profits by MML, David would be entitled to claim a 2/3rds refund of the tax paid, grossed up by the foreign tax, but limited to the actual Malta tax.
- Claim double tax relief through the flat rate foreign tax credit and allocate the business profits income to the FIA. In this case, a distribution of profits will entitle David to claim a 2/3rds tax refund of only the Malta tax paid.
- Claim an exemption from tax on the profits attributable to the PE and allocate the income to the Untaxed account. A distribution of these profits to David would not trigger any withholding tax, since David is not tax resident in Malta, and would not give rise to any right to tax refunds.

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(c) Maltese tax treatment of any dividends paid by Harmony Limited (HL) to MML

Although MML is taxable in Malta on its worldwide income, upon a distribution of profits by HL, MML may be able to benefit from the participation exemption. This is subject to MML's shareholding in HL meeting the participating holding definition.

MML's shareholding in HL is an equity shareholding as it grants MML to profits, votes and assets on winding up. Moreover, it is a participating holding as it entitles MML to at least 5% of any two of the equity holding rights.

In addition, in order for dividend income to qualify for the participation exemption, the entity in which the participating holding is held must also satisfy at least one of the anti-abuse conditions. This is satisfied because HL's income from passive interest and royalties amounts to less than 50% of its total income.

Finally, HL is not a property company as it does not own any assets, and it is not resident in a non-cooperative jurisdiction. Therefore, MML is entitled to claim the participation exemption on the dividend received from HL. This income is allocated to the Untaxed Account and would not be subject to any withholding tax on a distribution to David.

Consultancy fee charged by HL to MML

In order for the consultancy fee charged by HL to MML to fall with the parameters of the transfer pricing rules in Malta, the following two conditions must be satisfied:

(i) MML must not be deemed to be an SME. Given that MML has more than 250 employees, this condition is satisfied; and

(ii) the value of MML's cross border transactions with related parties must exceed €6m, which is also satisfied given that the consultancy fee is €8m.

(d) Advice on the best exit strategy for David

The two mutually exclusive offers proposed to David have very different tax consequences, which must be taken into account when deciding which option will be more beneficial for David.

Option 1: Acquire MML through a transfer of shares for €10 million

Under the first option, David might be able to claim a full exemption from income tax on capital gains on the transfer of shares in MML, on the basis of a transfer of shares in a company by a non-resident. The exemption is available if MML is **not** a property company. Since MML does not own its office, it is not a property company, and therefore David would be expected to retain the full €10 million being offered by Mr. X for the purchase of the company.

Transfers of shares generally trigger stamp duty of €2 per €100 of value. However, given that:

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- MML is owned to the extent of more than 50% by non-resident shareholders (100% owned by non-residents); and
  MML's business interests are to the extent of more than 90% outside of Malta (all its clients are established outside of Malta); and
- MML is not a property company,
  a duty determination can be obtained, thereby resulting in no stamp duty payable on the acquisition of MML's shares by Mr. X.

Tutorial note: the duty exemption determination is referred to as a DDT10b.

Option 2: MML to first acquire the office, followed by the transfer of shares for €12 million

Under the second alternative, Mr. X would require MML to purchase the office prior to his acquisition of the company. It appears that he is offering a higher consideration that is in excess of the apparent cost to acquire the office and therefore leading to David's merger and acquisitions expert friend recommending that he choose this option. However, this option creates tax considerations that may impact the ultimate recommendation.

The acquisition of the office by MML would trigger stamp duty of €5 per €100, that is €85,000 (€1,700,000 x 5%) payable by MML.

More importantly, once MML acquires the office, it would own an immovable property in Malta. The definition of a property company contains a proviso that could potentially exclude MML from being a property company despite purchasing the office, if such office is used for the conduct of the company's operations and it does not account for more than 50% of MML's assets. Given that the office will be acquired for €1,700,000 and MML's other assets appear to be valued at €175,000 (Working 1), i.e., considerably less, the proviso does not seem to be satisfied and MML would be deemed to be a property company. Although the information provided indicates that the office will account for more than half of MML's assets, we should base our assessment on a Statement of Financial Position prepared as at the date of the contemplated transfer.

Therefore, David will not be able to avail himself of the income tax exemption applicable on transfers of shares by non-residents. Since it is a transfer of a controlling interest, and the gain will be subject to tax on the difference between the higher of the market value (€11.885 million - Working 2) and the consideration (€12m) less the cost of acquisition, i.e. €12 million less €100,000 initial capital share capital and less the further €1.785m further injection , giving a capital gain of €10,115,000. Given that the property acquisition by MML and David's sale of shares will happen within the year, he will not be able to avail himself of any inflation allowance.

The transfer of shares will trigger a 35% income tax charge on the capital gain of €10.115m which is €3,540,250. There will be an immediate cash flow impact for David because the tax will be payable at 7% on €12 million followed by settlement of the residual at the tax return date in June 2028. Under this option David will end up with a net

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cash flow from the sale of €6,674,750 (see working 3) and therefore he will be worse off compared with option 1.

Since MML will become a property company, Mr. X's acquisition of the shares in MML will trigger a stamp duty charge. Since MML's non-current assets will exceed 75% of the total non-current assets (see working 1), rather than stamp duty being charged at the standard rate of €2 per €100, it is payable at the higher rate of €5 per €100, equivalent to €600,000 (€12 million x 5%). This rule ensures that transfers of immovable property and shares in companies which derive 75% or higher of value from such immovable property are taxed at the same rate. This option will lead to a stamp duty liability for Mr. X which would not be payable under the first option.

Workings:

Working 1

Non-current assets before office acquisition:

	€
Computer and furniture	25,000
Investment in HL	150,000
Total	**175,000**

Office will account for €1,700,000 / (€175,000 + €1,700,000) = 91%

Working 2

	€
Original market value of MML	10,100,000
Capital injection from David to purchase property and stamp duty (€1,700,000 + €85,000)	1,785,000
Total market value	**11,885,000**

Working 3

	€
Proceeds on transfer of MML shares to Mr. X	12,000,000
Less further capital injection (as in working 2)	(1,785,000)
Income tax on gain on sale of shares	(3,540,250)
Net cash flow	**6,674,750**

Recommendation

Taking into account the tax implications, under option 1, David's net cash flow will be €10 million. This compares with €6,674,750 under option 2. On this basis, our recommendation is option 1.

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Section B

Question 2

(a) Enterprise Limited (EL)

EL's Maltese tax basis and liability to tax in Malta

Although EL is a company that is incorporated outside of Malta, it is clear that both its management and control occur in and from Malta and therefore is tax resident in Malta. However, given that it is not domiciled in Malta because it is not incorporated in Malta, any foreign income will be taxed in Malta only if remitted to Malta.

The trading profits from consultancy services offered from the Maltese office is Malta sourced income and is taxable in Malta, with the income allocated to the Maltese Taxed Account (MTA). The fair value movement is not a crystallised income and therefore it is not brought to tax in Malta and is allocated to the Untaxed Account (UA). Finally, the foreign interest is not taxed in Malta since it was not remitted to Malta and is also allocated to the company's UA.

Tax implications on dividend distributions

On the distribution of the dividends from the MTA to each of the shareholders, there are no withholding tax obligations. However, dividend distributions out of the UA are subject to a 15% withholding tax when made to a resident person other than a company. Therefore, EL must withhold 15% tax on the dividend paid to Joe Mizzi, whereas no such withholding tax obligation exists on the distribution to Jane Ives or to Ftira Limited.

Moreover, on the distributions from the UA to the non-resident companies, EL must withhold tax on the UA dividend to Oasis Limited because it is acting on behalf of an individual who is both ordinarily resident and domiciled in Malta. On the other hand, on the dividend paid to Mirage Ltd, no withholding tax obligations arise because Mirage Ltd is owned by an individual who although resident in Malta, has a non-Maltese domicile.

EL is required to pay the tax so withheld to the Commissioner for Revenue by the fourteenth day of the month following the month in which the dividend was paid.

(b) Paulo

Place of supply of valuation services

The place of supply of valuation services by Paulo as a taxable person to the Maltese museum which is another taxable person is, in terms of the general place of supply rule, deemed to be where the customer as a taxable person is established, which in this case is Malta.

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On the other hand, when Paulo provides the valuation services to the non-taxable persons in Malta, the place of supply is shifted to the country where the valuation services are physically carried out, which is again Malta.

Paulo's obligation to register for value added tax (VAT) in Malta

Paulo's taxable supplies to non-taxable persons during the open day will require him to obtain a Maltese VAT registration since such supplies are deemed to take place in Malta. He is not able to benefit from a simplified VAT registration that would have enabled him to register only in his country of establishment since he is established in a non-EU country. The valuation services provided by Paulo to the Museum could be accounted for in terms of the reverse charge mechanism for VAT purposes and on their own would not require him to obtain a Maltese VAT registration. However, given that Paulo will obtain a VAT registration in Malta in view of the open day supplies of services, both supplies will be subject to VAT in Malta at a rate of 18%.

(c) Super Pharma Limited (SPL)

VAT rate on rent received from clinics

The VAT Act provides that leasing of immovable property is, by default, exempt without credit. An exception applies when the property is leased by a limited liability company to a taxable person registered for VAT in terms of Article 10 of the VAT Act and used by such person in the course of his economic activity. However, since the family doctors are not VAT registered, the lease of the clinics is exempt from VAT.

Right to claim a credit for input VAT

SPL is entitled to claim a full credit for input VAT directly and exclusively related to its taxable and exempt with credit supplies. On the other hand, SPL has no right to claim a credit for input VAT related to its exempt without credit supplies.

Input VAT on the general overheads

With respect to input VAT on the general overheads, SPL has a limited right to claim back input VAT, calculated in terms of the partial attribution rules. During a particular year (year 2), SPL is entitled to provisionally claim a credit for input VAT on overheads based on the proportion of sales which entitle it to claim input VAT credit (i.e. taxable and exempt with credit sales to total sales) for the previous year (year 1). Once year 2 is over and the company is in a position to establish the exact ratio for year 2, SPL is required to make an adjustment:

- in its favour if the definitive ratio is higher than the provisional ratio; or

- in the Commissioner for Revenue's favour if the definitive ratio is lower than the provisional ratio.

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Question 3

Modern Entertainment Limited (MEL)

(a) Luka's tax residence

In case that both Croatia and Malta both claim that Luka is resident therein, reference must be made to the tie breaker rules in the treaty between the two countries. This requires us to first consider the jurisdiction where Luka has his permanent home. In this case, Luka will have a permanent home in both Malta (rented apartment) and in Croatia (the apartment he owns there and where he will stay when in Croatia). Given that he has a permanent home in both countries, then residence would be determined on the basis of his centre of vital interests considering his family and economic relations, with particular emphasis on the place where he has the closer personal ties. In this case, it is clear that both his personal (family) and economic (employment) will be in Malta and therefore he should be deemed to be resident in Malta for tax treaty purposes. The number of days he spends in the two countries is irrelevant for the purpose of determining his residence under the treaty.

Croatia's and Malta's right to tax employment income

The tax treaty between Malta and Croatia, would allow Malta, as the residence state, to tax the employment income and fringe benefits paid by MEL to Luka. However, the treaty also allows Croatia to tax the employment income derived by Luka that relates to the activities carried out in Croatia. Notwithstanding this, if all of the following conditions are satisfied, Malta would have exclusive right to tax the employment income:

(i) Luka is not present in Croatia for a period or periods exceeding in aggregate 183 days in any 12-month period commencing or ending in the tax year; and

(ii) the remuneration is not paid by, or on behalf of an employer which is Croatian tax resident; and

(iii) the remuneration is not borne by a permanent establishment which MEL has in Croatia.

The first two conditions will be satisfied. Therefore, as long as MEL does not have a permanent establishment in Croatia and his presence and activities in Croatia do not create one, Croatia would have no right to tax any of the employment income paid by MEL to Luka.

(b) Maltese tax treatment of fringe benefits

The salary paid by MEL to Luka and any benefits that are deemed to be linked to his employment will be taxable in Malta.

In this respect, relocation costs paid by MEL to Luka for the purpose of taking up a new employment or posting, that is expected to last for at least 12 months, is exempt from tax. Similarly, the reimbursement (but not an allowance) of telecommunication

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equipment, mobile phone bills and internet expenses evidenced by receipts, when such equipment and services are used by the employee for the purpose of the employer's business, is also exempt from tax. The provision of a free meal is also exempt, if this is provided in a canteen where meals are served to all staff. Health insurance is also exempt if it is provided under a scheme which is generally available to all employees.

The grant of a car cash allowance is 50% taxable and 50% exempt up to an annual allowance of €2,340. In the case of a car cash allowance exceeding €2,340 the annual exempt portion is limited to €1,170. The supermarket vouchers do not qualify for any exemption and are brought to tax at the applicable progressive tax rates.

The grant of share options does not trigger any taxable charge, since the taxable event is shifted to the point in time when the options are exercised. An option exercise is taxable at a 15% flat tax rate on the difference between the market value and the strike price of the option.

Calculation of tax on employment income

	€
Salary	25,000
Supermarket vouchers (12 x €200)	2,400
Taxable car cash allowance (50% x €1,200)	600
Taxable employment income	**28,000**
Tax thereon at single rates	3,600

Share option tax calculation and tax on eventual share transfer

Calculation of tax due on share option exercise

Number of options	10,000
Exercise price	€1
Market price on date of exercise	€3
Taxable fringe benefit (€30,000 - €10,000)	€20,000
Tax thereon at 15%	€3,000

Calculation of tax due on share transfer

	€
Transfer price	4
Actual cost of acquisition	1
Deemed cost of acquisition	3
Taxable capital gain	10,000*
Tax thereon at 25%	2,500

*10,000 shares x (€4 selling price less €3 deemed purchase price)

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Mark scheme

Question 1

(a) New client engagement

Engagement	3
Anti-money laundering procedures	2
Professional behaviour	1

Maximum 5 marks

(b) Maltese operations and right to tax profits

MML	4
GR	6
Conclusion	2
Options	3

Maximum 13 marks

(c) HL and MML

Participating holding	7
Consultancy fee	4

Maximum 9 marks

(d) Exit strategy

Option 1	6
Option 2	9
Recommendation	1

Maximum 13 marks

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Professional skills marks:

Communication

General report format and structure (use of headings, sub-headings and an introduction)

Style, language and clarity (tone of report response, presentation of calculations, appropriate use of the tools, easy to follow and substantive amount of content)

Analysis and Evaluation

Logical and structured approach taken in relation to MML's Maltese operations and activities in Italy

Clear analysis of the transactions between Harmony Ltd and MML is provided

Commercial Acumen

Advice to David includes appropriate, valid and commercial considerations in relation to the two options

Scepticism

Assessment of the new client engagement procedures are clearly explored and justified in respect of the provision of advice to David

Maximum 10 marks

Total 50 marks

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Question 2

(a) Enterprise Limited (EL)

Tax basis and liability	5
Dividend distributions	7

Maximum 10 marks

(b) Paulo

Place of supply	2
Obligation to register	3

Maximum 4 marks

(c) Super Pharma Ltd (SPL)

Clinic rent	3
Right to claim credit for input VAT	4

Maximum 6 marks

Professional skills marks:

Analysis and Evaluation

Clear, logical and systematic approach focused on the appropriate attempt to assess the Maltese tax treatment of all three types of income and the withholding tax obligations

VAT advice to SPL addressed all matters in a comprehensive and coherent manner

Commercial acumen

VAT advice offered to Paulo is relevant and appropriate to his situation

Maximum 5 marks

Total 25 marks

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Question 3

(a) Luka's tax residence and taxing rights

Malta	5
Croatia	4
Conclusion	1

Maximum 9 marks

(b) Maltese tax treatment of fringe benefits/tax calculation

Benefits	7
Calculation	2

Maximum 7 marks

(c) Exercise of options and disposal of GEL shares

Exercise	2
Disposal	2

Maximum 4 marks

Professional skills marks

Analysis and Evaluation

Clear, logical and systematic approach taken to the advice in respect of Luka's tax residency and Croatia's and Malta's right to tax his employment income

Clear quantification of the tax due in respect of the share options is provided

Commercial Acumen

Comprehensive assessment of the tax treatment of Luka's benefits in kind which recognises the key tax issues.

Maximum 5 marks

Total 25 marks

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