Answers

1 Anthony and Angela, Bernard, Bridget and Chris

Calculation of settlement tax under the self assessment system for the year ended 31 December 2007

		Anthony	Angela	Bernard	Bridget	Chris	
		Lm	Lm	Lm	Lm	Lm	Lm
Article 4(1)(a)							
Share of profit (see Note 1)		5,400		5,400			7,200
Article 4(1)(b)							
Salary from partnership		16,500		3,000			
Employment income			4,200	14,000		14,000	
						2,800	16,800
Category 1 fringe benefit – use of car							
Car use value	Lm22,000 x 17%					3,740	
Maintenance value	Lm22,000 x 5%					1,100	
Fuel value	Lm22,000 x 5%					1,100	
						5,940	
Private use value	Lm5,940 x 60%					3,564	
Use for 10 months	Lm3,594 x 10/12						2,970
Category 2 fringe benefit – subsidised loan							
	Lm6,500 x [8% – 6%]						130
Article 4(1)(c)							
Gross dividend (need not be declared)		0					
Interest on current account		2,000		0			3,200
Foreign source interest		300					
Article 4(1)(e)							
Rental income					1,200		
Article 4(1)(g)							
Other income					4,800		
Total income before deductions		24,200	4,200	22,400	6,000		30,300
Deductions							
School fees – Andrea		(180)					
School fees – Alison (maximum)		(300)					
Alimony payments				(4,800)			
Maintenance allowance					(240)		
Chargeable income		23,720	4,200	17,600	5,760		30,300
Tax thereon at personal rates – single		6,745	170	4,603			9,048
Tax thereon at personal rates – married					219		
Tax credit							
Double taxation relief		(30)					
Tax payments							
Final settlement system (FSS)		(4,218)	(170)	(3,342)			(5,407)
Provisional tax		(1,800)					(800)
Balance of tax payable by 30 June 2007		697	0	1,261	219		2,841

Note 1:
The partnership profit is Lm18,000, arrived at as follows:

	Lm
	60,000
Wages and salaries – Anthony	(16,500)
Wages and salaries – Bernard	(3,000)
Interest on current accounts – Anthony	(2,000)
Interest on current accounts – Bernard	400
Interest on current accounts – Chris	(3,200)
Capital allowances – year ended 31 December 2006	(6,700)
Capital allowances – year ended 31 December 2005	(11,000)
	18,000

2 SCM Limited

(a) Capital allowances for the year of assessment 2007

	Industrial building	Machinery	Electronic equipment	Commercial motor vehicles	Total
	Lm	Lm	Lm	Lm	Lm
Additions	195,000	341,200	170,000	40,000	746,200
Disposals	–	(21,200)	–	–	(21,200)
Cost as at 30 June 2007	195,000	320,000	170,000	40,000	725,000
Initial allowance	19,500	–	–	–	19,500
Wear and tear	3,900	64,000	42,500	8,000	118,400
Capital allowances	23,400	64,000	42,500	8,000	137,900

(b) Income tax computation for the year of assessment 2007

	Lm	Lm
Profit before taxation as per financial statements		305,000
Add back:		
Depreciation	41,000	
Wages and salaries	3,000	
Capital expenditure	15,000	
Formation expenses	1,800	
Pre-trading expenditure	3,400	
Fines and penalties due to VAT Department	200	
Fines and penalties due to Inland Revenue Department	400	
Interest paid to the IRD for late payment of FSS	350	
		65,150
		370,150
Less:		
Capital allowances	137,900	
Profit on disposal of machinery	23,800	
		161,700
		208,450
Less:		
Interest taxed at source	1,200	
Dividend income (FIA)	45,000	
		46,200
		162,250
Tax thereon at 35%		56,787
Interest income subject to 15% FWT		1,200
Tax thereon at 15%		180
Foreign dividend income (net)		38,250
Flat rate foreign tax credit (FRFTC)		9,562
Chargeable income (FIA)		47,812
Tax thereon at 35%		16,734
Flat rate foreign tax credit		(9,562)
Tax payable		7,172

Total tax payable: Lm56,787 + Lm180 + Lm7,172 = Lm64,139

Tax charge in financial statements: Lm64,139 + Lm6,750 (foreign tax) = Lm70,889

(c) Companies are not required to pay provisional tax during their first year of operation. Thus, the entire amount of SCM Limited's tax payable, other than that withheld on the local interest (i.e. Lm63,959) will be unsettled tax. The company must pay the tax due on its Maltese Taxed Account profits (Lm56,787) by the date due for submission of its tax return, which is nine months after its accounting year end (i.e. by 31 March 2008). The tax due on its Foreign Income Account profits (Lm7,172) is payable within eighteen months from the end of its accounting period (i.e. by 31 December 2008).

(d) No balancing statement needs to be prepared because under Article 24 of the Income Tax Act, a balancing statement is required only where initial allowances or wear and tear allowances have been claimed in respect of a capital asset.

(e) SCM Limited cannot avail itself of the loss incurred by TLG Limited since the two companies do not form part of the same group of companies in terms of Article 16 of the Income Tax Act as their parent company is not tax resident in Malta.

3 Mary and Anne

(a) **Calculation of the net proceeds upon the transfer of shares in Milestone Properties Limited**

Market value of the ordinary shares

	Lm
Net asset value as per last financial statements	680,000
Adjustment re market value of property (1,230,000 – 750,000)	480,000
Goodwill (28,500 + 17,800 – 5,300 + 19,900 + 19,250 = 80,150/5 x 2)	32,060
Market value of all shares as per capital gains rules	1,192,060
Less value attributable to preference shares	(500,000)
Value of ordinary shares	692,060

Market value of Mary's ordinary shares: 80% of Lm692,060 = Lm553,648

Market value of Anne's ordinary shares: 20% of Lm692,060 = Lm138,412

The book value of preference shares is not taken into account in determining the net asset value of the company.

Chargeable capital gain made by Mary and Anne on the disposal of their ordinary shares in Milestone Properties Limited

	Mary Lm	Anne Lm
Deemed consideration/Consideration	553,648*	120,000*
Cost of acquisition	(80,000)	(20,000)
Inflation element (see workings)	(95,003)	–
Chargeable capital gain	378,645	100,000
Tax thereon at 35%	132,526	35,000

* The deemed consideration is higher than the actual consideration received by Mary and therefore the higher amount is taken into account in calculating the chargeable capital gains as provided in rule 5 of the Capital Gains Rules. In the case of Anne the actual consideration is taken into account (as opposed to the deemed consideration) since she does not have a controlling interest.

Workings re index of inflation

	Lm
Lm40,000 x (703·88 – 536·61)/536·61	12,469
Lm210,000 x (703·88 – 567·95)/567·95	50,260
Lm320,000 x (703·88 – 607·07)/607·07	51,031
Lm180,000 x (703·88 – 684·88)/684·88	4,994
	118,754

Inflation for Mary = 80% of Lm118,754 = Lm95,003

Calculation of the net proceeds upon the transfer of the shares

	Mary Lm	Anne Lm
Consideration – preference shares	448,000	112,000
Consideration – ordinary shares	480,000	120,000
Capital gains tax on the sale of the ordinary shares (see above)	(132,526)	(35,000)
Capital gains tax on the sale of the preference shares	–	–
Net proceeds on the transfer of all shares	795,474	197,000

(b) **If Milestone Properties Limited sells its immovable property, the property transfer tax and the net proceeds will be as follows:**

Description of property	Market value Lm	Tax at 12% Lm	Net Lm
Plot of land	180,000	21,600	158,400
Block of apartments	390,000	46,800	343,200
Showroom and offices	480,000	57,600	422,400
Penthouse	180,000	–	180,000
	1,230,000	126,000	1,104,000

(c) **After the transfer of the immovable property and the re-payment of the bank loan and the preference shares, the balance sheet or statement of affairs of Milestone Properties Limited will be as follows:**

	Lm
Cash at bank	534,000
	534,000
Share capital	100,000
Retained earnings	434,000
	534,000

The net proceeds which Mary and Anne will receive upon liquidation will be as follows:

	Mary	**Anne**
	Lm	**Lm**
Preference shares – return of capital	400,000	100,000
Ordinary shares – return of capital	80,000	20,000
Net dividend – no further tax	347,200	86,800
Net proceeds on liquidation	827,200	206,800

(d) From the above it appears that the two shareholders, Mary and Anne are better off if the company were to dispose of the immovable property, pay the liabilities and then proceed with the liquidation. Under this scenario they will have more disposable funds than if they were to transfer the entire shareholding in Milestone Properties Limited.

4 **Pi Limited group of companies**

(a) **Income tax computations for the year of assessment 2007**

	Pi Ltd	**Bo Ltd**		**Ca Ltd**		**Du Ltd**
	FIA	**MTA**	**FIA**	**MTA**	**FIA**	**MTA**
	Lm	**Lm**	**Lm**	**Lm**	**Lm**	**Lm**
Profit as per financial statements	600	17,600	(4,400)	4,800	3,200	(25,400)
Add Depreciation		4,800		2,400		5,200
Add Capital loss						9,200
	600	22,400	(4,400)	7,200	3,200	(11,000)
Less Capital allowances		(8,400)		(1,800)		
	600	14,000	(4,400)	5,400	3,200	(11,000)
Transfer		(4,400)	4,400			
Group relief				(5,000)		5,000
Group relief		(6,000)				6,000
	600	3,600	0	400	3,200	0
Add FRFTC	200				–*	
Chargeable income	800	3,600	0	400	3,200	0
Unabsorbed capital allowances carried forward						6,000
Capital loss carried forward						9,200
Tax at 35%	280	1,260		140	1,120	
Tax credits						
Double tax relief (DTR)					(1,020)	
Tax at source (TAS)		(1,260)		(140)		
Final withholding tax (FWT)						
FRFTC	(200)					
Tax payable	80	0	0	0	100	0

* It is not beneficial for Ca Ltd to claim FRFTC on this dividend as the foreign withholding tax rate is in excess of 20%.

(b) Capital allowances

The Income Tax Act, specifically provides, in the following two articles that capital allowances cannot be surrendered to other group companies:

(i) Article 14(1)(f) proviso (ii) states that any capital allowances in excess of current year profits may only be carried forward to be deducted against profits from the same source of income.

(ii) Article 22 of the Income Tax Act defines an 'allowable loss' that may be surrendered to a group company as a loss referred to in article 14(1)(g), that is, a loss in a trade, business, profession or vocation, which loss does not include any deductions for initial or wear and tear allowances.

5 Krats Limited

Calculation of excess VAT credit claimed for the year ended 30 September 2007

	Lm	Lm
Output tax:		
Cash sales – standard rated – Lm40,000 at 18%		7,200
Cash sales – reduced rate – Lm50,000 at 5%		2,500
Cash sales – exempt with credit – Lm160,000		0
Credit sales – standard rated – Lm8,000 at 18%		1,440
Credit sales – reduced rate – Lm12,000 at 5%		600
Credit sales – exempt with credit – Lm25,000		0
Sale of equipment – Lm4,000 at 18%		720
		12,460
Input tax:		
Purchases – standard rated – Lm38,400 at 18%	6,912	
Purchases – reduced rate – Lm49,600 at 5%	2,480	
Purchases – exempt with credit – Lm148,000	0	
Expenses – standard rated – Lm23,300 at 18%	4,194	
Expenses – reduced rate – Lm4,400 at 5%	220	
Capital expenditure – standard rated – Lm20,000 at 18%	3,600	
Bad debt – standard rated – Lm1,600 at 18%	288	
		(17,694)
Excess VAT credit		5,234

Notes:

(1) VAT on the purchased motor car is not recoverable.

(2) The making of a provision is not relevant for VAT purposes.

Fundamentals Level – Skills Module, Paper F6 (MLA)
Taxation (Malta) **December 2007 Marking Scheme**

This marking scheme is given as a guide in the context of the suggested answer. Scope is given to markers to award marks for alternative approaches to a question, including relevant comment, and where well reasoned conclusions are provided. This is particularly the case for essay based questions where there will often be more than one definitive solution.

		Marks
1	Partnership profit Lm18,000	1·5
	Share of profit	1·5
	Salaries from partnership	1
	Employment income	1·5
	Car fringe benefit	2·5
	Loan fringe benefit	1
	Gross dividend	1
	Interest on current accounts	1·5
	Foreign source interest	1
	Rental income	0·5
	Other income (alimony)	1
	School fees – Andrea	1
	School fees – Alison	1
	Alimony payments	1
	Maintenance allowance	1
	Tax at personal rates – single	2
	Tax at personal rates – married	1
	Double tax relief	1
	FSS payments	2
	Provisional tax	1
		25

			Marks
2 (a)	**Capital allowances**		
	Industrial buildings at correct cost value	0·5	
	Machinery at correct cost value	0·5	
	Initial allowance on industrial building	1	
	Wear and tear allowance on industrial building	0·5	
	Wear and tear allowance on machinery	0·5	
	Wear and tear allowance on equipment	0·5	
	Wear and tear allowance on motor vehicles	0·5	
			4
(b)	**Income tax computation**		
	Depreciation	1	
	Wages and salaries re: outsourced work	1	
	re: deductibility of other items	1	
	Capital expenditure	1	
	Formation expenses	1	
	Pre-trading expenditure	1	
	Fines and penalties due to VAT Department	1	
	Fines and penalties due to Inland Revenue Department	1	
	Interest paid to the IRD for late payment of FSS	1	
	Deductibility of training and advertising	1	
	Deductibility of interest paid on VAT	1	
	Capital allowances (as per part (a))	0·5	
	Profit on disposal of machinery – Lm23,800	1	
	Adjustment for interest subject to FWT and dividend income	1	
	Tax at 35% on MTA	0·5	
	Tax at 15% on interest income	0·5	
	Net dividend income of Lm38,250	1	
	FRFTC of Lm9,562	1	
	Tax payable on dividend income net of FRFC	1·5	
	Tax provision in financial statements – Lm70,889	1	
			19
(c)	No provisional tax (first year)	0·5	
	Unsettled amount – Lm63,959	1	
	Tax due on MTA to be settled by 31 March 2008	0·5	
	Tax due on FIA to be settled by 31 December 2008 (18 months from year end)	1	
			3
(d)	No balancing statement required under Article 24 of ITA		2
(e)	No group relief available since parent is not tax resident		2
			30

				Marks
3	**(a)**	**Tax implications on the transfer of shares**		
		Net asset value as per last financial statements – Lm680,000	1	
		Adjustment re market value of immovable property – Lm480,000	1	
		Goodwill (2 years' average profits of last five years) – Lm32,060	1	
		Deduction for value of preference shares	1	
		Market value of ordinary shares (Mary and Anne)	1	
		Deemed consideration of Lm553,648 – Mary	1	
		Cost of acquisition of Lm80,000 – Mary	0·5	
		Inflation adjustment of Lm95,002 – Mary	2	
		Consideration of Lm120,000 – Anne	1	
		Cost of acquisition of Lm20,000 – Anne	0·5	
		No inflation adjustment – Anne	1	
		Tax paid by Mary – Lm132,526	0·5	
		Tax paid by Anne – Lm35,000	0·5	
		No tax on sale of preference shares	1	
		Net proceeds for Mary – Lm795,474	0·5	
		Net proceeds for Anne – Lm197,000	0·5	
				14
	(b)	**Tax implications on the sale of the property**		
		Tax paid by company on transfer of immovable property – Lm126,000	1	
		No tax on sale of penthouse	0·5	
		Net proceeds from transfer of immovable property – Lm1,104,000	0·5	
				2
	(c)	**Tax implications on liquidation**		
		Net proceeds for Mary – Lm827,200	1	
		No additional tax on distribution	1	
		Net proceeds for Anne – Lm206,800	1	
				3
	(d)	Liquidation better than transfer of shares		1
				20

				Marks
4	(a)	**Income tax computations of Pi Ltd, Bo Ltd, Ca Ltd and Du Ltd**		
		Profit – Pi Ltd (FIA)	0·5	
		Profit/(loss) – Bo Ltd (MTA) and (FIA)	1	
		Profit – Ca Ltd (MTA)	0·5	
		Profit – Ca Ltd (FIA)	1	
		Loss – Du Ltd (MTA)	0·5	
		Add depreciation charge – Bo Ltd, Ca Ltd and Du Ltd	0·5	
		Add capital Loss – Du Ltd	1	
		Deduct capital allowances – Bo Ltd	0·5	
		Deduct capital allowances – Ca Ltd	0·5	
		Capital allowances carried forward – Du Ltd	0·5	
		Capital loss carried forward – Du Ltd	0·5	
		Transfer of loss from FIA to MTA – Bo Ltd	1	
		Surrender of loss from Du Ltd to Ca Ltd – Lm5,000	1	
		Surrender of loss from Du Ltd to Bo Ltd – Lm6,000	1	
		FRFTC on interest – Pi Ltd	0·5	
		Tax at 35%	0·5	
		Credit for FRFTC – Pi Ltd	0·5	
		Credit for tax at source on local dividend – Bo Ltd	0·5	
		Credit for tax at source on local dividend – Ca Ltd	0·5	
		Credit for withholding tax on foreign dividend – Ca Ltd	0·5	
				13
	(b)	**Capital allowances**		
		Capital allowance to be carried forward – article 14(1)(g)	1	
		Allowable loss does not include capital allowances – article 22	1	
				2
				15

5	**Calculation of excess VAT credit claimed**	
	Cash sales – standard rated – Lm40,000 at 18%	0·5
	Cash sales – reduced rate – Lm50,000 at 5%	0·5
	Cash sales – exempt with credit – Lm160,000	0·5
	Credit sales – standard rated – Lm8,000 at 18%	0·5
	Credit sales – reduced rate – Lm12,000 at 5%	0·5
	Credit sales – exempt with credit – Lm25,000	0·5
	Sale of equipment – Lm4,000 at 18%	1
	Purchases – standard rated – Lm38,000 at 18%	0·5
	Purchases – reduced rate – Lm49,600 at 5%	0·5
	Purchases – exempt with credit – Lm148,000	0·5
	Expenses – standard rated – Lm23,300 at 18%	1
	Expenses – reduced rate – Lm4,400 at 5%	1
	Capital expenditure – standard rated – Lm20,000 at 18%	1·5
	Bad debt – standard rated – Lm1,600 at 18%	1
		10