Fundamentals Level – Skills Module

Taxation (Malta)

Monday 3 December 2007

Paper F6 (MLA)

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

ALL FIVE questions are compulsory and MUST be attempted.
Tax rates and allowances are on pages 3–4.

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.

The Association of Chartered Certified Accountants

The Malta Institute of Accountants

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The question paper begins on page 3.

SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings need only be made to the nearest Lm.
2. All apportionments should be made to the nearest month.
3. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates and allowances are to be used in answering the questions.

Individual tax rates for the year of assessment 2007

Married Individuals:

Lm		Lm	Rate (%)
0	to	4,300	0
4,301	to	6,000	15
6,001	to	7,250	20
7,251	to	8,500	25
8,501	to	10,000	30
10,001 and over			35

Other Individuals:

Lm		Lm	Rate (%)
0	to	3,100	0
3,101	to	4,100	15
4,101	to	5,000	20
5,001	to	6,000	25
6,001	to	6,750	30
6,751 and over			35

Non-resident Individuals:

Lm		Lm	Rate (%)
0	to	300	0
301	to	1,300	20
1,301	to	3,300	30
3,301 and over			35

Capital allowances

Industrial buildings and structures

Initial allowance	10%
Wear and tear allowance	2%

Plant and machinery

Minimum number of years over which items of plant and machinery are to be depreciated:

Computers and electronic equipment	4
Computer software	4
Motor vehicles	5
Furniture, fixtures, fittings and soft furnishings	10
Equipment used for the construction of buildings and excavation	6
Catering equipment	6
Aircraft	12
Ships and vessels	10
Electrical and plumbing installations and sanitary fittings	15
Cable infrastructure	20
Pipeline infrastructure	20
Communication and broadcasting equipment	6
Medical equipment	6
Lifts and escalators	10
Air-conditioners	6
Equipment mainly designed or used for the production of water or electricity	6
Other machinery	5
Other plant	10

Capital gains

Capital gains index of inflation:

1983	428·06	1995	536·61
1984	426·18	1996	549·95
1985	425·17	1997	567·95
1986	433·67	1998	580·61
1987	435·47	1999	593·00
1988	439·62	2000	607·07
1989	443·39	2001	624·85
1990	456·61	2002	638·54
1991	468·21	2003	646·84
1992	475·89	2004	664·88
1993	495·60	2005	684·88
1994	516·06	2006	703·88

Capital gains rules

Inflation formula: $$\frac{\text{cost of acquisition/improvements}}{1} \times \frac{\text{index}^{yd} - \text{index}^{ya}}{\text{index}^{ya}}$$

Deduction for inflation not to exceed: TP – CA – D or MV – CA – R

Where:
TP = the transfer price of the property
CA = the cost of its acquisition, taking into account any reduction in the value of the property
D = the other deductions, excluding the deduction for inflation

MV = the market value of the portion of the immovable property represented by the shares transferred
CA = an equivalent portion of the cost of acquisition or completion of that property
R = the amount of the reduction

Corporate income tax

Company rate of tax:	35%

Value added tax (VAT)

Standard rate	18%
Reduced rate	5%

ALL FIVE questions are compulsory and MUST be attempted

1 Anthony, Bernard and Chris have been trading as a commercial partnership for many years, sharing profits and losses in the proportion 3:3:4. A partnership agreement exists which provides for the following:

– Anthony is entitled to an annual salary of Lm16,500 from which Lm4,218 is paid under the final settlement system;
– Bernard receives a gross salary of Lm3,000 as he works on a part-time basis and has not elected for 15% withholding tax on his income; and
– Chris is not entitled to a salary as he is a 'sleeping partner'.
– Interest is to be credited at 8% per annum when the balance brought forward on a partner's current account is in credit but is charged at 8% per annum when the balance brought forward on a partner's current account is in debit. At 1 January 2006 the following balances were brought forward on the partners' current accounts:
Anthony's account was Lm25,000 in credit;
Bernard's account was Lm5,000 in debit; and
Chris' account was Lm40,000 in credit.

The partnership made a profit of Lm60,000 for the year ended 31 December 2006. This profit figure is stated before charging partners' salaries, interest on partners' current accounts and capital allowances. Capital allowances for the year ended 31 December 2006 amounted to Lm6,700 and during the year ended 31 December 2005, the partnership had been unable to deduct capital allowances of Lm11,000 from its profits for that year.

Anthony and his wife Angela have opted for separate income tax computations. Angela has a part-time job as a secretary and her employment income for the year ended 31 December 2006 amounted to Lm4,200 from which her employer deducted Lm170 under the final settlement system. Anthony and Angela received a dividend of Lm1,780 gross from a company incorporated in Malta during the year ended 31 December 2006 and also received foreign source interest of Lm270 which was subject to withholding tax of 10%. Anthony also paid provisional tax payments amounting to Lm1,800. Anthony and Angela have two children: Andrea who is six years old and attends primary school and Alison who is thirteen years old and attends secondary school. During the year ended 31 December 2006, school fees of Lm180 and Lm480 were paid respectively.

Bernard is separated from his wife Bridget and he pays her alimony of Lm400 per month from his full-time employment income. During the year ended 31 December 2006 Bernard's full-time employment income amounted to Lm14,000, Lm3,342 being deducted under the final settlement system and he paid no provisional tax. Bernard and Bridget were separated in 1998 by means of a public deed of separation and although the alimony of Lm400 per month was not ordered by the Court, it was included in the public deed. Bridget has custody of their only child, Blake who is fourteen years old and attends a state school. Apart from the alimony she receives from Bernard, Bridget also receives rental income of Lm1,200 per annum and she had paid no tax during the year ended 31 December 2006.

Chris is not married. He has a full-time job as a manager with a local company. His basic salary for the year ended 31 December 2006 amounted to Lm14,000 but he also received bonuses and cash allowances of Lm2,800 and paid Lm5,407 under the final settlement system. Chris' contract of employment required him to travel to other countries outside Malta although his main duties were performed locally. Chris' employer provided him with a car which had cost Lm22,000 in 2002 and it is estimated that Chris used it for ten months during the year and his employer pays for all car expenses in full. Chris had taken a loan from his employer in order to put capital into the partnership. The amount of the loan outstanding as at 1 January 2006 was Lm6,500 and Chris had made no loan payments during the year ended 31 December 2006. The loan had a subsidised interest rate of 6% per annum. Chris had paid provisional tax payments of Lm800 during the year ended 31 December 2006.

Required:

Calculate the settlement tax payable by Anthony and Angela, Bernard, Bridget and Chris under the self assessment system for the year of assessment 2007.

Note: in arriving at the settlement tax amount calculations should show the total chargeable income and the outstanding income tax payable after taking into account all tax credits and reliefs available in each case.

(25 marks)

2 SCM Limited and TLG Limited are two Maltese registered and tax resident manufacturing companies, fully owned by a UK resident company. Both companies have a financial year end of 30 June.

SCM Limited was incorporated on 30 December 2006 and the company's summarised profit and loss account for the six-month period from the date of incorporation to 30 June 2007, which is the period that will be reported in the tax return for the year of assessment 2007, is as follows:

	Notes	Lm	Lm
Gross profit			478,400
Operating expenses			
Depreciation	1	41,000	
Wages and salaries	2	97,000	
Repairs and maintenance	3	20,400	
Professional fees	4	8,800	
Other expenses	5	51,200	
			(218,400)
Operating profit			260,000
Income from investments			
Interest	6	1,200	
Dividends	7	45,000	
			46,200
Profit from the sale of fixed assets			
Disposal of machinery	8		23,800
			330,000
Interest payable	9		(25,000)
Profit before taxation			305,000

Notes

1. Depreciation has been charged for the six-month period of operation on the assets held at 30 June 2007. No depreciation was charged in respect of assets acquired and disposed of during the period. Details of the assets and the depreciation charge are:

	Industrial building	**Machinery**	**Electronic equipment**	**Commercial motor vehicles**	**Total**
	Lm	**Lm**	**Lm**	**Lm**	**Lm**
Additions	180,000	341,200	170,000	40,000	731,200
Disposals	–	(21,200)	–	–	(21,200)
Cost as at 30 June 2007	180,000	320,000	170,000	40,000	710,000
Depreciation	–	20,000	17,000	4,000	41,000
Depreciation rate	Nil	12·5%	20%	20%	

2. Wages and salaries include an amount of Lm3,000 in respect of outsourced work which was not reported under the final settlement system (FSS). It represented work under a contract of services with a self-employed individual, who has not provided the company with a tax invoice.

   The company paid bonuses amounting to Lm7,500, which are included in the profit and loss account and were reported for FSS purposes.

   One of the company's employees had his contract terminated on 30 May 2007 and became entitled to a terminal payment of Lm2,000, which the company paid immediately and which was reported for FSS purposes.

3. The company incurred costs amounting to Lm20,400 in connection with the purchased building. Of this amount Lm15,000 was spent on adding another storey to the building, whereas the remaining Lm5,400 was spent on repairs to the acquired building.

4. Professional fees are made up of the following:

	Lm
Accountancy and audit fees	4,500
Registration and legal fees in connection with the company's incorporation	1,800
Legal retainer fee	2,500
	8,800

The accountancy and audit fees figure includes Lm3,400 with respect to a feasibility study and a budget prepared by consultants two months before the company was incorporated. This amount was originally invoiced to the company's promoters and paid by the company a few weeks after its incorporation.

5. Other expenses are made up of the following:

	Lm
Fines and penalties due to the VAT Department for late registration	200
Fines and penalties due to the Inland Revenue Department in respect of FSS	400
Interest paid to the VAT Department on the late payment of VAT	250
Interest paid to the Inland Revenue Department for the late payment of FSS	350
Training given in the UK to prospective employees of the Malta company during the six months before the company's incorporation	45,800
Advertising expenses incurred during the six month period before the company's incorporation	4,200
	51,200

6. The interest of Lm1,200 was received from a local bank and represents the amount gross of tax even though the bank withheld the 15% final withholding tax.
7. The dividend of Lm45,000 was received by SCM Limited from a shareholding in an overseas company. This amount is gross of 15% foreign withholding tax.
8. Machinery which had been acquired at a cost of Lm21,200, was sold to another group company for Lm45,000.
9. The interest payable is in respect of the company's 8% bonds issued during the period. The bonds were subscribed to by the UK parent company and the proceeds were used to finance the company's trading activities.

Additional notes:

(i) TLG Limited made a trading loss from its Malta operations of Lm102,250 before wear and tear allowances for the year ended 30 June 2007. It also had foreign income of Lm10,000 in that year.

(ii) The objective of the UK parent company of SCM Limited and TLG Limited is to reduce the combined tax liability of its two Maltese subsidiaries.

Required:

(a) Calculate the initial allowances and wear and tear allowances that may be claimed by SCM Limited for the year of assessment 2007. (4 marks)

(b) Prepare the income tax computation of SCM Limited for the year of assessment 2007 starting with the profit before tax figure as per the financial statements of Lm305,000, clearly identifying the tax charge on the trading operations, on the local interest income and on the foreign sourced income, the total tax payable and the tax charge that will appear in the company's financial statements. (19 marks)

(c) State the balance of SCM Limited's unsettled tax for the year of assessment 2007 and state the date by when it must be paid. (3 marks)

(d) State, giving reasons, whether a balancing statement should be prepared in respect of the assets sold during the period. (2 marks)

(e) State, giving reasons, whether SCM Limited can avail itself of group loss relief in respect of the losses incurred by TLG Limited. (2 marks)

(30 marks)

3 In 1996, Mary and Anne, who are unrelated to each other, subscribed to shares in Milestone Properties Ltd at their nominal value as follows:

Shareholder	Number of shares	Type of shares	Nominal value per share	Nominal value
			Lm	Lm
Mary	800	Ordinary	100	80,000
Mary	4,000	Preference	100	400,000
Anne	200	Ordinary	100	20,000
Anne	1,000	Preference	100	100,000
Total	6,000			600,000

In November 2007, they received an offer from a third party who was willing to buy their shares in the company. The prospective purchaser offered Lm600 for every ordinary share and Lm112 for every preference share.

They have approached you as their tax consultant to advise them on their tax liability and the net proceeds that would be receivable should they decide to accept the offer. They are also considering selling the company's immovable property, in which case they will subsequently liquidate the company and receive the proceeds on liquidation.

The company's latest audited financial statements are those relating to 30 September 2007 and the balance sheet on that date is as follows:

	Notes	Lm
Immovable property	1	750,000
Cash at bank		130,000
		880,000
Share capital		600,000
Retained earnings	2	80,000
		680,000
Bank loan		200,000
		880,000

Notes

1. The following is a description of the immovable property owned by the company, its year of acquisition, cost and current market value:

Description of property	Year of acquisition	Cost	Market value
		Lm	Lm
Plot of land	1996	40,000	180,000
Block of apartments	1998	210,000	390,000
Showroom and offices	2001	320,000	480,000
Penthouse	2006	180,000	180,000
		750,000	1,230,000

2. The following is a breakdown of the retained earnings at 30 September 2007:

	Accounting profit/(loss)	Tax	Net
	Lm	Lm	Lm
Balance brought forward	46,350	16,350	30,000
2003	28,500	10,000	18,500
2004	17,800	6,300	11,500
2005	(5,300)	–	(5,300)
2006	19,900	7,100	12,800
2007	19,250	6,750	12,500
	126,500	46,500	80,000

All of the company's taxed profits have been subject to tax at the rate of 35% and are in excess of the accounting profits of the respective years.

3. Both Mary's and Anne's marginal rate of tax is 35%.

Required:

Advise Mary and Anne on:

(a) **Their personal tax liability and the net proceeds that would be receivable should they decide to sell the shares in Milestone Properties Ltd for the price offered by the prospective purchaser.** (14 marks)

(b) **The company's tax liability and the net proceeds that would be receivable should it sell all of its immovable property at its market value.** (2 marks)

(c) **The net proceeds that would be receivable by Mary and Anne on the liquidation of the company following the sale of all its immovable property.** (3 marks)

(d) **Whether or not it would be better to accept the offer from the prospective purchaser for the shares or to sell the property and liquidate the company.** (1 mark)

(20 marks)

4 Pi Ltd is a Malta incorporated holding company, which has three subsidiaries: Bo Ltd, Ca Ltd and Du Ltd. All four companies are tax resident in Malta and have identical financial periods. The results of the four companies for the year of assessment 2007 were as follows:

	Pi Ltd	**Bo Ltd**	**Ca Ltd**	**Du Ltd**
Accounting profit/(loss)	600	13,200	8,000	(25,400)
Depreciation charged in arriving at the accounting profit/(loss)	–	4,800	2,400	5,200
Capital allowances	–	8,400	1,800	6,000

Notes:

1. The accounting profit of Pi Ltd of Lm600 has been arrived at by deducting interest payable of Lm200 from foreign source interest of Lm800. No foreign tax was suffered by Pi Ltd. The company has no trading activities and no assets and therefore has no depreciation or capital allowances.
2. The profit figure of Lm13,200 of Bo Ltd includes Malta trading profits of Lm14,000 and a gross dividend of Lm3,600 received from a Malta company. The tax withheld at source on the dividend amounts to Lm1,260. Bo Ltd has an overseas branch which during the year made a trading loss of Lm4,400. This amount is equal to the tax loss and the branch does not have any assets.
3. Ca Ltd received a foreign gross dividend of Lm3,200 and a local gross dividend of Lm400. These amounts are included in the accounting profit of Lm8,000, the remaining Lm4,400 being trading profits from local operations. The withholding tax on the foreign dividend amounted to Lm1,020 and the tax at source on the local dividend amounted to Lm140.
4. During the year Du Ltd disposed of an immovable property situated in Malta at a capital loss of Lm9,200. This amount is equal to the capital loss for tax purposes. The remaining loss was incurred from local trading operations.

Required:

(a) Prepare the income tax computation of each of the four companies for the year of assessment 2007 assuming that the group's policy is to minimise the overall tax liability for the year. (13 marks)

(b) State, giving reasons, whether unabsorbed capital allowances may be surrendered under the group relief provisions of the Income Tax Act. (2 marks)

(15 marks)

5 Krats Limited operates a small supermarket and is registered for value added tax (VAT) under Article 10 of the Value Added Tax Act. The following information is available with respect to the company's transactions for the year ended 30 September 2007.

1. Cash sales for the year amounted to Lm250,000, of which Lm40,000 were standard rated, Lm50,000 were at the reduced rate and the balance of Lm160,000 were exempt with credit.
2. Credit sales for the year amounted to Lm45,000, of which Lm8,000 were standard rated, Lm12,000 were at the reduced rate and the balance of Lm25,000 were exempt with credit.
3. Purchases for the year amounted to Lm236,000, of which Lm38,400 were standard rated, Lm49,600 were at the reduced rate and the balance of Lm148,000 were exempt with credit. All purchases were made on credit.
4. Standard rated overheads for the year amounted to Lm28,000. This includes Lm2,200 spent on lunches with clients, Lm1,400 spent on cigarettes and alcohol and Lm1,100 for petrol for the director's car (see (6) below).
5. Electricity bills for the year amounted to Lm4,400.
6. During the year a motor car costing Lm18,600 has been purchased for the use of the company's director. The director is provided with free petrol to run this car, the cost of which amounted to Lm1,100 and is included in the standard rated overheads (see (4) above).
7. During the year ended 30 September 2007 machinery was purchased for Lm20,000 and office equipment sold for Lm4,000. Input VAT had been claimed when the office equipment was originally purchased.
8. On 30 September 2007 Lm1,888 (inclusive of VAT at 18%) due from a customer was written off as a bad debt. Apart from this amount written off the company also made a provision for bad debts amounting to Lm600.

Unless stated otherwise all of the above figures are stated exclusive of any applicable VAT.

Required:

Calculate the total amount of VAT payable by Krats Limited or the excess credit claimable by the company for the year ended 30 September 2007.

(10 marks)

End of Question Paper