

## THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2019

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### MODULE 2.07 – MALTA OPTION

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#### ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

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TIME ALLOWED – 3¼ HOURS

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This exam paper has **three** parts: **Part A**, **Part B** and **Part C**.

You need to answer **five** questions in total.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **The** question in **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

#### Further instructions

- All workings should be made to the nearest month and in Euros, unless otherwise stated.
- Start each answer on a new page and clearly indicate which question you are answering. 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.
- Marks may be allocated for clarity of presentation of your answers.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering questions in Parts B and C.
- The first 15 minutes of the exam is reading time. You will be allowed to annotate the question paper during this time; however, you will **not** be permitted to start writing or typing your answer. The Presiding Officer will inform you when you can start answering the questions.

## PART A

**You are required to answer BOTH questions from this Part.**

1. In 2007 Mr Borg, a Maltese domiciled individual living solely in Malta, incorporated a Maltese registered company, Digital Limited (DL). Between 2007 and 2010, DL developed a software application, DX SOFT, comprising DX Application Software and DX System Software and to which DL is the sole proprietor of rights.

In 2011, Mr Borg transferred 51% of shares in DL to Borg Holdings Ltd, a private limited liability company incorporated in the Netherlands. The remaining 49% of the shares was transferred to AF plc, a public limited liability company incorporated in the United Kingdom. All of AF plc's investors are individuals who are neither resident nor domiciled in Malta. DL is present in many countries, and trades with an international client base.

In the year under consideration, DL received the following items of income and/or gains; amounts stated are gross of any tax:

- A sum equivalent in value to €500,000 paid under the terms of a software licensing agreement, allowing a Latvian company exclusive use of DX SOFT in Latvia. The sum was paid to DL in cryptocurrency, a method of payment that is expressly recognised in the software licensing agreement.
- A sum of €600,000 consisting of profits attributable to DL's Italian branch. The sum was retained in DL's Italian bank account and was neither received in Malta, nor remitted to Malta.
- A gain of €5 million from the sale of a component of DX System Software to Borg Holdings Ltd. This transaction is treated as a sale of intellectual property. The proceeds were received in DL's Maltese bank account.
- A gain of €6 million from the sale of a component of DX Application Software to AF plc. This transaction is treated as a sale of intellectual property. The proceeds were received in DL's Maltese bank account.
- A sum of €200,000, payable as a first instalment due under the terms of a software installation contract into which DL entered with a French company. The duration of the contract is two years and, in the course of the year under consideration, DL posted one of its employees to France.
- A sum of €100,000 payable under the terms of a software maintenance services agreement entered into with Maltija Ltd, a company registered in Malta.
- A sum of €250,000 for services rendered by one of DL's employees within Italy to an Italian customer under the terms of a three month-long services agreement.
- A sum of €400,000 paid under the terms of a confidential agreement, in which DL bound itself not to compete with a particular competitor in France. Based on advice received, the directors of DL consider that this receipt is of a revenue nature, rather than of a capital nature.
- €50,000 in interest paid on the late payment of an invoice relating to DL's trading activities that DL had issued to a Belgian company.
- A tax refund of €20,000 paid by the Spanish tax authorities. The tax refund does not relate to the trading activities of DL.

Continued

1. Continuation

- €2,000 in interest paid on the late payment of the abovementioned tax refund by the Spanish tax authorities.
- The sum of €200,000 gross of Spanish withholding tax at the rate of 25% attributable to DL's permanent establishment in Spain.

DL incurred the following expenses incurred by DL in the year under consideration:

	€
Salaries and wages	400,000
Interest paid (business bank overdraft)	20,000
Business travelling expenses	50,000
Donations to foreign charities	10,000
Rental expense (business premises)	<u>20,000</u>
	<u>€500,000</u>

**You are required to:**

- 1) **Allocate DL's distributable profits to its tax accounts using the most tax efficient mechanisms available, and calculate the tax due. You should provide reasons for each allocation, and assume that the company does not have an Flat Rate Foreign Tax Credit (FRFTC) empowerment clause but does maintain a policy of applying the Participation Exemption whenever it is available.** (15)
- 2) **Explain the tax consequences of the distribution of DL's profits to Borg Holdings Ltd and AF plc from each tax account, indicating the type(s) of tax refund entitlements arising, if any.** (10)

Total (25)

2. International Shipping Company Ltd (ISC), a company registered in Liberia, owns a large and diversified shipping fleet registered under the Greek flag. ISC also fully owns a Maltese registered subsidiary named Melita Shipping Ltd (MSL), a company that operates a trawler (Sajjied MV) which is engaged in fishing activities in Sicily. ISC and MSL are considering the following transactions:

- The transfer by ISC of Sajjied MV to a Maltese resident fishing company that is not owned or controlled by the shareholders and ultimate beneficial owners of ISC or MSL. Sajjied MV will be sold at a loss relative to its tax written down value.
- The transfer at current market value of a pipe-laying ship (Pipe MV) from ISC to MSL.
- The transfer at current market value from ISC to MSL of a self-propelled dredging vessel (Dredger MV) engaged in maritime transport services.
- The transfer at current market value from ISC to MSL of a stationary ship (Stationary MV) engaged in a catering operation in a Greek Island.
- The transfer to third parties of MSL's permanent berthing right located within a harbour in Italy at a profit.
- The transfer of MSL's fishing licence to a third party Maltese registered company at a profit.
- The transfer of MSL's fishing equipment physically situated in Malta to a third party Maltese registered company at a loss relative to its tax written down value.
- An interest-bearing loan of €20 million from ISC to MSL.
- The secondment of 50 ISC employees to MSL's base in Malta, with a consideration to be charged for the supply of the staff.
- Use of ISC's intellectual property by MSL, with an annual royalty payment to be paid by MSL to ISC.

**You are required to explain:**

- 1) **The tax consequences, including Income Tax, VAT and Duty on Documents and Transfers, of each of the transactions described above; and** (15)
- 2) **The Maltese Income Tax treatment of MSL and ISC after the transactions have taken place.** (10)

Total (25)

## PART B

**You are required to answer THIS question.**

3. Generous Employer Ltd (GEL) is a Maltese resident company which employs a workforce of several hundred employees and is licensed by the competent authority responsible for the regulation of financial services in Malta. Due to the highly specialised nature of GEL's activities, all employees are domiciled outside of Malta. All employees benefit from a highly beneficial and innovative remuneration package.

GEL's standard contract of employment provides for:

- A base salary to be paid by bank transfer.
- An additional salary paid in virtual currency.
- A number of coupons entitling employees to consume meals at the GEL canteen free of charge.
- A bonus paid to employees who do not avail themselves of their entire leave entitlement.
- Free access to GEL's in-house gym.
- A free annual 'teaming vacation' in Greece, a five-day event held abroad in a five-star hotel for employees and spouse equivalents. All travelling and lodging expenses will be borne by GEL's Permanent Establishment in Greece.
- Free health insurance.
- A private pension plan, contemplating annual payments to be borne by GEL.
- A virtual equity token, entitling all employees with more than five years of service to acquire an equity share in the company.
- A performance bonus calculated on GEL's annual turnover.
- Use of a car owned by GEL, with the employee to pay all fuel and maintenance costs.
- Free accommodation in a flat situated in a condominium owned by GEL Property Ltd, GEL's full owned Maltese subsidiary.
- Free use of a childcare centre owned by a company that is ultimately controlled and beneficially owned by the sole shareholder of GEL.
- Reimbursements for primary school fees in respect of descendants of employees attending a school approved by the government.
- Reimbursements for elderly care home fees paid in respect of ascendants.

**You are required to explain the tax implications of the remuneration package discussed above, identifying any possibilities of tax mitigation.** (20)

**PART C**

**You are required to answer TWO questions from this Part.**

4. Mr Gomes is a Brazilian national who has recently relocated to Malta. Mr Gomes recently retired from his partnership and has since acquired Maltese citizenship under the Individual Investor Programme, purchasing an apartment in Sliema, Malta. Mr Gomes's plan for the next ten years is to spend the spring, autumn and winter months in Malta and the summer months in Scandinavia.

Mr Gomes has acquired tenancy rights in a home for the elderly in the south of France, and intends to move to France as soon as he begins to experience mobility issues. Mr Gomes has learned of Malta's remittance basis of taxation and would be keen to benefit from it.

**You are required to explain:**

- 1) **Whether Mr Gomes is entitled to benefit from the remittance basis of taxation, and any circumstances leading to loss of the remittance basis of taxation;** (10)
- 2) **Any tax benefits applicable to persons who are eligible for the remittance basis of taxation; and** (2)
- 3) **The specific tax obligations of a person who qualifies for the remittance basis of taxation.** (3)

Total (15)

5. Innovation Agricultures Limited (IAL) is a company that was incorporated in Malta in 2016 to export pharmaceuticals produced in Malta. The sole shareholder of IAL is a listed company, owned and controlled by individuals resident and domiciled in the United States. IAL holds tenancy rights over large areas of agricultural land in the south of Malta.

IAL has recently obtained a licence to develop, produce, sell, distribute and market medicines based on a plant which IAL is permitted to cultivate under tightly controlled laboratory conditions. IAL is preparing its financial projections and seeks to forecast its tax costs for the future.

**You are required to answer the following questions asked by IAL's management:**

- 1) **Are IAL's research and development costs, or the costs of feasibility studies, tax deductible? Can IAL's initial tax losses be carried forward and, if so, for how many years may such losses be carried forward?** (5)
- 2) **Should IAL eventually charge VAT on its products? Will IAL be eligible for credits for input VAT incurred on supplies acquired for the purposes of its business?** (2)
- 3) **Will IAL's profits be subject to either the refundable tax credit system or the Flat Rate Foreign Tax Credit? Will IAL's employees be eligible for any special, favourable tax treatment?** (3)
- 4) **Is IAL entitled to capital allowances on any of the following expenditure items:**
  - a) **Costs incurred in building greenhouses on land belonging to the landlord. The contract of rent provides that, upon termination of the lease, all improvements shall revert to the landlord.**
  - b) **Costs incurred in the acquisition of the compost needed to grow the plants. Compost is replaced every six months.**
  - c) **Laboratory equipment.**
  - d) **Capital costs incurred in developing a brand name.**
  - e) **Lands and buildings.**(5)

Total (15)

6.

- 1) US Dating Corporation (USDC) is a United States (US) company incorporated in Delaware, which runs a dating website and whose sole shareholder is an individual resident and domiciled in the US. While all USDC employees and functions are based in the US, the company has an international clientele including several individuals (non-taxable persons) who habitually reside in Malta.

USDC regularly collects fees from Maltese customers and such fees are collected via a third party, Maltese licensed and resident payment gateway. USDC has hired an independent Maltese resident public relations company which advertises USDC's services on Maltese websites.

**You are required to determine the Maltese Income Tax and VAT implications of the activities pursued by USDC.** (5)

- 2) Irlandiza Ltd is a company that was incorporated in Luxembourg in 2011. From 1 January 2016, company decisions within Irlandiza Ltd began to be taken from Malta. The company began renting office space in Malta, and appointed a Maltese resident Chief Executive Officer. From 1 January 2016, all meetings of the board of directors were held in Malta, but the company's general meeting was held in Ireland.

Decisions relating to the day-to-day administration of the company were taken by the board of directors, but matters relating to the distribution of dividends were taken by the general meeting. The company's objects are limited to the holding of assets, and at present the company owns two assets:

- a long-term receivable (loan granted to a fully owned subsidiary); and
- an intangible asset (a trademark yielding annual royalties).

Irlandiza's board of directors has resolved to remit the interest income from its long-term receivable to its main bank account in Malta, but to transfer royalty income directly to the company's secondary bank account in Switzerland.

**You are required to determine, giving reasons:**

- a) **Whether Irlandiza is subject to the worldwide basis of taxation.** (2)
- b) **Whether Irlandiza's revenues should be classified as passive or active, and the relevance for tax purposes of the classification of the company's income.** (4)
- c) **Whether Irlandiza's income will be taxable in Malta, and whether the company can either claim double tax treaty relief under Malta's tax treaty with Ireland or avail itself of the participation exemption in relation to the interest received from its subsidiary.** (4)

Total (15)

7. **Discuss the Maltese legislative framework governing tax rulings and determinations from the revenue authority regarding Income Tax and VAT, including the cross-border exchange of information thereon within the European Union.**

(15)