

International Tax Planning – The Malta Company

Introduction

Maltese companies remain one of the most popular vehicles in Europe for the purposes of international trade. A Maltese company is a normal limited liability company that would be charged to tax at the rate of income tax applicable at the time (currently 35% on its chargeable income or net profits) and both Malta residents and non-residents may hold any amount of shares in this company.

The shareholders of the company may be entitled to refunds of tax as applicable to their particular circumstances. In particular, any resulting dividends to non-resident shareholders may qualify for tax relief in the receiving jurisdiction. Incidentally, Malta has double taxation agreements in place with most of the major European states and a number of other states around the world.

Hence, the fiscal benefits associated with the Malta Company arise once the Company distributes its profits to its shareholder/s. A shareholder may wish to retain the funds in Malta or in the Company itself, or alternatively have them repatriated to a country of his choice.

Liability to tax in Malta

The main legislation regulating income tax in Malta is included in the Maltese Income Tax Act and the Maltese Income Tax Management Act.

The total income from all sources, including capital gains, is aggregated into one amount for the purpose of the income tax, and charged to tax in the hands of the tax payer.

Persons (including companies, other bodies of persons and individuals) who are both ordinarily resident and domiciled in Malta are liable to tax in Malta on their worldwide income.

Persons who are either not ordinarily resident or not domiciled in Malta are liable to tax on any income and capital gains arising in Malta and on any foreign income, but excluding capital gains, received in Malta.

Persons who are not resident and not domiciled in Malta may be liable to tax on income and capital gains arising in Malta.

A company is considered resident in Malta if it is incorporated in Malta, or (in the case of a non-Maltese body of persons) if its control and management are exercised in Malta.

Malta's unique tax system

Malta's tax system is a full imputation system, the only one of its kind in the EU, which treats residents and non-residents in the same way and is therefore non-discriminatory and does not fall foul of EU law on this count.

A full imputation system is one that entitles shareholders to claim a credit for the tax paid by the company and ensures that distributions out of taxed company profits are not subject to further tax in the hands of the shareholders. In certain cases the distribution of a dividend entitles the shareholder to a tax refund where such income falls to be taxed at a lower rate of tax in the hands of the shareholder, than the rate of tax incurred by the company.

The only feature in Malta's imputation system which required amendment to be fully compliant with ECJ decisions on imputation systems is to allow a credit for foreign underlying corporate tax to individuals in addition to companies where such a credit is already available. Such amendment now strengthens the harmony of our tax system by not discriminating in favour of the corporate form.

The Maltese full imputation system has recently been approved by the EU Commission. The Commission, agreed with the Maltese Government proposals on a revised tax system and in its decision, the Commission invited Malta to implement these with effect from 1 January 2007. On the 28th November 2006, ECOFIN – the EU Finance Ministers - formally approved the agreement reached between the Maltese Government and the EU Commission.

Participation Exemption

Where a holding of shares by a Maltese company (including a Maltese partnership en commandite with its capital divided into shares) in a non-Maltese entity (including companies and limited liability partnerships) qualifies as a participating holding, the Maltese company may claim a participating exemption from Maltese tax on income and gains derived from such participating holding.

The participation exemption is available where the non-Maltese entity is either (i) resident or incorporated in a EU country, or (ii) is subject to foreign tax of at least 15%, or (iii) does not have 50% or more of its income from passive interest and royalties.

However, if none of the above are satisfied, but the income from a non-Maltese entity has been subject to foreign tax of at least 5% and the investment in the non-Maltese entity does not constitute a portfolio investment, the participation exemption should be available to the Maltese company.

Participating Holding

A participating holding arises where:

- a) a Maltese company holds directly at least 10% (including right to at least 10% of the voting rights, the dividend rights and the rights to assets on a winding up) of the equity shares of a non-Maltese entity
- b) where a Maltese company is an equity shareholder in a non-Maltese entity and is entitled to either sit on the Board or appoint a person to sit on the Board of the non-Maltese entity
- c) where a Maltese company is an equity shareholder investing at least Lm500,000 (approx Eur. 1,165,000) for at least 183 days in a non-Maltese entity
- d) where a Maltese company is an equity shareholder in non-Maltese entity and is entitled to, at its option, call for and acquire the entire balance of the equity shares not held by it
- e) where a Maltese company is an equity shareholder in non-Maltese entity and is entitled to first refusal in the event of a proposed disposal, redemption or cancellation of all the equity shares in the non-Maltese entity not held by the Maltese company
- f) where a Maltese company is an equity shareholder in a non-Maltese entity where the holding of such shares is for the furtherance of the business of the Maltese company and is not held as trading stock for the purpose of a trade.

Double taxation relief

Malta has entered into double taxation treaties with forty-six countries including most of the major European trading nations and is currently in the process of negotiating others. These treaties are in the main based on the OECD model. Malta grants relief from double taxation under the credit method on the source by source and country by country basis.

The Maltese tax regime governing double taxation relief includes treaty relief, unilateral relief and the flat rate foreign tax credit (FRFTC). Malta allows relief from double taxation on a unilateral basis where overseas tax is suffered on income received from a country with which Malta does not have a treaty.

The overseas tax suffered may be allowed as a credit against tax chargeable in Malta on the gross amount, limited to the total tax liability in Malta on the particular income. Unilateral relief for underlying tax suffered is also available under these provisions where the taxpayer holding shares in the foreign company is a Maltese resident company.

The flat rate foreign tax credit is available to a Maltese resident company, which receives income or capital gains from overseas which are allocated to its Foreign Income Account. This credit is calculated at 25% of the amount of the overseas income or gains received by the company before deductions and it provides double taxation relief for foreign tax suffered on income received from a country with which Malta does not have a treaty and where unilateral relief is not available, e.g. where evidence of foreign tax on the overseas income is not available or not presented. In practice the flat rate foreign tax credit also acts as a means of unilateral tax sparing relief in respect of foreign tax suffered at lower rates.

Tax Accounting

The tax accounting and refund system described below is available to Maltese companies (including partnerships *en commandite* whose capital is divided into shares) and to non-resident companies carrying on activity in Malta through a branch.

The income of a Maltese company is divided into 5 different tax accounts. These are the Final Tax Account (FTA), the Immovable Property Account (IPA), the Foreign Income Account (FIA), the Maltese Taxed Account (MTA) and the Untaxed account:-

1) Final Taxed Account (FTA)

The FTA includes distributable profits that have suffered tax, including income taxed under the investment income provisions, profits from sale of immovable property situated in Malta taxed at the final 12% rate, profits where tax has been relieved under various tax incentive legislation, etc.

2) Immovable Property Account (IPA)

The IPA includes distributable profits that have suffered tax, including profits derived - directly or indirectly - from immovable property situated in Malta (that has not been allocated to the FTA), profits from rents and premiums, profits derived from providing accommodation, profits deemed to constitute an economic rent, etc.

3) Foreign Income Account (FIA)

The FIA includes distributable profits that have suffered tax, including profits resulting from royalties and similar income arising outside Malta and from dividends, capital gains, interest, rents and any other income derived from investment situated outside Malta including income from an overseas branch, agency or permanent establishment of a Maltese company.

4) Maltese Taxed Account (MTA)

The MTA includes distributable profits that have suffered tax and has not been allocated to the FTA, IPA or FIA.

5) Untaxed Account

The Untaxed Account is made up of the difference between the company's accounting profits and the amounts allocated to the FTA, IPA, FIA and MTA.

The refund provisions are applicable to tax charged on income allocated to the FIA and MTA, whilst the Flat Rate Foreign Tax Credit (FRFTC) only applies to income allocated to the FIA.

Refunds of Malta tax paid

Company profits are to be allocated to the tax accounts in order to determine the tax

treatment of such profits upon distribution to shareholders as dividends. Within the above economic conceptual framework company profits will be divided between profits on which tax will not be available for refund since they are deemed to be the company's contribution towards the country's provision of public goods, and profits which will be allocated to the relevant Tax Accounts above, on which a tax refund is available.

Upon the payment of a dividend from such profits, shareholders, whether they are resident or non-resident, are entitled to claim refunds of tax paid in Malta by the company on income allocated to the FIA and MTA, when such income is distributed as a dividend.

Shareholders are normally entitled to claim a refund of 6/7 of the tax charged to the Maltese company, subject to a maximum of the tax actually paid to the Maltese tax authorities. Where the income in question is made up of passive interest and royalties, the shareholders would be entitled to claim a refund of 5/7 of the tax charged to the Maltese company, subject to a maximum of the tax actually paid to the Maltese tax authorities.

Where interest and royalties have been subject to foreign tax at a rate of 5% or more, it will automatically no longer be considered passive, and therefore qualify for the 6/7 refund. Where passive income and royalties have been subject to a claim for double taxation relief, including the FRFTC, the refund applicable is 2/3 of the Malta tax charged.

Income and gains from participating holdings, where the participation exemption is not availed of, would qualify for a full (100%) refund of Malta tax paid.

No outbound withholding taxes

No Maltese withholding tax is imposed on dividends distributed to non-residents. No tax is imposed on interest and royalties derived by non-residents as long as the statutory conditions are complied with, particularly that the relevant income is not effectively connected with a permanent establishment through which the non-resident carried on business in Malta.

No Maltese tax is imposed on gains realised inter alia from transfers of corporate securities by non-residents as long as the statutory conditions are complied with, particularly that the sole or main assets of the company whose securities are being transferred do not consist of Maltese immovable property.

Group taxation provisions

Where assets (including shares, other securities and immovable property) are transferred between companies being members of the same group, or companies controlled and beneficially owned directly or indirectly to the extent of more than 50% by the same shareholders, it shall be deemed that no loss or gain has arisen from the transfer.

Maltese resident companies being members of the same group of companies may surrender and claim tax losses between them. Such losses may only be surrendered by a company in the year in which they are incurred, but may be utilised by the claiming company in the same year, or carried forward against future profits.

Payment of tax and refunds

A company is assessed and pays tax in the currency in which its share capital is denominated. All or any refunds of tax are made in the same currency. For companies with more than 90% of its business interests outside Malta, tax is payable on the earlier of the date of distribution of profits or eighteen months after the end of the relevant accounting period of the company.

The tax legislation binds the Revenue to issue refunds not later than the fourteenth day of the month following that in which the tax has been paid and a valid claim for the refund is submitted.

Advance Revenue Rulings

The International Tax Unit within the Inland Revenue Department deals with all international tax matters and provides advance rulings in areas where there might otherwise be uncertainty or fear of infringing Maltese legislation.

In this way, the fiscal implications of investing in or through Malta, or of setting up a base in Malta, or of any particular international transaction may be made clear up front.

Rulings are available to confirm the tax position issues such as:

- a) the position regarding general anti-avoidance provisions
- b) whether a shareholding is in the course or furtherance of the shareholder's business for the purposes of a participating holding
- c) the tax treatment of any particular financial instrument
- d) the tax treatment of any transaction which involves international business

The rulings guarantee the tax position for a period of five years and may be renewed for a further five-year period. They will also survive any changes of legislation for a period of two years after the entry into force of such new law.

Conclusion

This is an important aspect for Malta's financial services sector and helps ensure its future ability to continue to be an attractive and competitive environment for international business and investment and boasts a legislative framework in line with the main EU directives and sufficiently flexible and versatile to relate to different legal systems. Malta's paramount anti-money laundering standards have nurtured the financial services sector to the level it is today over a short span of just over ten years.