

Guidance Notes

Audit Reporting On Schedules A, C, D and E of the Capital Gains Rules

TECH 01/07

These Guidance Notes are issued by the Malta Institute of Accountants with the collaboration of the Inland Revenue Department in March 2007 to assist Members engaged as practicing auditors in complying with the reporting requirements stemming out of the amended Capital Gains Rules. This guidance is intended to direct auditing practitioners to their obligations under the relevant legislative provisions and is by no means a substitute to any legislation or rules issued there under.

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Preface

Subsidiary Legislation 123.27 of the Laws of Malta, the “Capital Gains Rules” (hereinafter referred to as “the Rules”) has been enacted by virtue of Legal Notice (L.N.) 102 of 1993 and was subject to four amendments as a result of L.N. 379 of 2002, L.N. 5 of 2005, L.N. 51 of 2006 and the most recent L.N. 37 of 2007. The Rules set out the manner in which capital gains on transfers of immovable property and company shares are computed.

Amongst others, the Rules lay down legislative provisions governing the determination of the cost of acquisition of an immovable property, and the determination of the value of an immovable property acquired *causa mortis*. The Rules also lay down legislative provisions on transfers of company shares, the criteria for the determination of whether the said transfer is a transfer of a controlling interest (as defined in the Rules) or otherwise, and the determination of the market value of such shares.

In addition the Rules prescribe five schedules that derive their authority either from the provisions embedded in the aforementioned Rules, or directly from the provisions of the Income Tax Act. These schedules have to be completed and submitted to the Inland Revenue Department (IRD) whenever the circumstances for which they are prescribed prevail, namely:

- Schedule A, which derives its authority from Article 5 (9) of the Income Tax Act, has to be filled in whenever an immovable property is either transferred between group companies, or transferred by a group company to another company or third party outside the group;
- Schedule B, which derives its authority from Rule 9 (2) shall be completed whenever there is a transfer of any rights acquired under a promise of sale agreement or transfer of immovable property, or a transfer of any rights over immovable property;
- Schedule C, it deriving its authority from Rule 5 (9), shall be completed and submitted by a transferor of shares whenever there is a transfer of a controlling interest whereas Schedule D must be completed and submitted when the transfer does not constitute a transfer of a controlling interest; and
- Finally, Schedule E needs to be submitted by a transferor of shares where the transfer is exempt from tax in the circumstances mentioned in Rule 5(14).

All these Schedules, with the exception of Schedule B, require some form of auditor’s attestation and the scope of these Guidance Notes is to lay down best practice guidelines with which Members should comply when undertaking such assurance engagements. These Guidance Notes are the result of discussions held, and conclusions reached, between the MIA Technical Steering Committee and the IRD. Members complying with these guidelines will therefore satisfy the reporting requirements expected by the Inland Revenue Department.

Introduction

1. The purpose of these Guidance Notes is to provide guidance on the auditor's reporting responsibilities arising out of the Capital Gains Rules. The guidance set out in these Guidance Notes has been agreed with the IRD and Members complying with the recommendations hereunder will therefore satisfy the reporting requirements expected by the Department.
2. These Guidance Notes do not replace the Act and the Rules, or any parts thereof.
3. It is beyond the scope of these Guidance Notes to go into the technical aspects that are of a current tax nature. These Guidance Notes are solely concerned with the reporting requirements imposed on practicing auditors by the Rules and the respective Schedules.

Auditor's reporting

4. This section will:
 - (a) Identify the main legislative provisions, stemming out of the Capital Gains Rules, which merit some form of auditors' reporting;
 - (b) Identify which parts of the data included in the relevant four Schedules of the Rules need to be reported upon by the auditor; and
 - (c) Establish guidance on the contents of the auditor's reports accompanying the schedules.
5. The auditor should refrain from attesting, or leading to believe that he is attesting, the whole of any of the four Schedules. The auditor should report his findings, on the lines set out in these Guidance Notes, and should sign the relevant Schedule for identification purposes only.

Schedule A – Notice of transfer of immovable property, within or from a group of companies pursuant to article 5(9), Income Tax Act

6. Article 5(9) of the Income Tax Act states that where an asset is transferred from one company to another and such companies are deemed to be part of a group as defined in Article 16 of the Act, or are controlled and beneficially owned as to more than 50% by the same shareholders (both situations are conveniently referred to as a 'group' throughout this sub-section), such transfer is deemed not to give rise to any gain or loss. The Article adds that, when the asset being transferred is an immovable property, and the property is either transferred between group companies, or transferred to another company outside the group or to an individual the notary publishing the deed shall attach a notice therewith. The Notice referred to in Article 5(9) is in turn entrenched in Rule 6(4) and prescribed in Schedule A, of the Rules.
7. Schedule A contains details of the transferor company and the transferee (company or individual as the case may be), the notary officiating the deed of transfer, the immovable property being transferred and details referring to all previous transferors and transferees since the immovable property entered the group. The Schedule has to be completed for every immovable property being transferred within the group or for the first time the property is transferred outside the group.
8. Schedule A requires an auditor to provide assurance that:
 - (a) The "purchase price" as declared in part 4 of Schedule A agrees with the purchase price as stated in the respective deed; and

- (b) Both the “purchase price” and the value of “improvements” as declared in part 4 of Schedule A have been properly extracted from the company’s accounting records; and
 - (c) The aforementioned values reconcile to the historical cost of the property.
9. The auditor’s report on Schedule A should contain at least the following information:
- (a) Title – “Report issued pursuant to Article 5(9)(ii) of the Income Tax Act as prescribed by Rule 6(4) of the Capital Gains Rules, 1993 (as amended)”;
 - (b) Addressee – the Board of Directors;
 - (c) An understanding of the circumstances necessitating the preparation of the report – i.e. reference to the relevant legislative provisions;
 - (d) A statement of directors’ responsibilities;
 - (e) Identification of the subject matter – that is the values reported in relation to the immovable property’s purchase price and improvements, or the total of both figures, as reported in part 4 of Schedule A;
 - (f) A clear expression of the auditor’s findings;
 - (g) A limitation on the use of the report – i.e. that it is being prepared solely to comply with the requirements of Article 5 (9) of the Income Tax Act and Rule 6 (4) of the Capital Gains Rules;
 - (h) Date of the report;
 - (i) Auditor’s address; and
 - (j) Auditor’s signature.
10. In this regard, the MIA is recommending the following wording to be used by its Members in compliance with the requirements set out above:

Article 5 (9) of the Income Tax Act (Chapter 123 of the Laws of Malta) requires, by virtue of Regulation 6 (4) of the Capital Gains Rules, a company’s directors to make a notice as prescribed on schedule A to the Capital Gains Rules whenever an immovable property is transferred within a group of companies as defined in Article 16 of the Income Tax Act, or between companies that are controlled and beneficially owned as to more than 50% by the same shareholder. The notice shall also be made when the immovable property is transferred from a group company to any other company not in the group, or an individual.

In making the said notice the directors are responsible for the truth, correctness and completeness of the contents therein and of making available to the auditors all books of accounts and accounting records to enable them to obtain assurance on the information they are required to report upon.

We refer to the amounts appearing as “Total of Purchase Price and Improvements” in part 4 of the attached schedule A (which we have initialled for identification purposes only) in connection with the transfer of [insert details of property – type, address, etc). We found the “Purchase Price” to be in agreement with the deed of acquisition of the relative property dated [insert date]. We also found that the said “Purchase Price” together with “Improvements” have been properly extracted from the books and records of the company and represent the historical cost of the property.

This report is being prepared solely to comply with the requirements of Article 5 (9) of the Income Tax Act and Rule 6 (4) of the Capital Gains Rules, and can only be used for the purpose of satisfying the requirements of the said Article and Rule.

Schedule C – Statement to be submitted by a transferor of shares where there is a transfer of a controlling interest, and Schedule D – Statement to be submitted by a transferor of shares where there is no transfer of a controlling interest

11. Rule 5 of the Capital Gains Rules lays down the legislative provisions pertinent to transfers of company shares. Very broadly, the said Rule deals with the following:
 - (a) The consideration received upon a transfer of a controlling interest for the purpose of determining the chargeable gain;
 - (b) The criteria used to assess whether a transfer is a transfer of a controlling interest or not, and the manner in which these may extend to transfers by related persons within a period of eighteen months or less;
 - (c) The determination of the market value of the shares being transferred, and the treatment of immovable property and goodwill in the determination of the relevant market value; and
 - (d) Transferors' obligations in any transfer of shares, namely:
 - (i) To submit a statement, prepared by an auditor, stating whether the transfer is a transfer of a controlling interest or not, and indicating the grounds on which this statement is based; and
 - (ii) To present the aforementioned statement separately but as an integral part of Schedule C, together with the computation of the market value of the shares and an architect's valuation of the immovable property (when applicable) on the prescribed Schedule C, whenever the transfer constitutes a transfer of a controlling interest; or
 - (iii) To present the statement referred to in (i) of this sub-paragraph separately but as an integral part of Schedule D when the transfer does not constitute a transfer of a controlling interest; or
 - (iv) To present the statement referred to in (i) of this sub-paragraph separately but as an integral part of Schedule E if the transferor is a person to whom the provisions of Articles 5(2)(e), 5(6)(e), 5(9), 5(14) and 12(1)(c)(ii) of the Income Tax Act apply.
12. The first three parts of Schedule C contain details of the transferor, the company in which shares are being transferred, and the share transfer, respectively. Part 4 includes the computation of the market value of the shares transferred and part 5 requires an architect's valuation if the company in which the shares are transferred owns immovable property. Once the relevant parts are attested by the auditor, this statement is submitted in triplicate to the Capital Transfer Duty Department.
13. The auditor's responsibilities in relation to Schedule C emanate from Rule 5(10) of the Capital Gains Rules and part 4 of the said Schedule. In relation to the former the auditor is required to state that the transfer is a transfer of a controlling interest, indicating the grounds on which this statement is based. In relation to the latter the auditor needs to provide assurance that the computation of the market value of the shares transferred, as represented in sections II, III and IV of part 4, has been properly prepared in accordance with the provisions laid down in Rule 5.

14. The auditor's report on Schedule C should contain at least the following information:
- (a) Title – “Report issued pursuant to Rule 5(10) of the Capital Gains Rules, 1993 (as amended)”;
 - (b) Addressee – the transferor;
 - (c) An understanding of the circumstances necessitating the preparation of the report – i.e. reference to the relevant legislative provisions;
 - (d) A statement of the transferor's responsibilities;
 - (e) A statement to the effect that the transfer is a transfer of a controlling interest and the grounds on which this statement is based;
 - (f) A clear expression of the auditor's findings resulting from his examination of the computation set out in sections II, III and IV of part 4 of Schedule C of the Capital Gains Rules;
 - (g) A limitation on the use of the report – i.e. that it is being prepared solely to comply with the requirements of Rule 5 (10) of the Capital Gains Rules;
 - (h) Date of the report;
 - (i) Auditor's address; and
 - (j) Auditor's signature.
15. In this regard, the MIA is recommending the following wording to be used by its Members in compliance with the requirements set out above:

Rule 5 (10) of the Capital Gains Rules (Subsidiary Legislation 123.27 of the Laws of Malta) requires a transferor who is transferring a controlling interest in a company to complete and submit to the Inland Revenue the information required on the prescribed Schedule C of the Capital Gains Rules. Pursuant to the said Rule, the transferor shall also obtain a statement prepared by an auditor stating that the transfer is a transfer of a controlling interest and on what grounds such a statement is made. In addition, he is also required to obtain an auditor's assurance that the computation of the market value of the shares transferred, as represented in sections II, III and IV of part 4, has been properly prepared in accordance with the provisions laid down in Rule 5.

In relation to the said Schedule C, the transferor is responsible for the truth, correctness and completeness of the contents therein and of making available to the auditors all books of accounts and accounting records to enable them to obtain assurance on the information they are required to report upon.

In this regard we refer to the proposed transfer of [insert number of shares to be transferred] out of the [insert total number of shares held] shares that you hold in ABC Company Limited (“the Company”). Based on the information that the Company's issued share capital currently amounts to [insert total company's share capital] ordinary shares having a nominal value of Lm1 each, in our opinion, the proposed transfer constitutes a transfer of a controlling interest in terms of Rule 5 of the Capital Gains Rules.

In addition to the statement in the preceding paragraph, you have also asked us to report on the computation of the market value of the shares being transferred (“the Computation”), that you

have performed on the basis of the formula set out in the Rules. The Computation is set out in Sections II, III and IV of Part 4 of the attached Schedule C, which we have initialled for identification purposes only.

We have examined the Computation with reference to the information and documentation that you have provided us with, and which we have not audited for the purpose of this report. In our opinion the Computation referred to above has been properly prepared in accordance with the provisions of Rule 5 of the Capital Gains Rules.

This report or any parts thereof do not constitute, and should not be interpreted as, a valuation of your investment in the Company. We are not expressing an opinion on the value of the said shares. This report is being prepared solely to comply with the requirements of Rule 5 (10) of the Capital Gains Rules, and can only be used for the purpose of satisfying the requirements of the said Rule.

16. Schedule D is made up of three separate parts: part 1 contains details of the transferor, part 2 contains details of the company in which shares are being transferred and part 3 contains details of the share transfer. The auditor's responsibilities in relation to Schedule D are the following:
- (a) Firstly, the auditor needs to state that the transfer is not a transfer of a controlling interest and the MIA is recommending the wording in the following paragraph to be used by its Members in compliance with this requirement; and
 - (b) Secondly, the auditor is also required to attest the valuation of the shares. Given the specific ad hoc circumstances surrounding every report so made, the MIA did not consider it appropriate to standardise such a valuation report. The valuation of the shares should be computed on the basis of the company's net asset value.
17. In satisfaction of the requirement in paragraph 16 (a), and in satisfaction of the guidelines in paragraph 14 (which *mutatis mutandis* apply to Schedule D), the MIA is recommending the following wording to be used by its Members in compliance with the respective requirements set out above:

Rule 5 (10) of the Capital Gains Rules (Subsidiary Legislation 123.27 of the Laws of Malta) requires a transferor who is not transferring a controlling interest in a company to complete and submit to the Inland Revenue the information required on the prescribed Schedule D of the Capital Gains Rules. Pursuant to the said Rule, the transferor shall obtain a statement prepared by an auditor stating that the transfer is not a transfer of a controlling interest and on what grounds such a statement is made.

In relation to the said Schedule D, the transferor is responsible for the truth, correctness and completeness of the contents therein and of making available to the auditors all books of accounts and accounting records to enable them to obtain assurance on the information they are required to report upon.

In this regard we refer to the proposed transfer of [insert number of shares to be transferred] out of the [insert total number of shares held] shares that you hold in ABC Company Limited ("the Company"). Based on the information that the Company's issued share capital currently amounts to [insert total company's share capital] ordinary shares having a nominal value of Lm1 each, in our opinion, the proposed transfer does not constitute a transfer of a controlling interest in terms of Rule 5 of the Capital Gains Rules.

This report is being prepared solely to comply with the requirements of Rule 5 (10) of the Capital Gains Rules, and can only be used for the purpose of satisfying the requirements of the said Rule.

Schedule E – Statement to be submitted by a transferor of shares where the transfer is exempt from tax in the circumstances mentioned in Rules 5(14)

18. As referred to in paragraph 11(d)(iv) of these Guidance Notes, whenever a transferor who is a person to whom the provisions of Articles 5(2)(e), 5(6)(e), 5(9), 5(14) and 12(1)(c)(ii) of the Income Tax Act apply transfers shares in a company, he or she shall complete and submit to the Inland Revenue the statement prescribed in Schedule E of the Capital Gains Rules. Moreover, the said transferor is not required to make a valuation of the shares, or of the immovable property owned by the company in which the shares are being transferred.
19. Part 1 of Schedule E contains details of the transferor, part 2 contains details of the company in which the shares are being transferred and part 3 contains details of the share transfer. In relation to the said Schedule the auditor is required to give assurance on the statement contained in part 4 of Schedule E, stating that the transfer detailed in the Schedule is exempt as it qualifies under one of the listed exemptions.
20. In this regard, the MIA is recommending the following wording to be used by its Members in compliance with the requirements emanating from Rule 5(14) and the prescribed Schedule E:

Article 5(2)(e)/ 5(6)(e)/ 5(9)/ 5(14)/ 12(1)(c)(ii) [delete as appropriate] of the Income Tax Act (Chapter 123 of the Laws of Malta) requires, by virtue of Regulation 5 (14) of the Capital Gains Rules, a company's directors to make a notice as prescribed on schedule E to the Capital Gains Rules whenever a transfer of shares is exempt as it qualifies under Article 5(2)(e)/ 5(6)(e)/ 5(9)/ 5(14)/ 12(1)(c)(ii) [delete as appropriate] of the Income Tax Act.

In making the said notice the directors are responsible for the truth, correctness and completeness of the contents therein and of making available to the auditors all books of accounts and accounting records to enable them to obtain assurance on the information they are required to report upon.

We have examined the statement made by the directors of [Company's name] in part 4 of the attached schedule E, which we have initialled for identification purposes only. In our opinion, the share transfer detailed in the schedule is exempt as it qualifies under Article 5(2)(e)/ 5(6)(e)/ 5(9)/ 5(14)/ 12(1)(c)(ii) [delete as appropriate] of the Income Tax Act.

This report is being prepared solely to comply with the requirements of Rule 5 (14) of the Capital Gains Rules, and can only be used for the purpose of satisfying the requirements of the said Rule.

Effective date

21. These Guidance Notes become applicable to MIA Members with immediate effect.