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Taxation of Malta companies

Since joining the EU in May 2004 and the Eurozone in 2008, Malta has become an attractive financial services centre which serves as a base for international investors for their activities. Malta offers various benefits to companies that are either resident or registered in Malta including a skilled workforce, low operational costs, various tax incentives and a double tax treaty network with over seventy countries.

Company Tax Rate

In terms of Maltese income tax legislation, a company is resident in Malta if it is incorporated in Malta. If the company is incorporated outside Malta, it is still resident in Malta, if its effective management and control is exercised in Malta. Companies are subject to tax in Malta at the standard corporate tax rate of 35%.

Full Imputation System

Malta adopts the full imputation system, which means that shareholders of a Malta company, will be entitled to a tax credit equivalent to the tax paid by the company upon a distribution of profits. The purpose of the imputation system is to eliminate any economic double taxation that might arise on the distribution of dividends, meaning that company profits will not be subject to tax twice, first at corporate level, then at shareholder level. The highest rate of tax applicable to individual shareholders is equivalent to the corporate rate of tax (35%), meaning that no further tax will be due on distribution of profits.

Tax Accounting for Companies

Companies must allocate their profits to one of the following tax accounts:

- Foreign Income Account (FIA) - royalties, dividends, capital gains, interest and other passive income arising outside Malta are allocated to this account.
- Maltese Taxed Account (MTA) - profits of a company which are not allocated to the FIA and which have suffered Malta tax are allocated to this account. As from year of assessment 2015 (basis year 2014), any profits the tax chargeable on which has been relieved from tax payment by any tax credit will also be allocated to this account.
- Immovable Property Account (IPA) - profits derived from transfers of immovable property situated in Malta and from other activities which are related directly or indirectly to immovable property situated in Malta are allocated to this account.
- Final Tax Account (FTA) - profits which are exempt from tax and which are also exempt in the hands of the shareholders upon distribution are allocated to this account.
- Untaxed Account (UA) - the difference between the company's accounting profits (or losses) and the total amounts allocated to the above four tax accounts is allocated to this account.

The proper allocation of profits to the correct tax accounts is of utmost importance in view of the refundable tax credit system explained below. Refunds of tax by shareholders can only be claimed in respect of dividends which are distributed from the FIA and MTA. Distributions from the FTA, IPA and UA do not entitle the shareholders to a tax refund.

Tax refunds can only be claimed by shareholders who are registered to receive them and the amount of refunds received will depend on the nature and source of income derived by the Malta distributing company.

Refundable Tax Credit System

Shareholders of companies registered in Malta are entitled to a tax refund upon the distribution of profits. In general, the tax refund amounts to 6/7ths of the tax paid by the company resulting in a maximum effective tax rate of 5% after tax refunds. Where double taxation relief is claimed by the company in respect of foreign tax suffered, the effective tax rate can be reduced further to 0%.

In the circumstances where the profits distributed are made up of passive interest or royalties, the tax refund is reduced to 5/7ths of the tax charge, resulting in a maximum net tax paid in Malta of 10% after tax refunds. Passive interest and royalty income is income which has not been derived directly or indirectly from a trade or business and where such interest or royalty income has not suffered or suffered any foreign tax, directly, by way of withholding or otherwise, at a rate of tax which is less than 5%.

Where the company has opted to claim relief from double taxation on its income which stands to be allocated to its foreign income account, refunds to shareholders will amount to 2/3rds of the total tax paid (including foreign tax). If the relief from double taxation claimed is the Flat Rate Foreign Tax Credit (refer to the section on Double Taxation Relief) the tax refund will amount to **2/3rds** of the Malta tax paid.

In general, the tax refunds are calculated on the total tax paid including foreign tax, subject to the tax refund not exceeding the Malta tax suffered. The only exception is where the FRFTC is claimed, as mentioned above.

The following is an example illustrating the 6/7ths refund

Company	
Profit before tax	1,000
Tax at 35%	(350)
Profit after tax	650
Shareholder	
Refund on distribution (6/7ths tax refund)	300
Effective rate of tax on profit before tax	5%

The refundable tax credit system has also been extended to shareholders of foreign companies that have Maltese branches. Tax paid in Malta by branches on profits attributable to activities performed in Malta is refunded to the shareholders of the foreign company when such profits are distributed in terms of the refundable tax credit system.

Claiming a tax refund is a very straightforward procedure. Shareholders can submit their claim for a refund of tax as soon as the tax return of the company (reporting the dividend distribution) is submitted. Once the tax refund claim form are processed by the local tax authorities and provided that the corporate tax has been paid, the tax refunds are normally effected within fourteen days.

Double Taxation Relief

Malta tax law provides for four forms of relief from double taxation with respect to foreign tax suffered.

The **Treaty Relief** is available in respect of income derived from a country with which Malta has concluded a Double Taxation Treaty. Malta has an extensive double tax treaty network given that up till now it already concluded double tax treaties with more than seventy countries.

Malta adopts the credit method of double taxation relief. This method brings to charge foreign source income in full and then grants a credit (or set-off) of the foreign qualifying tax suffered against Malta's tax liability. The taxpayer must provide evidence of the foreign tax paid.

The **Unilateral Relief** is similar to treaty relief and is available when a resident taxpayer pays tax in a country with which Malta does not have a double tax treaty for the avoidance of double taxation. The taxpayer must provide evidence of the foreign tax paid.

Commonwealth income tax relief applies to a person who is liable to pay Commonwealth income tax in respect of any part of his income. Commonwealth income tax is income tax or tax of a similar nature imposed in a Commonwealth country and is only granted on a reciprocal basis.

The **Flat Rate Foreign Tax Credit (FRFTC)** is a type of relief which can be availed of where the other forms of relief from double taxation listed above are not available. The FRFTC applies only to companies registered in Malta (and not to individuals). It is a form of relief for a deemed tax and therefore the taxpayer is not required to provide any evidence of foreign tax paid.

The FRFTC is equivalent to 25% of the amount of the net overseas income or gain received by the company, before allowing for any deductible expenses. The income plus the credit less allowable expenses will be subject to Malta income tax at 35%. Relief for the deemed tax (up to a maximum of 85% of the Malta tax payable) will be allowed as a credit.

The mechanics of the FRFTC are illustrated in the following example:

Company Level	
Net foreign income (before expenses)	€1,000
Grossing-up with flat rate foreign tax credit (25%)	€250
Gross foreign income (before expenses)	€1,250
Allowable expenses	(€200)
Foreign income (after expenses)	€1,050
Malta tax at 35%	€367.50
Less FRFTC (maximum 85% of Malta tax)	(€250)
Net Malta tax payable	€117.50
Effective tax rate on net income after expenses (€1,000-€200)	14.68%

Upon distribution of profits, refund of tax will be due to the shareholders of the company, which will effectively reduce the tax rate to a very low rate of tax, depending on the amount of expenses incurred.

Shareholder Level	
Gross Dividend	€1,050
Tax at 35%	€367.50
Tax at source (Full Imputation System)	(€117.50)
Flat Rate Foreign Tax Credit	(€250.00)
Tax due by the shareholder	NIL
Tax Refund (2/3rds of the Malta tax i.e. on €117.50)	€78.33
Effective Tax (€117.50 - €78.33)	€39.17
Effective Tax Rate on net income after expenses (€39.17/€800)	4.90%

Participation Exemption

Malta has in 2007 introduced a participation exemption regime whereby dividends and capital gains derived from a participating holding will be exempt from Maltese tax. In other words dividends from a participating holding or gains from the disposal of such a holding derived by a company registered in Malta will be exempt from Maltese tax.

The participating holding must be an equity holding, meaning that at least two of the following equity holding rights are satisfied:

- (i) Right to votes;
- (ii) Right to profits available for distribution;
- (iii) Right to assets available for distribution on a winding up of the company.

A participating holding arises when any one of the following criteria is met:

- A company holds directly at least 10% of the equity shares of a company whose capital is wholly or partly divided into shares, which holding confers an entitlement to at least 10% of any two of the above-mentioned rights; or
- A company is an equity shareholder in a company and the equity shareholder company is entitled at its option to call for and acquire the entire balance of the equity shares not held by that equity shareholder company to the extent permitted by the law of the country in which the equity shares are held; or
- A company is an equity shareholder in a company and the equity shareholder company is entitled to a first refusal in the event of the proposed disposal, redemption or cancellation of all of the equity shares of that company not held by that equity shareholder company; or
- A company is an equity shareholder in a company and is entitled to either sit on the board or appoint a person to sit on the board of that company as a director; or
- A company is an equity shareholder which holds an investment representing a total value of at least €1,164,000 in a company and that investment in the company is held for an uninterrupted period of not less than 183 days; or
- A company is an equity shareholder in a company and where the holding of such shares is for the furtherance of its own business and the holding is not held as trading stock for the purpose of a trade.

A number of anti-abuse provisions have been introduced in respect of the participation exemption. Dividends received from participating holdings will be exempt from tax provided that the body of persons in which the participating holding is held satisfies at least one of the following conditions:

- (i) It is resident or incorporated in a country or territory which forms part of the EU; or
- (ii) It is subject to any foreign tax of at least 15%; or
- (iii) It does not have more than 50% of its income derived from passive interest or royalties.

Where none of these conditions is satisfied then both of the following two conditions must be satisfied for the participation exemption to apply:

- (i) The equity holding by the company registered in Malta in the body of persons not resident in Malta is not a portfolio investment and for this purpose the holding of shares by a company registered in Malta in a company or partnership not resident in Malta which derives more than 50% of its income from portfolio investments shall be deemed to be a portfolio investment; and
- (ii) The body of persons not resident in Malta or its passive interest or royalties, have been subject to foreign tax at a rate which is not less than 5%.

Alternatively the Malta registered company may opt to be taxed at a flat rate of 35%, with the possibility of being granted relief from double taxation on the income or gains derived from a participating holding. In such circumstances, however, upon a subsequent distribution of dividends by the company, the shareholders of the Malta company would be entitled to a full refund (100%) of the Malta tax paid.

A shareholding in a Maltese company can also qualify as a participating holding. With respect to holdings in Maltese resident companies, the participation exemption is however restricted to the gain on the transfer of such holding.

The concept of a participating holding also includes holdings in collective investment vehicles that provide for limited liability of investors and to a body of persons constituted, incorporated, or registered outside Malta which is similar to a partnership *en commandite*, the capital of which is not divided into shares and which is not a property partnership.

The definition of a participating holding has also been extended to include a holding of a company in a partnership *en commandite* the capital of which is not divided into shares which is constituted under the Maltese Companies Act and which is not a property partnership. A property partnership is a partnership which owns immovable property in Malta or any real rights thereon. It also includes a partnership which, directly or indirectly holds shares or other proprietary interests in any entity or person, which owns immovable property in Malta or any real rights thereon, where at least 5% of the total value of the said shares or other proprietary interests so held is attributable to such immovable property or rights.

Branches of Overseas Companies

As an alternative to setting up a subsidiary in Malta having a separate distinct personality, foreign companies can opt to set up a branch in Malta to carry on business in Malta as an extension of the foreign company. The branch is treated for Maltese income tax purposes as a company registered in Malta.

Under domestic tax rules, a branch of a foreign company is subject to tax in Malta only on any income arising in Malta. Given that a branch is deemed to be a permanent establishment in Malta for tax purposes, the overseas company will be subject to tax in Malta on the profits attributable to the branch.

The profits attributable to the branch will be subject to tax at 35%, while the shareholders of the foreign company will be entitled to tax refunds as explained above.

Re-Domiciliation to Malta

Companies registered outside Malta can re-domicile to Malta, while Maltese companies can re-domicile to another foreign jurisdiction. There is no need for such companies to be dissolved and wound up and will therefore be able to continue to exist under the rules and

regulations of a different country.

Re-domiciliation takes place when a company incorporated under the laws of one country migrates into the legal system of another country, without being liquidated and wound up. The company therefore changes its place of domicile and becomes regulated by the laws of a different country.

A company which is re-domiciled to Malta, will as from date of re-domiciliation, be subject to tax on its worldwide income and capital gains. Such company is subject to tax at 35%, is entitled to claim double tax relief, while its shareholders will be entitled to benefit from the imputation system of taxation and from the refundable tax credit system upon receipt of a dividend.

There will be no Maltese tax implications when a company is re-domiciled to Malta. In addition, any undistributed profits of the company as at the date of re-domiciliation will not be subject to further tax in Malta and will be allocated to the company's Untaxed Account.

Maltese tax law also provides for a 'step-up' which allows a company being re-domiciled to Malta to claim a step up in the tax base costs of any assets held outside Malta. This will enable the company to revalue its overseas assets to a fair market value at the time the re-domiciliation process takes place. The re-valued cost, which should be notified to the Maltese tax authorities, will constitute the new acquisition cost of the assets when calculating any subsequent gain on a disposal. In addition, capital allowances (tax depreciation) will be calculated on the stepped-up value of the assets.

Two Tier Structures

To take maximum advantage of the refundable tax credit system, it is very common for a Malta trading company to be owned by a Malta holding company. The Malta holding company will serve as a dividend feeder company, receiving dividends from the Maltese trading company and tax refunds from the Maltese tax authorities. This avoids the problem of classification of income in those foreign countries which considers the tax refund as a dividend or any other income.

Any dividends and tax refunds received by the Malta holding company can be either distributed to the ultimate beneficial owners in the form of dividends or reinvested in the operating company. Malta does not impose any withholding tax on the distribution of dividends and due to its full imputation system of taxation, the tax suffered at the level of the Malta trading company will be granted as a credit against the tax due by the Malta holding company upon receipt of a dividend. Therefore the Malta holding company will not incur any further tax on the dividends received from the Malta trading company.

Exemption from Stamp Duty

Companies whose business activities are mainly carried out outside Malta are eligible for an exemption from stamp duty on the transfer of shares. This exemption from duty also applies where more than half of the ordinary share capital, voting rights and rights to profits are held by persons who are not resident in Malta.

Stamp duty is paid by the person acquiring the shares. The above mentioned exemption also applies to the transfer of shares by/to such companies.

No Withholding Tax

Malta does not impose any withholding tax on the outbound payment of dividends, interest and royalties.

CFC, Thin Capitalisation and Transfer Pricing Rules

Malta does not yet have any CFC rules, Thin Capitalisation Rules and specific Transfer Pricing Rules.

Wealth and Capital Taxes

Malta does not impose any tax on wealth or capital.

EU Parent-Subsidiary Directive and EU Interest and Royalty Directive

By application of the EU Parent - Subsidiary Directive and the EU Interest and Royalty Directive, any dividends, interest and royalties received by a Malta company from an EU resident company will not be subject to withholding tax provided that certain conditions are met.

Exemption on Income Derived from a foreign Permanent Establishment

Income or gains derived by a company registered in Malta that are attributable to a permanent establishment (including a branch) situated outside Malta, are exempt from tax in Malta, irrespective of whether or not the permanent establishment belongs exclusively or in part to the Maltese company.

The exemption also applies to the income derived from the transfer of such permanent establishment.

Exemptions to Non-Residents

Maltese tax law provides for a number of exemptions to non-residents. Interest and royalties derived by non-residents are exempt from tax in Malta. The same exemption applies to gains derived from the transfer of shares in companies in Malta by a non-resident person provided that the Maltese company is not a property company and provided that the non-resident person is not owned or controlled by persons who are ordinarily resident and domiciled in Malta.

Election to be Treated as Companies for Tax Purposes

As from year of assessment 2016, any partnership *en nom collectif* and any partnership *en commandite* as well as any European Economic Interest Grouping (EEIG) can elect to be treated as a company for tax purposes. This means that partnerships and EEIG which elect to be treated as companies (which election must be made within 60 days from the setting up of the respective partnership/EEIG) will benefit from the above mentioned beneficial tax regimes that Malta has to offer.

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