THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2016

PAPER 2.07 – MALTA OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

TIME ALLOWED – 3¼ HOURS

You should answer **FIVE** out of the seven questions: **BOTH** questions from Part A; the **ONE** question in Part B; and **TWO** questions from Part C.

Part A questions are worth 25 marks each. The Part B question is worth 20 marks. Part C questions are worth 15 marks each.

You should aim to spend approximately half of your exam time answering Part A, and the remaining half answering Parts B and C. The amount of time you spend answering each question should correspond broadly to the number of marks available for that question.

Start each answer on a new page. If you are using the on-screen method to complete your exam, you must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.

All workings should be made to the nearest month and Euro, unless the question requires otherwise.

Marks are specifically allocated for presentation.

For your information this paper is accompanied by:

Avoidance of Double Taxation Arrangement between Malta and Italy;

Avoidance of Double Taxation Arrangement between Malta and the Russian Federation;

Avoidance of Double Taxation Arrangement between Malta and Spain; and

Avoidance of Double Taxation Arrangement between Malta and the United States of America

PART A

You are required to answer BOTH questions from this Part.

1.

1) Property Exploitations Limited (PEL) is a company which was incorporated in Malta in 2000. PEL is managed and controlled in Malta, and was established to carry on a business consisting of the commercial exploitation of immovable property. The property is situated in both Malta and Italy.

   The Memorandum and Articles of Association of PEL specifically empower it to receive income which falls to be allocated to the foreign income account.

   PEL received the following:

   a) Gross rental income of €50,000 from the rental of a residential property in Italy (a restored heritage property) on a short-term basis;

   b) Gross rental income of €20,000 from the rental of a residential property in Sliema, Malta.

   c) Gross rental income of €25,000 from the rental of an office block in Valletta, Malta.

   d) Sales proceeds of €550,000 from the sale of a warehouse in Valletta, Malta. PEL had acquired the property in 2000 for €450,000. PEL had carried out improvements on the warehouse, costing €100,000. Notice of the promise of sale agreement had not been given before 17 November 2014.

   e) Sales proceeds of €650,000 from the disposal of an office block in Sliema, Malta. PEL had acquired the property in 2005 for €400,000. PEL had carried out improvements on the warehouse, costing €50,000.

   You are required to calculate PEL's chargeable income using the most tax efficient mechanisms available, and allocate its distributable profits to its tax accounts. You should provide reasons for each allocation. (15)

2) **You are required to explain the VAT treatment of the following transactions:**

   a) The rental, by a Maltese VAT registered company acting as landlord, of residential accommodation situated in Malta to a tourist.

   b) The rental, by a Maltese VAT registered company acting as landlord, of residential accommodation in Malta to a Maltese national who has been living in Malta for more than ten years.

   c) The rental, by a Maltese VAT registered company acting as landlord, of office premises in Malta to a Maltese VAT registered company.

   d) The rental, by a Maltese VAT registered company acting as landlord, of office premises in Bulgaria to a Bulgarian VAT registered company.

   e) The rental, by a Maltese VAT registered company acting as landlord, of residential property situated in China to a Chinese tax resident.

   (10)

Total (25)

2. Nikolai is a retired international soccer player. He was born to Russian parents, in Russia, in 1960, and in 1965 emigrated to Spain. In the course of his career, Nikolai played for leading Spanish soccer teams and amassed significant wealth. He also played for the Russian national team but severed all citizenship and other ties with Russia in 1985, except for the passive holding of certain assets in Russia.

In 1980 Nikolai married a Russian woman, with whom he had a son named Alexi. In 1985 Nikolai was divorced from his Russian wife, and married a Spanish woman with whom he had a son named Felix. In 2014 Nikolai met a Maltese woman living in the United Kingdom named Cetta, and shortly afterwards filed for divorce with his Spanish wife before moving into Cetta's London apartment.

In 2015 Nikolai and Cetta left the United Kingdom, moving to Malta permanently. Nikolai applied for Maltese citizenship by naturalisation under the Malta citizenship by investment programme, and his acquisition of Maltese citizenship received advanced media publicity. In interviews with the press, Nikolai declared that he intended to become "fully Maltese", and made a point that he would never return to Spain and Russia and would end his days in Malta.

Cetta wants to have a baby with Nikolai, and has asked him to transfer most of his assets to her. However Nikolai wants to provide for Alexi and Felix too, and has decided to dispose of his property as follows:

1) Nikolai intends to transfer his apartment in Moscow to Alexi, who is a Russian tax resident.

2) Nikolai intends to transfer his rights over cash held in a Russian bank to his mother, who is a Russian tax resident.

3) Nikolai intends to transfer all his ordinary voting shares (constituting a controlling interest) in his Russian resident real estate company to Alexi's mother, a Russian tax resident. 90% of the company's assets consist of immovable property situated in Russia.

4) Nikolai intends to transfer his lands and buildings in Spain to Felix.

5) Nikolai intends to transfer his image rights to Felix.

6) Nikolai intends to transfer the perpetual emphyteusis of a property in Malta to Cetta.

7) Pursuant to an undertaking assumed in connection with his citizenship application, Nikolai intends to transfer his collection of Old Master paintings (all of which are situated in his villa in Malta) to Fondazzjoni Wirt Artna (FWA), a Maltese heritage foundation.

8) Nikolai intends to transfer his remaining assets, namely the entire equity shareholding he holds in a Swiss company, to a Maltese trust constituted by written instrument of which he will be sole settlor and sole beneficiary.

You are required to determine the Maltese Income Tax implications (including Double Taxation Treaty implications), VAT implications, and Duty on Documents and Transfers implications of the transfers listed above, explaining any options available. You are not required to make any calculations of tax payable. (25)

PART B

You are required to answer THIS question.

3. Smithfield & Addison is a partnership en commandite (or limited partnership), with capital divided into shares, which was constituted in Malta in 2007 by two US individuals. Neither individual is resident or domiciled in Malta. Smithfield & Addison owns securities in companies incorporated in a number of countries, and a diamond mine in South Africa.

Smithfield & Addison has received the following dividends and distributions:

1) A dividend of €200,000 from Youkay Ltd, a commodities trading company incorporated in the United Kingdom. Smithfield & Addison holds 5% of the shares in Youkay Ltd. Smithfield & Addison's shares in Youkay Ltd are non-voting, but the shares carry rights to profits available for distribution and rights to assets available for distribution on a winding up. The total value of the shares is €5 million held for a period of more than two years, but the shares neither carry pre-emption rights nor the right to appoint a director to sit on the board of Youkay Ltd.

2) A dividend of €5,000 from Cash Drive Ltd, a holding company incorporated in Delaware, in the United States. Cash Drive Ltd is tax exempt in the US. Smithfield & Addison holds 100% of shares in Cash Drive Ltd. Smithfield & Addison's shares are voting equity shares, and carry rights to profits available for distribution and rights to assets available for distribution on a winding up. The total value of the shares is €20,000. Cash Drive Ltd's only income consists of passive interest from related parties.

3) A dividend of €500,000 from Lux Ltd, a company incorporated in Luxembourg. Smithfield & Addison holds 100% of shares in Lux Ltd. Smithfield & Addison's shares are voting equity shares, and carry rights to profits available for distribution and rights to assets available for distribution on a winding up. The total value of the shares is €2 million. The dividend received from Lux Ltd was exempt from withholding tax under the terms of Directive 2011/96/EU, and Lux Ltd claimed a deduction in Luxembourg for the distribution paid to the Maltese partnership.

4) A distribution of €100,000 from Island LP, a limited partnership established in Ireland. Smithfield & Addison holds 99% of shares in Island LP. Smithfield & Addison's shares are voting equity shares, and carry rights to profits available for distribution and rights to assets available for distribution on a winding up. The total value of the shares is €500,000. Island LP did not claim a deduction in Ireland for the dividend paid to the Maltese partnership.

5) Business profits of €3,000 attributable to the diamond mine in South Africa.

6) Net local bank interest of €2,000 on which tax was withheld in terms of the investment income provisions.

7) Gross local bank interest of €100,000 on which Smithfield & Addison elected to be paid gross.

The partnership deed of Smithfield & Addison specifically empowers it to receive income which falls to be allocated to the foreign income account.

Smithfield & Addison occupies office premises in Valletta, which were acquired by title of perpetual emphyteusis from the Government of Malta. Smithfield & Addison's office has a service area of 300 square metres.

Continued

3. Continuation

You are required to calculate Smithfield & Addison's chargeable income using the most tax efficient mechanisms available, and allocate its resulting distributable profits to its tax accounts. You should provide reasons for each allocation, and explain the tax consequences of a distribution from each tax account. In particular, you should consider the refundable tax credit system, Double Taxation Treaty relief and participation exemption implications. (20)

PART C

You are required to answer TWO questions from this Part.

4.

1) IT Corporation (IT Corp) is a US resident company which recently won a tender to provide information technology solutions to a Maltese registered company headquartered in Valletta. The tender award document permits IT Corp to assign the contract to its subsidiaries, and IT Corp has assigned the functions contemplated in the tender document to subsidiaries as follows:

   a) Services contemplating the assembly and installation of a computerised system will be undertaken by IT Corp's Spanish resident subsidiary. This project is expected to last for seven months, beginning and ending in the same calendar year.

   b) Hardware will be sold directly by IT Corp's Russian resident company to the Maltese client, and exported from Russia to Malta. This task will be finalised within three months, because goods will be shipped from Russia to Malta.

   c) The whole information technology system will be maintained, serviced, updated and repaired by employees belonging to IT Corp's Italian subsidiary. The employees are expected to be working in Malta, and based at the client's premises, for ten months each year for a period of five years.

   A team of IT Corp employees will visit Malta for a few days per quarter, for a period of five years, to carry out supervisory activities. These employees will not have a fixed place allocated to them at the Maltese company's premises. IT Corp will charge the Maltese client for the employees' time. Separate invoices will be issued to the Maltese client by IT Corp and its Spanish, Russian and Italian subsidiaries.

   You are required to determine whether IT Corp and its Spanish, Russian and Italian subsidiaries will be subject to Income Tax in Malta, relating to business profits derived from invoices raised to the Maltese client, explaining the Double Tax Treaty implications of their activities in Malta. (10)

2) Pegasus SICAV Ltd (Pegasus) is a Maltese Collective Investment Scheme incorporated in Malta and licensed by the MFSA. Pegasus has declared that the value of its assets situated in Malta is at least 85% of its total asset value, and on this basis has been classified by the Commissioner for Revenue as a prescribed fund. It has derived the following gains:

   a) Rental income from immovable property (residential accommodation leased to an individual) situated outside Malta;

   b) Rental income from immovable property (residential accommodation leased to an individual) situated in Malta;

   c) Maltese source bank interest;

   d) Maltese source investment income which is not bank interest; and

   e) Dividend received from a foreign company which does not qualify as a Participating Holding.

   You are required to determine the Income Tax rate applicable to each income stream, assuming that Pegasus SICAV Ltd selects the method of taxation which results in the lowest available tax charge at its level. (5)

Total (15)

5.

1) **You are required to determine whether the following expenditure incurred by a trading company is deductible for Income Tax purposes:**

   a) A VAT penalty charged for the late payment of a VAT return.

   b) Interest on late payment of VAT.

   c) A penalty levied because of an infringement of the Occupational Health and Safety Act.

   d) Promotional expenses.

   e) Expenditure on market research.

   f) Expenditure of a capital nature relating to the acquisition of a concession to excavate a mine.

   g) Pre-trading expenditure consisting in rent paid.

   h) Salaries and wages. (5)

2) HL SICAV Ltd (HL) is a Maltese licensed and incorporated Collective Investment Scheme. HL owns 60% of the equity shares in Operations Ltd (OL), a company that was incorporated in Malta and all the shares in Taljani Ltd, a Maltese limited liability company effectively managed and controlled in Italy. Taljani Ltd is deemed resident in Italy under Italian fiscal law. OL has a branch in Italy but has elected not to apply the participation exemption with respect to any income from OL's permanent establishment in Italy.

   The Income Tax computations, before any group relief, of each of the three companies for the year are as follows:

<u>Company</u>	<u>HL</u>	<u>OL</u>		<u>Taljani Ltd</u>
Tax Account	Immovable property <u>account</u>	Foreign income <u>account</u>	Maltese tax <u>account</u>	Maltese tax <u>account</u>
Chargeable income/(loss)	€500,000	(€70,000)	(€90,000)	(€100,000)

   All companies' accounting reference periods begin and end on the same date.

   You are required to answer, with detailed reasons, the following questions:

   a) Are HL, OL and Taljani Ltd regarded as members of the same group?

   b) May losses be surrendered between the companies mentioned above?
   (5)

3) Piers and Paul, two individuals who are both ordinarily resident and domiciled in Malta, have been in a relationship for more than ten years, and have been living together for more than five years. Piers is a highly qualified professional employed by a company licensed by the Malta Financial Services Authority (MFSA), and is independently wealthy as he receives substantial bank interest from a Swiss bank account. Paul is retired, and receives a pension for past employment and passive rental income. Piers's earned income is much higher than Paul's earned income and unearned income combined. Piers and Paul are seriously contemplating registering their partnership as a civil union.

   How will the registration of a civil union impact on Piers and Paul's Income Tax computations and Income Tax compliance obligations? (5)

Total (15)

6. "The Constitutional Court's judgment in *Angelo Zahra vs the Prime Minister* (2005) will inevitably have a profound impact on the Maltese tax system."

You are required to discuss the conclusions of the Constitutional Court, and to explain the relevance of the judgment. (15)

7. Maltija Ltd is a company which was incorporated in Malta in 2009. The immediate shareholders of Maltija Ltd are two limited liability companies, both of which are incorporated in the British Virgin Islands (BVI) and owned in turn by individuals who are neither ordinarily resident nor domiciled in Malta.

The following profits (after tax) have been allocated to Maltija Ltd's tax accounts:

Final tax account (FTA)	Immovable property account (IPA)	Foreign income account (FIA)	Maltese tax account (MTA)	Untaxed account (UA)
€100,000	€5,000	€100,000	€500	€10,000

Income allocated to the FTA comprised the following:

- €50,000 in post-tax profits, derived from the transfer of property chargeable to property transfers tax; and
- €50,000 in profits resulting from income or gains, in respect of which the participation exemption was applied.

Profits allocated to the IPA consisted of a market rent allocation.

Profits allocated to the FIA comprised the following:

- €20,000 in passive royalty relieved by the Flat Rate Foreign Tax Credit;
- €20,000 in passive interest relieved by unilateral relief;
- €20,000 in foreign source capital gain on the sale of immovable property situated outside Malta, on which no form of double taxation relief was claimed;
- €20,000 dividend from a participating holding which did not meet the anti-abuse conditions; and
- €20,000 dividend from a participating holding which met the anti-abuse conditions, but in respect of which the participation exemption was waived.

The profits allocated to the MTA consisted of local source bank interest received gross of tax.

The profits allocated to the UA consisted of exempt income received, which is not exempt from tax in the hands of the shareholders.

You are required to confirm the type of tax refunds, if any (namely 2/3, 5/7, 6/7 or 100%), due to Maltija Ltd's shareholders in relation to the distributions made from each of the company's tax accounts.

You should assume that all of Maltija Ltd's distributable profits are distributed by way of dividends to its shareholders, and that the company and its shareholders attend to all required compliance obligations. (15)