Fundamentals Level – Skills Module

Taxation (Malta)

Monday 2 June 2008

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 printed on pages 2–3.

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

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 for the year of assessment 2008 are to be used in answering the questions.

Individuals:

Married				Other			
Lm		Lm	%	Lm		Lm	%
0	to	4,500	0	0	to	3,250	0
4,501	to	8,000	15	3,251	to	5,500	15
8,001	to	10,000	25	5,501	to	6,750	25
10,001 and over			35	6,751 and over			35

Non-resident person

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

Companies:

Corporate rate of income tax 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

Fringe benefits – motor vehicles

Car use value: 17% of the car value
10% of the car value if car is older than six years

Maintenance value and fuel value
If the car value is less than or equal to Lm12,000 it is 3% of the car value.
If the car value is more than Lm12,000 it is 5% of the car value.

Private use value

Car value		Private use value
From	To	
0	7,000	30%
7,001	9,000	40%
9,001	14,000	50%
14,001	20,000	55%
20,001 and over		60%

Capital gains

Capital gains index of inflation:

1983	428·06	1996	549·95
1984	426·18	1997	567·95
1985	425·17	1998	580·61
1986	433·67	1999	593·00
1987	435·47	2000	607·07
1988	439·62	2001	624·85
1989	443·39	2002	638·54
1990	456·61	2003	646·84
1991	468·21	2004	664·88
1992	475·89	2005	684·88
1993	495·59	2006	703·88
1994	516·06	2007	712·68
1995	536·61		

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

Value added tax (VAT)

Standard rate	18%
Reduced rate	5%

ALL FIVE questions are compulsory and MUST be attempted

1 (a) During 2007 Robert and Fiona Wilkonson, who are not ordinarily resident and domiciled in Malta, bought a farmhouse in Gozo for the price of Lm990,000 and spent more than six months in Malta. They financed the acquisition by the following:

1. Disposed of an apartment in Valletta for the price of Lm420,000. They had bought the apartment in 1991 for the price of Lm260,000;
2. Disposed of a country house they had outside Malta for the price of Lm499,000. They had bought this property as a holiday home in 2001 for the price of Lm400,000 and they remitted the gain to Malta leaving Lm400,000 in a bank account held outside Malta;
3. Disposed of various listed securities on various stock markets outside Malta none of which are recognised under the Financial Markets Act. The securities were disposed of for a total consideration of Lm85,400 even though the original cost of the same securities was Lm94,200. Robert and Fiona remitted all the sales proceeds to Malta;
4. Disposed of some securities which they held in a non-listed Maltese company and made a capital gain of Lm10,600 on the disposal consideration of Lm132,500. The company had no immovable property and the shares did not constitute a controlling interest;
5. Disposed of some other securities in other Maltese companies for Lm60,000. All securities were listed on the Malta Stock Exchange and they made a total gain of Lm22,800. Earlier in the year Robert and Fiona had received gross dividends of Lm60,000 from these securities which they also declared in their tax return. All the dividends were paid out of profits taxed at 35% from the Maltese Taxed Account;
6. Remitted Lm45,000 from their foreign pension to Malta. The pension entitlement for the full year was Lm74,000;
7. Closed a bank account they had in Malta and withdrew the sum of Lm15,420. The amount of Lm420 represented interest on which no tax was withheld by the bank;
8. Closed one of the bank accounts they had with a foreign bank outside Malta and remitted the capital amount of Lm83,000 together with interest credited by the bank amounting to Lm4,580;
9. Took a loan of Lm80,000 from a Maltese bank to finance the remainder of the farmhouse purchase price and some other expenses related to the acquisition.

Required:

(i) Calculate the chargeable income of Robert and Fiona and the income tax paid and payable for the year of assessment 2008. (7 marks)

(ii) State, giving reasons, which of the couple's income and capital gains or losses arising in 2007 are not subject to income tax or are not deductible for Maltese income tax purposes. (5 marks)

(iii) Assuming (1) that Robert and Fiona did not take up residence in Malta during 2007 and were not considered to be tax resident in Malta during that year, and (2) that any capital gains arising on transfers of immovable property situated in Malta are subject to tax in the country of residence of Robert and Fiona: recalculate their income tax payable for the year of assessment 2008 on the basis that they would opt for the most beneficial tax treatment(s).

Note: you should ignore the provisions of the Duty on Documents and Transfers Act. (6 marks)

(b) Keith Tolput is an expatriate who was offered the post of general manager with a Maltese company which is a wholly owned subsidiary of a foreign parent company.

Keith Tolput commenced his employment with the Maltese company on 2 January 2007 and during the calendar year ended 31 December 2007 he earned the following:

1. Basic salary of Lm24,000
2. Statutory bonuses and production bonuses of Lm4,800
3. Travel and entertainment allowance of Lm6,000

Apart from the above, his package also included the following fringe benefits:

1. Use of an apartment as his own residence. The company had bought the apartment in 1998 for Lm120,000 but its market value is now estimated at Lm260,000.
2. Use of a company car that the company bought in 2005 for Lm28,000. All expenses except for fuel were paid for by the employer. Keith estimates that he spent around Lm720 in fuel expenses during 2007.
3. Executive health insurance costing Lm1,484 per annum. Keith is aware that the company offers a standard health insurance cover costing Lm120 per annum to all its employees. These amounts are paid directly by the employer to the insurance company.
4. Use of a mobile phone which Keith uses for business purposes. All bills, averaging Lm150 per month, are paid by the employer.
5. Payment of private school fees capped at Lm1,140 in total for Keith's two children who attend private schools (at secondary level). The company pays the school fees directly to the school whilst Keith pays an additional Lm300 for each child out of own funds.
6. Vouchers for a one week holiday for his family (his wife, two children and himself), all expenses included, costing Lm4,500.

Keith's social security contributions as paid by the employer and the employee are capped at Lm1,354, half of which is paid by Keith and the other half paid by the company.

Required:

(i) Calculate Keith's chargeable income and tax liability for the year of assessment 2008. (9 marks)

(ii) Calculate the net cash salary received by Keith from the company during 2007 and calculate any settlement tax which Keith will have to pay by the tax return date. (3 marks)

(30 marks)

2 The accountant of Macilu Limited prepared the following profit and loss account for the year ended 31 December 2007:

	Note	Lm	Lm
Gross profit			256,650
Other income			
Dividends received	1	143,500	
Interest received	2	4,050	
Rent and ground rent received	3	6,000	
			153,550
			410,200
Overheads and expenses			
Advertising	4	5,840	
Audit fee		1,600	
Depreciation	5	13,170	
Exchange loss	6	3,600	
Insurance	7	2,560	
Interest paid	8	15,280	
Legal fees	9	1,850	
Provision for bad debts	10	6,230	
Repairs and maintenance	11	8,520	
Telecommunication costs		5,440	
Travelling		3,690	
Wages and salaries	12	44,520	
Water and electricity		3,900	
			116,200
Profit before taxation			294,000

Notes:

1. Dividends received are gross of tax at source and comprise:

	Lm
Dividends received out of tax exempt profits which remain exempt in the hands of the shareholder	35,000
Dividends received out of profits taxed at 35%	100,000
Dividends received out of the untaxed account of the distributing company	8,500
	143,500

2. Interest received includes bank interest of Lm2,550 received net of withholding tax at 15%. The remaining balance of Lm1,500 represents interest charges to trade debtors on overdue balances.

3. Rent received is partly in respect of a warehouse which the company owns and rents out at Lm4,860 per annum, stated net of the ground rent payable on the same warehouse of Lm360. The company also owns a plot of land on which it receives ground rent of Lm1,500 per annum.

4. Advertising includes a donation of Lm240 given to a philanthropic institution approved for the purposes of article 12(1)(e).

5. The amount of Lm13,170 comprises a loss on disposal of Lm3,170 in respect of motor vehicle 2 and a depreciation charge of Lm10,000 as follows:

	Cost	Depreciation up to 2006	Depreciation 2007	Proceeds	Loss
	Lm	Lm	Lm	Lm	Lm
Office electronic equipment	13,000	6,500	3,250	–	–
Motor vehicle 1	27,000	13,500	6,750	–	–
Motor vehicle 2	16,000	8,000	–	4,830	(3,170)
			10,000		(3,170)

The office equipment and both the non-commercial motor vehicles were acquired during 2005 and are depreciated over four years charging a full year's depreciation in the year of acquisition and no depreciation in the year of disposal.

No depreciation is charged in the profit and loss account in respect of the warehouse which the company rents out.

6. The exchange loss is made up of the following:

	Lm
Unrealised exchange gain	(1,200)
Unrealised exchange loss	2,000
Realised exchange loss	2,800
	3,600

7. Insurance premiums for the year amount to Lm4,460. The company received an amount of Lm1,900 in respect of a claim made for damages caused to its equipment by fire and this amount was offset against the premiums paid.

8. Interest paid comprised Lm14,770 charged by the bank on a loan, Lm300 charged by the Inland Revenue Department and Lm210 charged by the VAT Department.

9. Legal fees include an amount of Lm500 incurred in contesting an income tax assessment and an amount of Lm550 incurred in a dispute with an ex-employee who was dismissed for misconduct. The remaining Lm800 is a retainer fee charged by the company's lawyer.

10. The provision for bad debts is made up of a general provision of Lm3,630 and a specific provision of Lm1,800. The accountant also included a bad debt of Lm800 written off during the year in the amount of Lm6,230.

11. Repairs and maintenance include: extraordinary repairs or capital expenditure of Lm2,660 incurred during the year on the rented warehouse; improvements made to the company's offices of Lm3,960; and repairs to equipment amounting to Lm1,900 which the company recovered from the insurance (as per note 7 above).

12. Wages and salaries include an amount of Lm3,600 paid to a registered childcare centre in respect of four children (of the company's employees) who attend the centre. The company did not pay the relevant tax under the final settlement system and the social security contributions in respect of this amount and incurred a fine imposed by the Inland Revenue Department amounting to Lm74. This amount is also included in wages and salaries.

Required:

(a) Prepare the income tax computation of Macilu Limited for the year of assessment 2008 by adjusting the profit before tax figure as per the financial statements of Lm294,000. Clearly identify the tax charge at 35%, the tax charge at 15% and the tax payable by the company. (19 marks)

(b) Assuming that only net investment and exempt dividends are to be allocated to the Final Tax Account, allocate the company's distributable profits to the Final Tax Account, the Maltese Taxed Account, and the Untaxed Account respectively. (3 marks)

(c) If the company were to distribute a net dividend of Lm200,000 to its individual shareholders, calculate the net dividend from each tax account that may be distributed in terms of article 68 of the Income Tax Act, together with any tax at source that may be claimed as a credit by the shareholders. (3 marks)

(25 marks)

3 In May 2007, Ruth, who is one of the two shareholders in Marshy Limited, disposed of her entire shareholding in the company for Lm500,000. Her shareholding consisted of 900 ordinary shares of Lm10 each which she had acquired as follows:

In 1990 she acquired 500 ordinary shares for Lm80,000.
In 1996 she acquired another 400 ordinary shares for Lm200,000.

The balance sheets of Marshy Limited for the years ended 31 December 1991 and 2006 are as follows:

		1991	**2006**
	Note	**Lm**	**Lm**
Fixed assets	1	100,000	460,000
Investment	2	20,000	20,000
Current assets		180,000	380,000
		300,000	860,000
Share capital	3	12,500	12,500
Retained earnings	4	193,500	541,500
		206,000	554,000
Liabilities		94,000	306,000
		300,000	860,000

Notes:

1. Included in the company's fixed assets are office premises which the company had acquired in 1991 for Lm40,000. These premises have a current market value of Lm200,000 but are stated at cost in the financial statements.
2. The investment consists of an 80% shareholding in Creams Limited whose balance sheet as at 31 December 2006 was as follows:

	Lm
Fixed assets	260,000
Current assets	140,000
	400,000
Share capital – 25,000 ordinary shares of Lm1 each	25,000
Retained earnings	195,000
	220,000
Liabilities	180,000
	400,000

   Creams Limited does not own any immovable property and the company made losses in each of the last five years.
3. The share capital of Marshy Limited consists of 1,250 ordinary shares of Lm10 each.
4. The profits of Marshy Limited for the five years prior to the disposal were as follows:

Year	**Profit**
	Lm
2002	81,500
2003	55,100
2004	53,275
2005	42,600
2006	52,525
	285,000

5. The financial statements for the year ended 31 December 1991 were submitted to the Inland Revenue Department before 25 November 1992.

Required:

(a) Explain the term 'controlling interest' as defined in rule 5 of the Capital Gains Rules and briefly explain the consequences when transferring a controlling interest as opposed to a share transfer which does not constitute a controlling interest. (5 marks)

(b) Compute Ruth's chargeable capital gain arising from the disposal of her shares in Marshy Limited. (9 marks)

(c) Calculate the chargeable capital gain if the other shareholder in Marshy Limited disposed of his/her 350 ordinary shares of Lm10 each for Lm200,000 in September 2007, assuming that these shares were all acquired in 1996 for Lm100,000. (3 marks)

(d) Explain whether and if so how, the computation of the chargeable capital gains in (b) and (c) above would change if either of the two shareholders is not resident in Malta. (3 marks)

(20 marks)

4 Pico Co Limited (Pico) is a Maltese holding company which was incorporated in January 2007 by two non-resident shareholders. Pico is to derive income from anywhere in the world including but not limited to income which would fall to be allocated to the foreign income account as defined in article 2 of the Income Tax Act. Pico's net foreign source income and capital gains for the nine month period from the date of incorporation to 30 September 2007 amounted to Lm1,120,000 as follows:

1. A dividend of Lm140,000 derived from a 12% shareholding in a company resident in Italy. No withholding tax was levied on the payment of the dividend by the Italian company.
2. A dividend of Lm420,000 derived from a 50% shareholding in a company resident in Panama. The Panamanian company's income consists solely of passive interest and no tax is levied in Panama on this income. No withholding tax was levied on the payment of the dividend by the Panamanian company.
3. A dividend of Lm30,000 received on 5 June 2007 from a 5% shareholding in a company resident in France. Pico had invested Lm800,000 when it bought the shares in the French company on 1 March 2007. The investment was sold for Lm850,000 on 30 June 2007. No withholding tax was levied in France on either the dividend or the gain.
4. Net interest and royalties amounting to Lm200,000 received from various foreign sources. The withholding tax suffered on both the interest and royalties was at the rate of 10%.

During the period ended 30 September 2007 Pico incurred administrative expenses amounting to Lm30,000 which are deductible against the various sources of income in proportion to the net income from each source, except for income from source 1 above to which no expenses are to be apportioned.

During the same period Pico paid a net dividend of Lm510,000 to its shareholders.

Required:

(a) Prepare the income tax computation of Pico Co Limited for the period ended on 30 September 2007, clearly distinguishing, if applicable, between income derived from a participating holding and income derived from a non-participating holding. Assume: (1) that the company will utilise the flat rate foreign tax credit; and (2) that if applicable, the company will avail itself of the participation exemption in terms of article 12(1)(u) of the Income Tax Act. (9 marks)

(b) Calculate the gross dividend, tax relieved and tax payable from each tax account or category in respect of the dividend distribution of Lm510,000. (6 marks)

(15 marks)

5 (a) Explain the term 'taxable value of supplies' as defined in the Seventh Schedule to the Value Added Tax Act, listing the items which are included and those which are excluded from the taxable value of a supply. (6 marks)

(b) Explain the general rules applicable in determining: (1) the place of supply of goods that are not transported, goods that are transported and goods that are installed or assembled, and (2) the place of supply of services, as laid down in the Third Schedule to the Value Added Tax Act. (4 marks)

(10 marks)

End of Question Paper