INTRODUCTION TO TAXATION

Lecture 2 - Fundamentals of Maltese Income Tax Law & Stamp Duty

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Overview

1. **Taxation of Companies**:
   - The Malta Tax Accounting System;
   - Taxation of Dividend Distributions including the Full Imputation System;
   - Tax Refunds

2. **Tax on Capital Gains;**
3. **Property Transfers Tax;**
4. **Duty on Documents and Transfers;**
5. **Taxation of Trusts, Foundations, Partnerships and Collective Investment Schemes**

Taxation of Companies – Tax Accounting

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Tax Accounting

- Every company registered for Malta income tax purposes is required to **keep and allocate its distributable profits** *(i.e. total profits available for distribution by a company registered in Malta)* **and / or losses** to **FIVE tax accounts**.
- The different tax accounts are defined in article 2 of the **Income Tax Act** and the **Tax Accounts (Income) Tax Rules**, S.L. 123.101 of the laws of Malta as being the following:

Order of allocation of profits

1	**The Final Tax Account ('FTA');**
2	**The Immovable Property Account ('IPA');**
3	**The Foreign Income Account ('FIA');**
4	**The Maltese Taxed Account ('MTA); and**
5	**The Untaxed Account**

Tax Accounting

Why is the allocation to the different tax accounts important?

- To **evaluate the Malta income tax implications** relevant to a shareholder upon the receipt of a dividend from a company registered in Malta.

- The implications depend on:

  i. The **tax account out of which the dividend is being distributed**; and

  i. the manner in which the profits distributed were subject to Malta income tax, for example, whether the shareholder will be subject/not subject to further tax upon receipt of the dividend or whether the shareholder receiving the dividend would be **able to benefit from the provisions of the Malta imputation system**.

- **Certain dividend distributions from certain tax accounts** are entitled to a **REFUND** of part of all of the Malta tax paid by the distributing company on the profits which are being distributed.

The Final Tax Account

- The taxed account to which an amount of distributable profits which suffered tax (..) shall be allocated **BEFORE any distributable profits are allocated to any other taxed account.**

- Profits subject to **final tax** and **certain exempt profits.**

- **Examples**:

  - Income on which the **participation exemption** has been applied;

  - Profits derived after tax, derived from the transfer of property chargeable to tax under **Article 5A of the ITA** (i.e. immovable property situated in Malta).

The Immovable Property Account

- The taxed account to which **distributable profits which have suffered tax** and which are **NOT** allocated to the Final Tax Account, shall be allocated **BEFORE** any distributable profits are allocated to the other taxed accounts (article 2 ITA).

- Generally speaking, profits **deriving directly/indirectly from immovable property situated in Malta** are allocated to this account.

The Immovable Property Account

- The profits which stand to be allocated to the IPA may be classified into the following two categories:

Primary Allocations

- Profits which are considered to be **derived from immovable property situated in Malta** and therefore such profits are to be **DIRECTLY** allocated to the IPA.

Secondary Allocations

- **Re-allocation of profits** from the **MTA and the FTA** to the IPA in the following scenarios:

1. Gross interest and premium income from the financing and insurance of immovable property situated in Malta;
2. Annual market rent

The Foreign Income Account

- Allocation of **Foreign Source Income** including:
    - Foreign source passive income / gains (dividends, royalties, interest, rent, capital gains etc.);
    - Taxable profits attributable to a Permanent Establishment / branch situated outside Malta [unless the company exempts such profits].

The Maltese Taxed Account

- Any profits which have **suffered tax** and which have **NOT been allocated** to the **FTA, IPA or FIA**.

The Untaxed Account

- Represents the **DIFFERENCE** between:

  - the **total accounting distributable profits** (a positive amount) or the total accumulated losses (a negative amount) as the case may be;

  AND

  - the **sum of the amounts** allocated to the **other four tax accounts** (FTA + IPA + FIA + MTA).

Taxation of Companies – Taxation of Dividend Distributions including the Full Imputation System

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Dividend Payments

What is a dividend?

- Dividend includes **any distribution made by a company to its shareholders** and any **amount credited to them** in their capacity as shareholders.

- Generally understood as referring to a **PAYMENT OF CASH to the shareholders**.

- However, the definition of "dividend" under Article 2 ITA also extends to:

  - **Bonus Shares -** additional shares given to the current shareholders without any additional cost, based on the number of shares that a shareholder owns, in lieu of cash dividends; and

  - Distribution made to shareholders in the **course of winding up,** to the extent that the distribution is made out of income of the company.

Taxation of Dividend Income

Dividends distributed by a company registered in Malta out of profits allocated to the **FIA, MTA or IPA,** to another company (whether resident or non-resident) should ***in principle*** be taxable at the **standard rate of 35%** in the hands of the receiving company,

HOWEVER

Malta operates the **full imputation system of taxation** and therefore there should be **NO FURTHER TAX** at the level of the shareholder

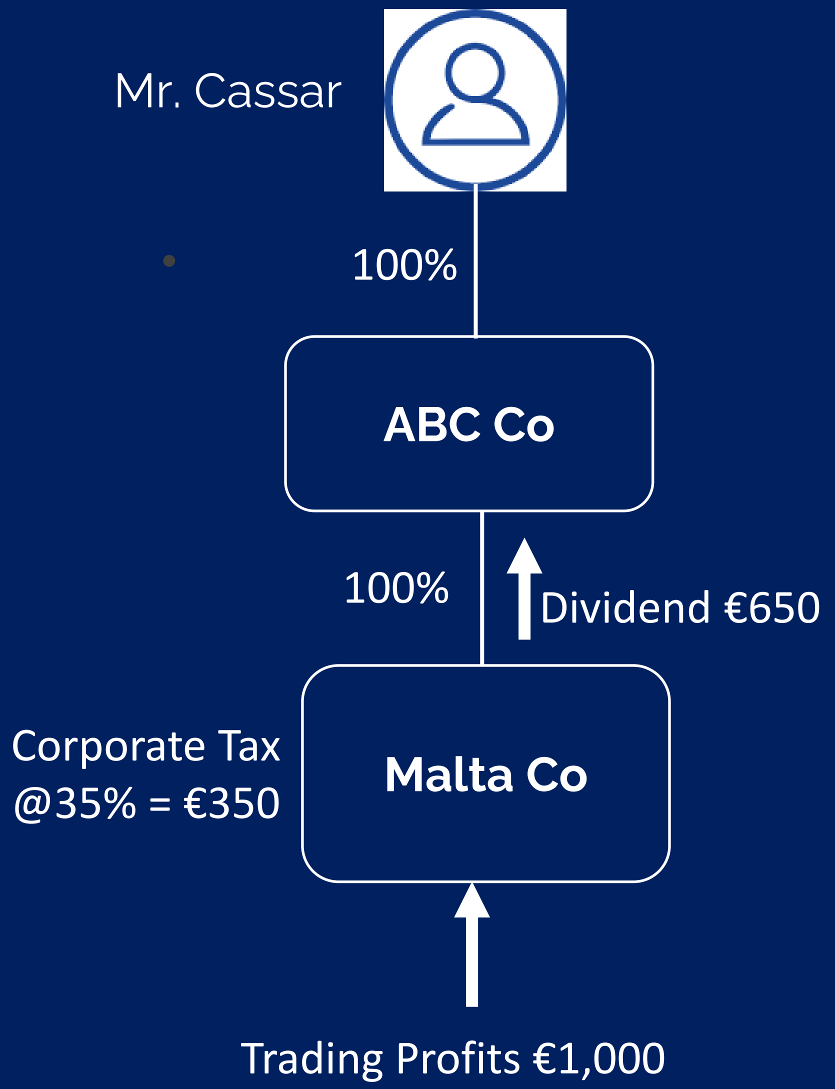
The Full Imputation System

- The full imputation system **ONLY** applies to dividends that are distributed by a company out of profits allocated to the company's:

Immovable Property Account	Maltese Taxed Account	Foreign income Account

- The application of the full imputation system is available in respect of dividend distributions made **by Maltese companies** and is thus **NOT applicable** in respect of dividends distributed by foreign companies.

The Full Imputation System



Tax at the level of Malta Co	
	€
Chargeable Income	1,000
Tax at 35%	350
Net Income	650
Tax at the level of ABC Co	
Net Dividend	650
Grossed Up by 35% tax suffered by Malta Co	350
Gross Dividend received by ABC Co	1,000
Tax @35%	350
Full Imputation Credit	(350)
Tax Due by ABC Co	0
Shareholder receives dividend of	650

The Full Imputation System

- The shareholder is deemed to receive a dividend equivalent to the ***amount of the dividend actually received (€650)*** **GROSSED UP** by the ***Maltese tax suffered on the profits being distributed (€350)***,

- The dividend paid by a company resident in Malta carries a **TAX CREDIT** equivalent to the tax paid by the company on its profits out of which the dividends are distributed, thereby **cancelling out the tax liability of the shareholder**.

- The imputation credit results in the **elimination of Maltese tax that is chargeable at the level of the shareholder** on the dividend received. This therefore has the effect of **eliminating economic double taxation.**

Tax Treatment of Dividends upon Distributions from the Tax Accounts

Distributions from the Final Tax Account

- Any dividends paid out of profits allocated to the Final Tax Account shall **NOT** be charged **to further tax**.
- Such dividends are **NOT considered** to form part of the **chargeable income of the shareholder**.

Distributions from the Immovable Property Account

- Subject to the Full Imputation System

Distributions from the Tax Accounts

Distributions from the Untaxed Account

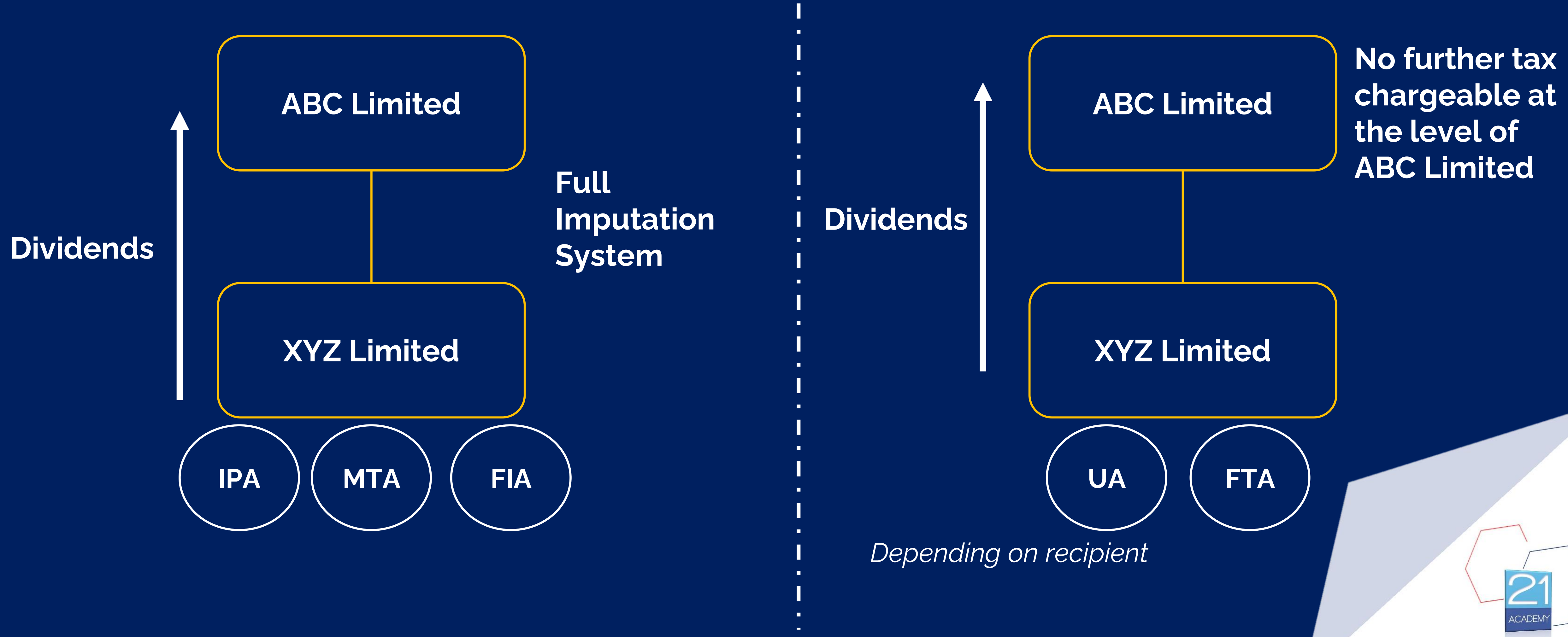
- The tax treatment of a distribution from the UA depends on whether the person receiving the dividend falls under the definition of the term '**RECIPIENT**':

  - person, **other than a company**, **resident in Malta** in the year in which a dividend is received by him or by any person on his behalf (therefore resident companies are not considered to be recipients, but only resident individuals); or

  - a **non-resident person** (including a non-resident company) who is owned and controlled by, directly or indirectly, or who acts on behalf of, an individual who is ordinarily resident and domiciled in Malta.

- The ITA imposes a **15% withholding tax** on distributions from the Untaxed Account **made to a 'recipient',** i.e. the payor must withhold tax at the rate of 15% upon a distribution of dividend from the UA – this is **not optional.**

Tax Treatment of Dividends upon Distributions from the Tax Accounts



Distributions from the Tax Accounts

Distributions from the Foreign Income Account and the Maltese Taxed Account

- Subject to the **Full Imputation System**
- Companies generally pay tax at 35% but the tax paid may be **refunded to the company's shareholder** in terms of the **tax refund system**.

Taxation of Companies – Tax Refunds

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Tax Refunds

Charging Provisions: ***Article 48(4) of 48(4A) of the Income Tax Management Act***

- When a company distributes a dividend to its shareholder/s out of profits allocated to **its MTA and FIA**, the shareholder may be entitled to claim a **FULL** or **PARTIAL refund** of the tax paid by the company on the profits that it distributes.

Company pays corporate tax due → Company distributes dividend to shareholders → Shareholders may claim refund of tax

1 2 3

Tax Refunds

- The quantum of the refund **VARIES** according to:
  - the **tax account** out of which the profits are distributed;
  - the **nature of the profits** being distributed; and
  - whether any **double tax relief** has been claimed by the distributing company in respect of the profits so distributed.

Types of Tax Refunds

6/7ths Refund

- A person in receipt of a dividend paid to him by a company registered in Malta from profits allocated to the **Foreign Income Account** (FIA) and **Maltese Taxed Account** (MTA), may claim a refund of **6/7ths** of the Maltese tax chargeable on those profits, subject to the following conditions:

  i. the company is **NOT entitled to claim double tax relief** on income allocated to FIA;

  ii. income is **NOT** qualified as **passive interest or royalties**.

- Availing of this refund typically results in a **net effective tax rate** of **5%.**

6/7ths Refund – Practical Example

UBO

Net Profit
Eur 650 + Eur 300 refund

ABC Limited (Malta)

Refund of 6/7ths of tax paid by XYZ — Eur 300

Full Imputation System = No further tax

Dividends
Eur 650

XYZ Limited (Malta)

Profit After Tax — Eur 650

Tax @35% — Eur 350

Profit Before Tax — Eur 1,000

MTA
Eur 1,000

Net Effective Tax Rate of 5% = Eur 50 Malta tax paid

6/7ths Refund – Practical Example

At the level of the Company (XYZ Limited)	
	€
Trading Profits	1,000
Tax at 35%	350
Amount allocated to the MTA	650
At the level of the Shareholder (ABC Limited)	
Net dividend income	650
Grossed up with tax	350
Gross dividend income	1,000
Malta Tax @35%	350
Imputation tax credit	(350)
Total Malta tax payable	0
Refund of tax suffered by XYZ Limited on profits distributed to ABC Limited (6/7ths of €350)	300
Tax paid by XYZ Limited	350
Ultimate Maltese Tax Burden	50

Types of Tax Refunds

5/7ths Refund

- The 5/7ths tax refund applies where:
  - the relative income comprises of **PASSIVE INTEREST** or **ROYALTIES;**

> *"Passive interest or royalties" consist of interest or royalties which have **not been derived from a trade or business**, and such interest or royalties have **suffered foreign tax** at a rate of **less than 5**%."*

  - in respect of dividends received from a **participating holding** in a body of persons which **DOES NOT** satisfy the **anti-abuse conditions** set out under the participation exemption.

- Like the 6/7ths refund:
  - ➢ the 5/7ths refund applies vis-à-vis dividends paid by a company registered in Malta from profits allocated to the **Foreign Income Account** (FIA) and **Maltese Taxed Account** (MTA),
  - ➢ The company is **NOT** entitled to claim double tax relief on income allocated to FIA

- Availing of this refund typically results in a **net effective tax rate** of **10%.**

Types of Tax Refunds

2/3rds Refund

- A 2/3rds Malta tax refund would apply where the dividend is being distributed out of profits that were subject to **relief from DOUBLE TAXATION** at the level of the distributing company.
- This refund **ONLY** applies to profits distributed out of the **FIA.**

Types of Tax Refunds

100% Refund

- This refund **ONLY** applies to profits distributed out of the **FIA.**
- Applies in relation to dividends being distributed out of a **participating holding**:

> - A company may claim the participation exemption in relation to income it derives from a **participating holding**;
> - The participation exemption is however **OPTIONAL**;
> - The company may therefore **elect to pay tax** on its income derived from a participating holding;
> - Upon **distribution of a dividend** out of profits available *(i.e. must be profits in respect of which the company was entitled to claim the participation exemption but chose not to claim it)*, the shareholder becomes entitled to a **FULL refund** of the tax paid by the company on the said profits.

The Participation Exemption (1)

- Companies that derive **dividends** or **capital gains** from a "**participating holding**" may qualify to apply the "participation exemption", in which case any dividends or gains derived from such participating holding would be **exempt from tax**.

What is a participating holding?

- A holding of **EQUITY** will qualify as a participating holding for the purposes of applying this exemption in the following circumstances:
  - When the holding constitutes a direct holding of **5% or more** of the equity shares or partnership capital; this participation holding entitles the company holding the shares to **TWO** out of the following three equity rights:
    A. voting rights;
    B. rights to profits available for distribution; or
    C. rights to assets available for distribution in the case of a winding up of the company in which the shares are held or;

The Participation Exemption (2)

- When 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**

- When a company is an equity shareholder in a company and the equity shareholder company is entitled to **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

- When the amount invested in the holding is at **least EUR 1,164,000** (or the equivalent sum in a foreign currency) and is held for an uninterrupted **period of at least 183 days**; or

- When the shareholder in question is **entitled to sit or be represented on the board of directors of the company** in which the equity holding is held; or

- When the equity shares **are held for the furtherance of the business** and the holding is not held as trading stock for the purpose of a trade.

The Participation Exemption (3)

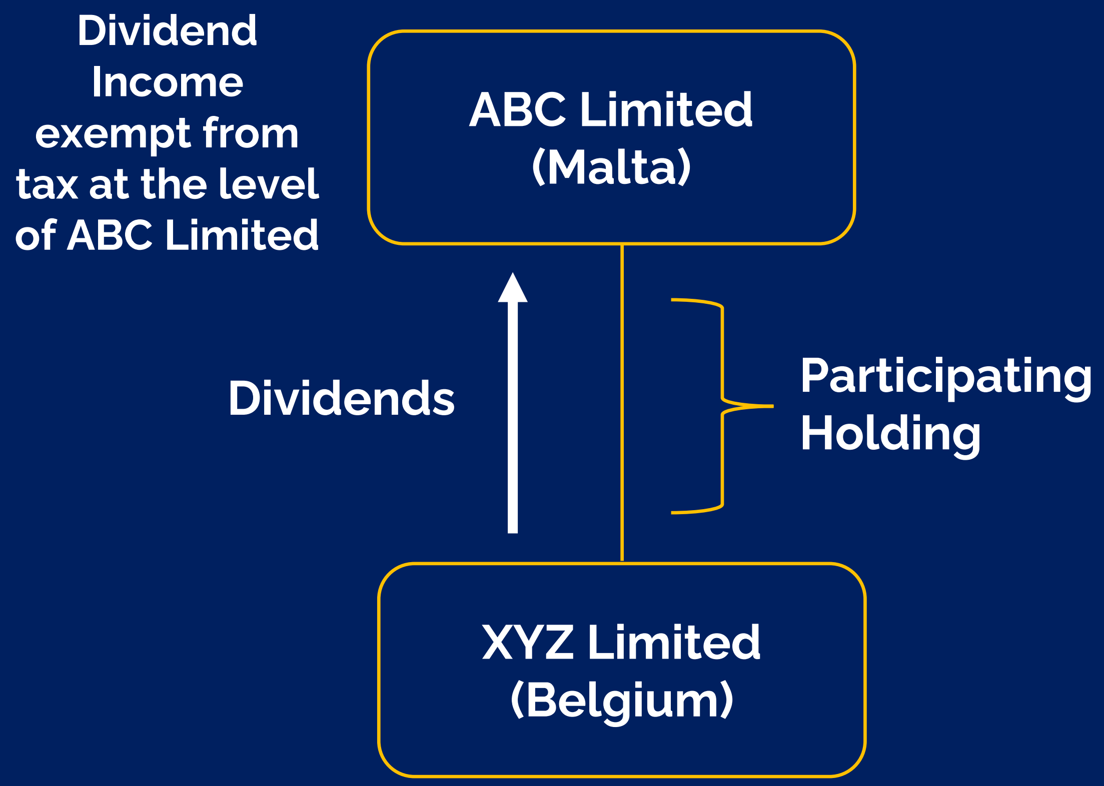
- The participation exemption will <u>**ONLY**</u> apply in respect of **DIVIDENDS** subject to a number of **anti-avoidance conditions** being satisfied, namely:

  1. where the body of persons in which the participating holding is held, satisfies <u>any **one**</u> of the following conditions, that is to say:

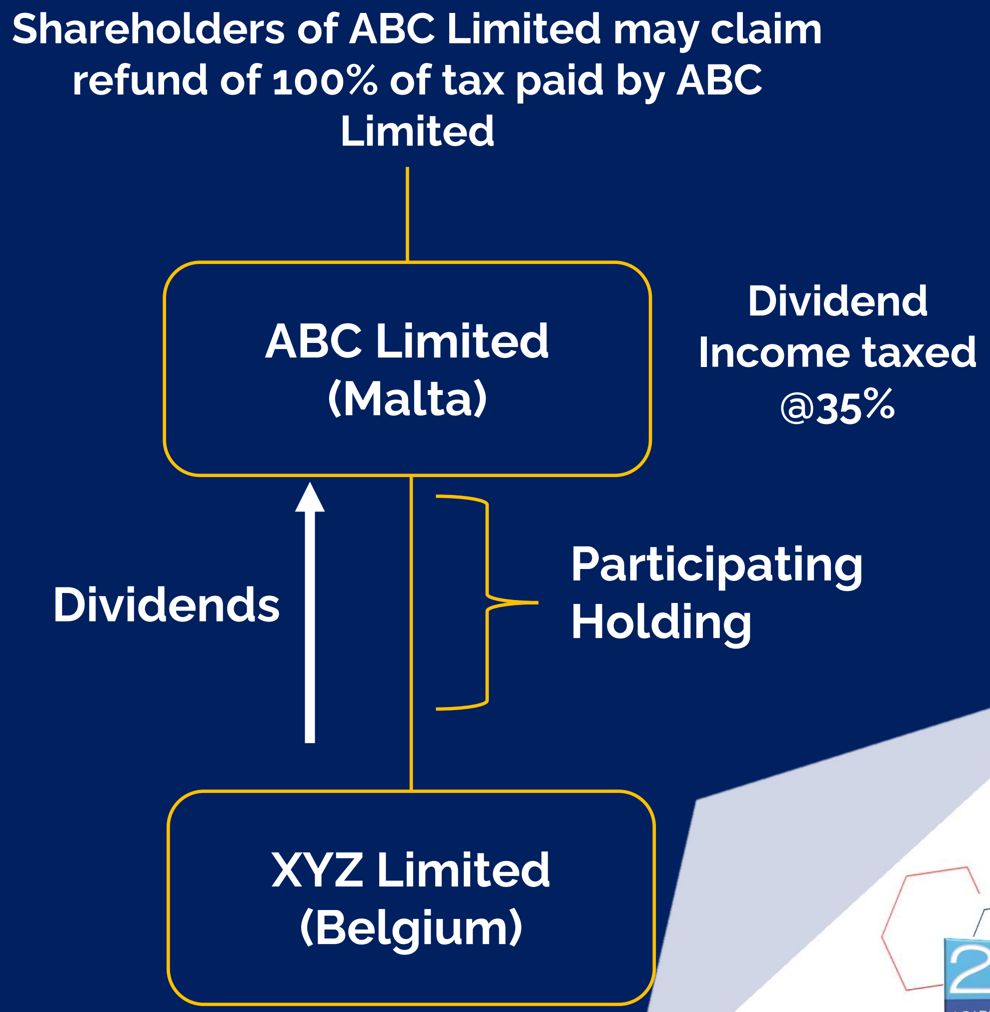
     i. it is resident or incorporated in a country or territory which forms part of the European Union;
     ii. it is subject to any foreign tax of at least fifteen per cent (15%);
     iii. it does not have more than fifty per cent (50%) of its income derived from passive interest or royalties;

  2. where none of the conditions set out in paragraph (1) are satisfied, then <u>both</u> of the following two conditions must be satisfied:
     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 body of persons not resident in Malta which derives more than fifty percent 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 any foreign tax at a rate which is not less than five per cent (5%).

Scenario 1: ABC Limited Claims Participation Exemption



Scenario 2: ABC Limited Does NOT Claim Participation Exemption



Capital Gains Tax

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Taxable Transfers (1)

- Special jurisdictional rule – Article 4(1)(g)(ii) ITA
  - **Foreign source capital gains** derived by persons domiciled in Malta but not ordinarily resident in Malta or vice-versa are **NOT taxable** at all in Malta (the position differs for foreign source income).

- **Article 5(1) ITA** imposes capital gains tax on an **exhaustive list** of assets. Only the following transfers of "taxable asset" give rise to capital gains:
  - *Gains or profits arising from the transfer of the ownership or usufruct of or from the assignment or cession of any rights over any:*


Intellectual Property

Immovable Property

Securities

Beneficial interest in a trust

Business Goodwill / Permits

Interest in a Partnership

  - *De-grouping;*
  - *Value Shifting*

Taxable Transfers (2)

What constitutes a *transfer* for the purpose of Article 5 ITA?

- any ***assignment***, ***sale***, ***emphyteusis*** or sub-emphyteusis, partition, ***donation***, settlement of property on trust, ***distribution and reversion of property settled on trust***, sale by instalments, and any alienation under any title;

- any ***redemption***, ***liquidation*** or ***cancellation of units or shares in a collective investment scheme*** as defined in article 2 of the Investment Services Act maturity or surrender of linked long term policies of insurance;

- includes ***any transfer of an asset by a company to its shareholders***, or by a commercial partnership *en nom collectif* or commercial partnership *en commandite* the capital of which is not divided into shares to its members, ***in the course of winding up the company*** or partnership or in the course of a distribution of assets to its shareholders or partners pursuant to a scheme of distribution.

- Also includes ***deemed transfers*** (provisions relating to value shifting).

Taxable Transfers (3)

What is **excluded** from the term "transfer"?

- a **transfer *causa mortis***

  On the death of an individual any asset transferred to the heirs is not subject to income tax (although it may be subject to duty under the Duty on Documents and Transfers Act) .

- The transfer of property by the trustee of a **disability trust** or **disability foundation** to any one or more of the remaining beneficiaries of such trust or foundation or the heirs thereof.

Provisional Tax

- The ITMA lays down a **withholding tax mechanism** which is **applicable to all taxable transfers** (i.e. transfers of all taxable assets).

- The withholding tax is known as **PROVISIONAL TAX** and must be paid to the CfTC within **15 days** from the date of the transfer of the taxable assets, at the rate of **7% of the value of the consideration**.

- Provisional tax shall not be payable in respect of any transfer of assets **not subject to tax under the provisions of articles 5 and 12 of the ITA**.

Capital Gains on transfer of securities

Definition of "securities"

- Shares that **participate in any way in the profits of the company** and whose return is **NOT limited** to a **fixed rate of return**.

The transfer of, for example, Preference Shares with a fixed rate of return falls outside the scope of tax.

- **Units in a collective investment scheme** (Art 2 of the Investment Services Act)

- **Units / Instruments linked long term business of insurance**

Capital Gains on transfer of securities

Basic Computation

Capital Gain = Transfer Value of Securities − Cost of Acquisition

Transfer Value

- Capital Gains computations are based on the **transfer price** of the securities, i.e. the ***transfer consideration***.

- The transfer consideration element is however substituted in case there is a transfer of a "***Controlling Interest***" taking place.

- Where a transfer of a controlling interest takes place, for the purposes of the capital gains computation, the transfer consideration may have to be substituted by the **MARKET PRICE** of the shares being transferred.

- Rule 5(1) of the Capital Gains Rules (CGR) states that where a transfer of a controlling interest takes place, the transfer is deemed to have been made at the **HIGHER** of the ***consideration*** and the ***market value*** of the shares.

- Therefore, in order to be able to determine the transfer value of the securities, one needs to determine whether the transfer is a transfer of a **controlling interest** or not.

Transfer Value

Transfer of a Controlling Interest

- A transfer is a transfer of a controlling interest when any one of the following criteria apply to the shares held by the transferor **<u>at any time during the period of 18 months preceding the transfer</u>** (not the shares transferred):

1.	their **nominal value** is at least 25% of the nominal value of issued share capital; or
2.	their **voting rights** are at least 25% of the company's voting rights;
3.	their rights allow the holder to be appointed, or to nominate or appoint or to withhold the nomination for **appointment of a company director**;
4.	their rights entitle the holder to at least 25% of the **profits available for distribution** to the company's ordinary shareholders.

Transfer Value

Transfer Value of Securities

- Transfer of a CI → Higher of **Market Value** & Consideration
- Transfer of a non- CI → Consideration (i.e. price paid to acquire the shares)

Transfer Value

Market Value

$Y = (0.4 \times A) + (0.2 \times B) + (0.4 \times C)$

- The 'market value' of **(unlisted) shares** in a company is determined in accordance with the following formula:

Y	=	(0.4 x A)	+	(0.2 x B)	+	(0.4 x C)
		'A' is the % of the issued share capital represented by the nominal value of those shares;		'B' is the % of the total voting rights in the company		'C' is the % of the profits available for distribution to the ordinary shareholders

- The 'market value' of shares that are **listed on a stock exchange** recognised by the CfTC is the last quoted price of those shares on that exchange before the date of the transfer.

Cost of Acquisition

Shares acquired AFTER 25 November 1992

- The **actual purchase price** of the shares

Shares acquired BEFORE 25 November 1992

- The Cost of Acquisition is the **HIGHER** of:

  i. The ***actual purchase price***; and

  ii. The value of the shares based on the ***Net Assets Value*** as per the last financial statements submitted to the Inland Revenue by 18 December 1992, as adjusted for an increase in inflation for any immovable property in the books at the time of transfer.

Exemptions in terms of Article 5 of ITA

Donations* to certain related persons (e.g. spouse, descendants and ascendants)
&
Donations to philanthropic institutions

**Restricted to donations of the following assets: securities, business, goodwill, trademarks, trade-names, copyright, patents but NOT beneficial interest in a trust*

Transfer of shares listed, or in consequence of listing, on a stock exchange recognised by CfTC

Transfer of securities listed on a stock exchange recognised by the CfTC. being securities in a CIS held in a prescribed fund

Securities assigned between spouses consequent to a judicial or consensual separation or a divorce

Assignment of securities forming part of the community of acquests /co-owned between spouses to one of the spouses on the dissolution of the community or partitioned between spouses

Exemptions in terms of Article 5 of ITA

Intra-Group Transfers

- Article 5(9) ITA exempts from tax assets transferred from **one COMPANY to another falling within the <u>SAME</u> group.**

- Applies to the transfer of **ANY** taxable asset.

- Applies ***restrictively*** to transfers between **<u>companies</u>**. Therefore entities have to fall within the definition of 'company' under Article 2 ITA to benefit from this exemption.

- The definition of "**group companies**" includes:

  - Companies that are deemed to be a group of companies for the purposes of surrendering of losses;
  - Companies that are controlled and beneficially owned directly or indirectly to the extent of more than **50%** by the same shareholders

Exemptions in terms of other Articles of the ITA (1)

Capital gains and gains of an income nature derived by non-residents upon disposal of securities [Article 12(1)(c)(ii)]:

The above-mentioned gains must be derived as a result of any of the below **TRANSFERS**:

- of units in a **collective investment scheme**;
- of units and such like instruments relating to linked **long term business of insurance**;
- of **interest in a partnership** which is not a property partnership;
- of **shares or securities in a company** which is not a property company (as defined in the ITA)

Exemptions in terms of other Articles of the ITA (2)

Beneficial Ownership Test Linked to Article 12(1)(c)(ii) exemption

An anti-tax provision

The exemption provided under 12(1)(c)(ii) applies provided that:

*the beneficial owner of the interest, royalty, gain or profit, as the case may be, is a person **NOT RESIDENT** in Malta and such person is **NOT owned and controlled** by, directly or indirectly, **nor acts on behalf of** an individual or individuals who are **ordinarily resident and domiciled** in Malta*

Exemptions in terms of other Articles of the ITA

The Participation Exemption [Article 12(1)(u)]:

- Malta's participation exemption applies to **dividends** and **capital gains** derived from a **participating holding** OR from the **transfer** of part or all of such participating holding.

- **NO anti-abuse conditions** need to be satisfied for the participation exemption to apply vis-à-vis any capital gains derived on the transfer of a participating holding.

Notifications to CfTC

- The Capital Gains Rules provide that for certain tax compliance matters relating to a transfer of shares.

Schedule C	Transfer of shares is a transfer of a Controlling Interest
Schedule D	Transfer of shares is a transfer of a non- Controlling Interest
Schedule E	Transfer of shares is a transfer which is exempt from capital gains tax

- An **auditor's report** is to be submitted alongside each of the above forms.

Property Transfers Tax

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Capital Gains on transfer of property

- Applicable article is **article 5A** of the ITA:

  - Rules stipulated under Article 5A ITA **closely mirror** the rules of Article 5 ITA, save certain differences as seen from certain <u>different definitions</u>.

  - Whereas ***Article 5 ITA*** applies to **<u>ALL</u>** taxable transfers of capital assets, ***Article 5A*** applies **<u>EXCLUSIVELY</u>** to transfers of **immovable property situated IN MALTA and any right over such property.**

- **Tax is FINAL**, i.e. the transfers are not taxable under any other article of the ITA, the tax paid is **not subject to a credit/refund**, and the transfer **is not subject to provisional sale** (i.e. full amount of tax is paid upon contract of sale).

General Principles (1)

- Default Rule – tax charged at a final tax of:

8% of the "Transfer Value"

- Transfer Value is the **HIGHER:**

CONSIDERATION **AND** **MARKET VALUE**

General Principles (2)

- Other applicable rates of tax apply under certain circumstances:
  - 12% of the excess, if any, of the transfer value over its acquisition;
  - 7% of the transfer value;
  - 7% of the transfer value;
  - 10% of the transfer value;
  - 5% of the transfer value;
  - 2% of the transfer value

Exempt Transfers of Immovable Property

- The exemptions which apply to transfers regulated in Article 5A ITA **mirror some of the exemptions which apply in an Article 5 ITA scenario**:

  - Donations to close relatives:
  - Donations to philanthropic organisations;
  - Assignment of property consequent to a personal separation or divorce;
  - Assignment of property consequent to a dissolution of the assets of the community of acquests;
  - Transfer of property not forming part of a project that was own residence for minimum of 3 consecutive years and sold within 12 months of vacating the property;
  - Intra-group transfers

Duty on Documents and Transfers

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Duty on Documents and Transfers

Main Legislation

Duty on Documents and Transfers Act **("DDTA") –** Chapter 364 of the laws of Malta

Imposes a tax (commonly referred to as "**stamp duty**") on certain **legal documents** and **transfers (including deemed transfers)**.

Duty under the DDTA is chargeable only on the documents specified in the Act either by reference to:

- the **DOCUMENT** (for example, ***policies of insurance*** and ***notarial deeds***); or
- the **TRANSACTION** executed by virtue of the document (for example, every ***document whereby immovable property is transferred***).

General Principles (1)

By way of summary, under the DDTA, duty is chargeable on documents and transfers / transmissions concerning:

- Documents relating to the **transfer of immovable property**;
- Documents relating to the **transfer of marketable securities**;
- Documents relating to the **transfer of interests in a partnerships**;
- Documents required to be created on a **transmission *causa mortis*** (i.e. that is to say a transfer that occurs on death) of immovable property, marketable securities and interests in a partnerships;
- **Contracts of exchange** where the asset being exchanged involves immovable property, marketable securities and interests in a partnerships;
- .**Policies of insurance**

General Principles (2)

Dutiable Documents

Use or Execution Principle

- Documents which are subject to duty under the DDTA become so dutiable if they are **EXECUTED IN MALTA** (in which case they are considered to be dutiable by reason of their "origin").

- A document that is <u>executed outside Malta</u> (which would have been dutiable had it been executed in Malta) becomes subject to duty **ONLY *if*** and ***when*** it is **USED IN MALTA** (i.e. is produced before any person or authority in Malta for its enforcement or registration).

General Principles (2)

- Duty is typically charged on the **HIGHER** of the amount of:
  - **Consideration;** or
  - **Value of the transaction**.
- The transferor and transferee are **JOINTLY AND SEVERALLY** liable for payment of transfers *inter vivos*. However, **in practice**, it is the **TRANSFEREE** who pays the duty.
- In the case of **value shifting**, duty is paid by the **deemed transferee** of the value.

Duty on Documents and Transfers – Glossary

What constitutes a 'transfer'? A widely defined term in the DDTA and includes any:

Assignment | Conveyance | Sale | Partition | Donation | Settlement of Dowry

Also includes:

- any occurrence that is **DEEMED** to be a transfer in accordance with the provisions of **Article 42B** (a change in share capital which is not proportionate –***value shift***);
- any transfer of any **asset by a company to its shareholders**, OR by a **partnership to its members**, in the course of winding up of the company or partnership or in the course of a distribution of assets to its shareholders or members pursuant to a scheme of distribution;

Does NOT include:

- any **transfer *causa mortis***, **EXCEPT** where **SPECIFICALLY** provided under the DDTA.

Duty on Documents and Transfers – Glossary (2)

"Marketable Security"

Means a **holding of share capital in any company** and any **document representing the same**.

"Property Company"

Means a company which:

- **owns immovable property situated in Malta** or **any real rights thereon**; or
- holds, directly or indirectly, **shares or other interests in any entity or person, which owns immovable property situated in Malta** or any real rights thereon, where **5% or more** of the total value of the said shares or other interests so held is attributable to such immovable property or rights.

Duty Due – Marketable Securities (1)

Charging Provision - ***Article 42 DDTA***

A duty of **€2.00 for every €100 or part thereof** of the **amount** or **value of the consideration** or the **real value**, whichever is the **HIGHER**, of the marketable security shall be charged:

1. Inter *vivos* transfers of **foreign marketable securities** (whether executed in or outside of Malta) (additional criteria apply in this case – e.g. transfer made **to** or **by** any **person resident in Malta**);

2. On every document whereby a **marketable security OTHER THAN** those mentioned in **paragraph (1)** is transferred ***to*** or ***by*** any **person in Malta.**

   Certain exemptions to (2) apply – e.g. restructuring of holdings exemption

3. On every notice of the **transfer *CAUSA MORTIS* of company shares** made in accordance with article 45 DDTA;

4. On a **transfer of REAL VALUE (i.e. value shifting)** in marketable securities as provided for in article 42B DDTA

Marketable Securities – Exemptions (1)

▪ Transfers between **spouses** *(certain restrictions apply, e.g. in relation to a transfer of assets consequent to a consensual or judicial separation or to a divorce between such persons or on the dissolution of the community of acquests existing between them);*
▪ Transfers between **co-habitants** *(certain restrictions apply, e.g. in relation to a transfer of assets assigned between them consequent to the dissolution of the cohabitation or on any transfer inter vivos of the cohabitation home or part thereof, of any or both of the cohabitants);*
▪ Transfer of marketable securities **listed on a stock exchange** recognised by the CfTC;
▪ Transfers effected through a **local bank** or through a person **holding a licence under the Investment Services Act**.

Marketable Securities – Exemptions (2)

- **Restructuring of holdings** through mergers, demergers, amalgamations and re-organisations **within a group of companies**;
  - The **transfer by an individual** of any shares forming part of a group of companies **in exchange of shares in a company or companies** forming part of the same group; or
  - The **exchange of shares** from **one company to another,** where such shares are in companies forming part of the same group of companies;
  - The **transfer of shares for consideration** from one company to another, where such companies form part of the same group of companies;

BUT

- If any of the above companies is a "**property company**", and is **NOT** directly or indirectly owned as to **at least 80%** by a company whose securities are **listed on a stock exchange** recognised by the CfTC, the exceptions shall ONLY apply if:
  - the individual, direct or indirect, **beneficial owners** of the companies referred to in the said proviso **are the SAME**; and
  - each such individual holds, directly or indirectly, **substantially the same** (refer to Art. 32 (6)(b) DDTA) percentage interest in the nominal share capital and voting rights in each of the said companies both before and after the transfer or exchange, as the case may be.

Marketable Securities – DDT10 Exemption (1)

Acquisitions or disposals of securities BY the persons below

Acquisitions or disposals of securities ISSUED BY the persons below

1. **Collective Investment Schemes**;

2. **Investment Services licence holders** whose activities comprise the provision of management, administration, safekeeping, or investment advice to collective investment schemes;

3. **A trust / fiduciary arrangement**, whose beneficiaries consist solely of individuals who are not resident in Malta; OR companies OR partnerships (provided that these satisfy the criteria under point 4(i) in the following slide), that they carry on or intend to **carry on business** or have **business interests** as to **more than 90% outside Malta**.

Marketable Securities – DDT10 Exemption (2)

4. A company or partnership :

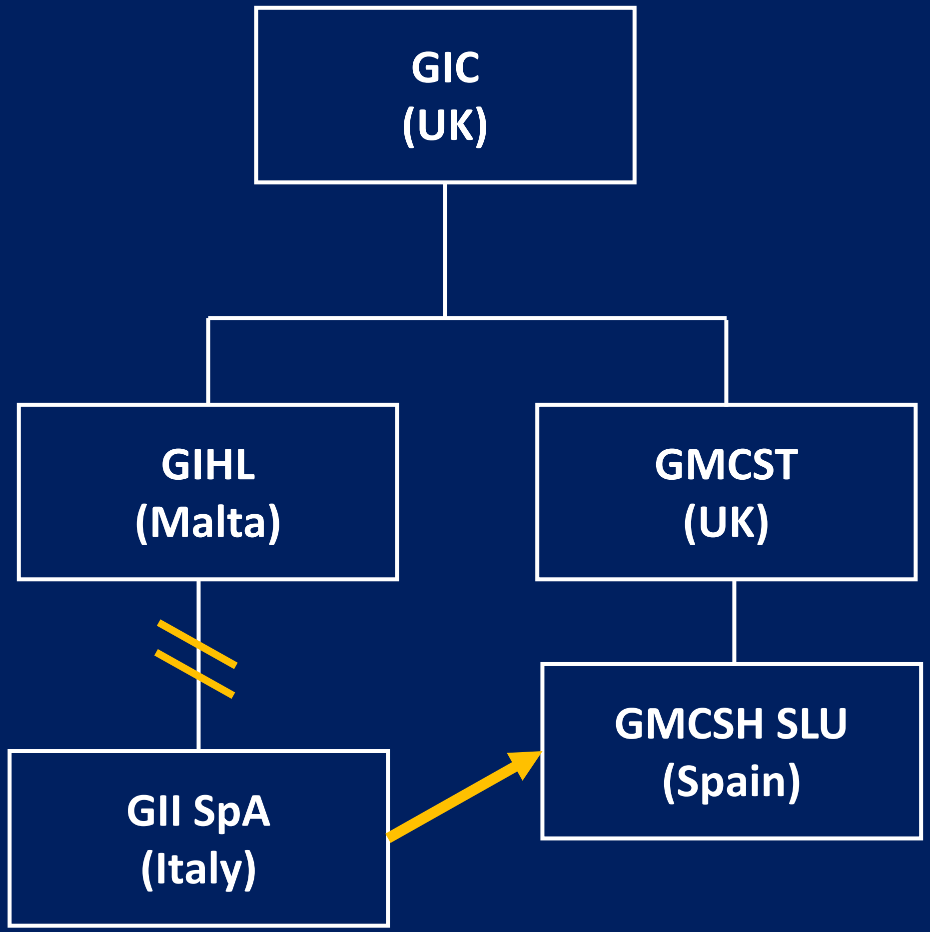
   i. with **>50%** of its ordinary share capital, voting rights and rights to profits, or **>50%** of the partnership capital, voting rights and rights to profits are held by:

      - any person who NOT RESIDENT in Malta and who is **NOT OWNED AND CONTROLLED BY**, directly or indirectly, **NOR ACTS ON BEHALF**, an individual or individuals, who are ordinarily resident and domiciled in Malta;

   AND

   ii. such company or partnership has been determined by the Commissioner as having the majority of its **business interests** **OUTSIDE MALTA.**

Stamp Duty – Practical Example (1)



GIHL, a Maltese company will be transferring all of the shares it holds in the issued share capital of GII SpA (Italy) to GMCSH SLU (Spain)

NOTE: In this case the holding is not in a Maltese company, therefore **foreign marketable securities** are involved

Stamp Duty – Practical Example (2)

- **NO** stamp duty implications or compliance obligations should arise if any of the below apply:

  1. **GIHL** or **GMCSH SLU** is in possession of a valid **DDT10 exemption** *(DDT10 may also be issued to the persons disposing, i.e. GIHL, or the persons acquiring, i.e. GMCSH SLU, the marketable securities, provided all requirements discussed previously are satisfied);*

  2. The transaction document is **NEITHER** **executed** **NOR** **used in Malta** (i.e. is produced before any person or authority in Malta for its enforcement or registration); or

  3. A **Ruling** is obtained from the Commissioner for Revenue, on the basis that the transfer forms part of a **group reorganisation**.

- In a scenario where the transaction document <u>will be executed or used in Malta</u>, and <u>none of the above exemptions are available:</u>

  - GIHL's acquisition of the shares would be subject to duty at the **rate of 2%** on the higher of the consideration payable and the real value of the shares determined via a prescribed formula.
  - Compliance obligations would also arise.

Duty chargeable on transfers of immovable property

Charging Provision - ***Article 32 DDTA***

*"There shall be charged on every **document** and on every judgment, decree or order of any court or other lawful authority whereby any **immovable or any real right over an immovable** is **transferred** to any **person**… a duty **of €5 for every €100 or part thereof** of the amount or value of the consideration for the transfer of such thing or the value of such thing, whichever is the higher".*

- Duty is charged by reference to the **amount or value of the consideration** **OR** to the **value of the property that is transferred**, whichever is the **HIGHER**. Therefore, one must compare:

the **consideration** paid for the transfer of the immovable property

AND

the **real value** of the immovable property

and pay duty on the higher of the two amounts.

Duty exemptions on transfers of immovable property

- Assignment of property between **spouses**:
  - *in relation to a transfer of property **consequent to a consensual** or **judicial separation** or to a divorce between such persons, including property owned by a company which is fully owned by any or both spouses;*
  - *on the **dissolution of the community of acquests** existing between them;*

- Transfers between **co-habitants**
  - *in relation to a transfer of assets assigned between them consequent to the dissolution of the cohabitation or on any transfer inter vivos of the cohabitation home or part thereof, of any or both of the cohabitants;*

- **Partition of property** held in common between spouses being community property, and partition of property on the death of one spouse between the surviving spouse and the heirs of the deceased spouse;

- Transfers of property **between companies forming part of a "group of companies"**.

- Transmission causa mortis on residence of the deceased to surviving spouse and eventually to descendants in the direct line

Value Shifting / Deemed Transfer

Relevant Provisions – *5(13)(b) ITA & Article 42B DDTA*

Change in the issued share capital or change in rights attached to shares

→

Reduction in Market Value of Shares held by a person

Value passes into other shares in or rights over the company held by another person

i.e. VALUE SHIFT

Examples:

- Allotment of shares;
- Reduction in share capital;
- Alternation of voting rights;
- Conversion of securities

Value Shifting

- The shift in value is taxed as if it were a **TRANSFER OF SHARES (hence why it is considered to be a deemed transfer).**

- Consequently, the shareholder whose value **DECREASES (the transferor)** is deemed to have made a transfer which is taxed as if they are transferring shares to the shareholder whose shares increase in value **(the transferee)**.

- To this end, the said deemed transfer of value would be brought to charge to capital gains tax and stamp duty under the provisions of the **Income Tax Act (ITA) and the Duty on Documents and Transfers Act (DDTA)** respectively.

Value Shifting

Value Shifting is not triggered under the ITA:

1. When there is **a** reduction in the shareholding of **ALL** the shareholders, such that the proportion of the shareholding of each shareholder with respect to number type, class, voting rights and value of shares is **EQUAL** before and after the reduction is effected. In this case, it shall be deemed that no loss or gain has arisen from the transfer.

2. When the change in the issued share capital, or change in voting rights, **DOES NOT:**

    - produce any change in the **individual, direct or indirect, beneficial owners** of the said company; **AND**
    - in the **proportion of the value of the said company** represented by the shares owned beneficially, directly, or indirectly, by each such individual.

Value Shifting

Value Shifting is not triggered under the ITA:

- Where the transfer of value is made by the transferor to a **person referred to in sub-article 2(e)(i) ITA**:
  - Includes: spouse, descendants and ascendants in the direct line and their relative spouses, or in the absence of descendants to his brothers or sisters and their descendants.
- Where the company is a company whose **securities are listed on a stock exchange** recognised by the CfTC.
- Where the change in the issued share capital consists of an **allotment of shares** in a company **as a result of an exchange of shares on a restructuring of holdings exempt from tax** under sub-article (14) ITA (exchange of shares upon mergers, de-mergers, divisions and amalgamations).

Value Shifting – Practical Example (1)

BEFORE SHARE ALLOTMENT

Company A

Company B

1000 shares
Eur 1.00 each

1000 shares
Eur 1.00 each

Company C

Company A: 50%
Company B: 50%

AFTER SHARE ALLOTMENT

Company A

Company B

2000 shares
Eur 1.00 each

2000 shares
Eur 1.00 each

Company C

NO Value Shift Occurs

Company A: 50%
Company B: 50%

Value Shifting – Practical Example (2)

BEFORE SHARE ALLOTMENT

Company A

1,000 shares
Having a nominal value of Eur 1.00 each

Company C

Company A: 100%

AFTER SHARE ALLOTMENT

Company A

Company B

1000 shares
Eur 1.00 each

1,500 shares
Eur 1.00 each

Company C

Value Shift Occurs

Company A: 40%
Company B: 60%

Value Shifting – Practical Example (1)

- An incidence of value shifting may STILL be **EXEMPT** from tax, in terms of the following derogations provided for under Maltese law:

Capital Gains

- ✓ In terms of the **Non-Resident Exemption** (provided that the company does not own any immovable property (or real rights over such property) that is situated in Malta).

Stamp Duty

- ✓ Possession of a **valid DDT10** stamp duty exemption

- In case the Non-Resident Exemption is not applicable and/or the company is ineligible for a DDT10, there is **one OTHER EXEMPTION which may be availed of** in respect of both capital gains & stamp duty:

Transaction carried out for ***BONA FIDE COMMERCIAL REASONS***
Moreover, this exemption may be availed of provided that the company does not own any immovable property (or real rights over such property) that is situated in Malta.

Taxation of Trusts, Foundations and Partnerships

21 ACADEMY

Diploma in Law (Malta)

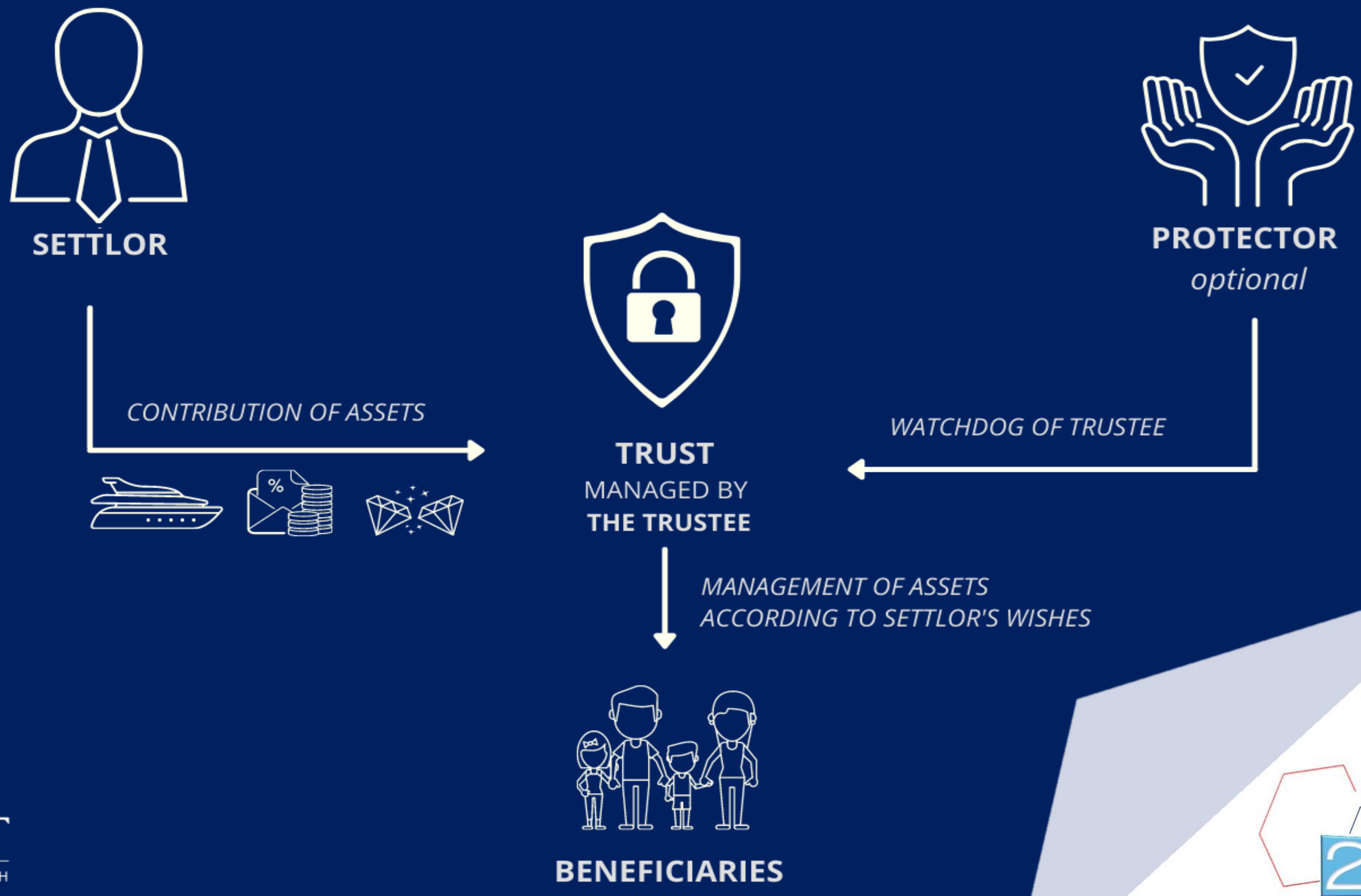
CAMILLERI PREZIOSI

ADVOCATES

Taxation of Trusts

What is a trust?

A trust is created where the **absolute owner of property** (**the settlor)** passes the **legal title in that property** to a person (**the trustee**) to **hold** that property on trust for the **benefit of another person** (**the beneficiary**) in accordance with the terms set out by the settlor.



Taxation of Trusts

- The Income Tax Acts and the Duty on Documents and Transfers Act, create several **distinct tax points** during the life of a trust:

- **Creation of / Settlement of property on Trust**
- **Day to day administration of the Trust** - any income derived by the trust is, in principle, taxable (in the hands of the trustee/s) under the Income Tax Act.
- **Distributions to beneficiaries** - any income distributed by the trustees to the beneficiaries is in principle taxable (in the hands of the recipients).
- **Transfers of beneficial interests in a Trust** - If the beneficiaries transfer their interest in the trust they are liable to pay income tax on capital gains (much like in a share transfer situation).
- **Termination of Trust / Reversion of Trust assets** - termination of a trust gives rise to tax implications.

Taxation of Foundations

- Foundations (Income Tax) Regulations – S.L. 123.114

DEFAULT POSITION

A foundation shall, for the purposes of the Income Tax Acts, be treated in the same manner as a **COMPANY**.

Therefore, any rules pertaining to the taxation of income applicable to companies shall **EQUALLY** apply to foundations.

ELECTION

A foundation may **elect,** by notice inwriting to the Commissioner ,to be treated as a **TRUST**.

Taxation of Partnerships

Article 2 ITA –Person: includes a **body of persons**.

Body of persons: any body corporate, including a company and any fellowship society or other association of persons, whether corporate or unincorporate, and whether vested with legal personality or not.

Definition of 'Company' includes:

- Any **partnership *en nom collectif*** and any **partnership *en commandite*** constituted under the Companies Act or under the Commercial Partnerships Ordinance;
- Any partnership regulated by the applicable provisions of the **Civil Code.**

Taxation of Partnerships

DEFAULT POSITION

Where **<u>NO election</u>** is made, the income of the partnership (ascertained in accordance with the provisions of the Income Tax Acts) will be brought to charge in the hands of the **PARTNERS**.

ELECTION

A partnership may elect, by notice in writing to the Commissioner, to be treated as a **COMPANY** for all purposes of the Income Tax Acts.

Taxation of Partnerships

Transfer of Interest in a Partnership

- An interest in a partnership is one of the **taxable capital assets** identified under Article 5 ITA. The transfer of the ownership or usufruct of or from the assignment or cessation of any rights over any interest in a partnership shall therefore constitute a taxable transfer for capital gains purposes.

- Transfer of an interest in a partnership also includes a **deemed transfer** (i.e. value shifting).

Taxation of Collective Investment Schemes

A scheme or arrangement which has as its object the collective investment of capital acquired by means of an offer of units for subscription, sale or exchange and which has certain specific characteristics.

Tax Treatment depends on classification of fund:

Non - Prescribed Fund

Having **MORE** than 85% of its underlying assets situated **OUTSIDE** Malta

Prescribed Fund

Having **at least 85%** of its underlying assets situated **IN** Malta

Prescribed Funds

- In terms of Article 12(1)(s), the income of a prescribed fund other than:

(1) Income derived from **immovable property situated in Malta**; and

(2) '**investment income**' (other than investment income paid by another CIS)

Shall be **EXEMPT** from tax in Malta

Investment Income refers to the categories of income outlined under Article 41 of the ITA.

Some examples include:

- interest, discounts or premiums payable in respect of a public issue by a company, entity or other legal person;
- capital gains arising on the disposal of shares or units in a collective investment scheme

Investment income received by a prescribed fund is subject to a **withholding tax.**

Non- Prescribed Funds

- In terms of Article 12(1)(s), the income of a prescribed fund other than:

(1) Income derived from **immovable property situated in Malta**

Shall be **EXEMPT** from tax in Malta

Tax Treatment at the level of the investor

- Number of considerations to be made:
  - ✓ whether the investor is holding units in a prescribed or in a non- prescribed fund;
  - ✓ whether the investor is a Maltese resident or a non-Maltese resident.

Stamp Duty Considerations for CIS

- If the CIS is licensed in terms of the Investment Services Act, then it may be eligible to benefit from a **blanket stamp duty exemption (DDT10)** under Article 47 of the Duty on Documents and Transfers Act, in respect of:

  - any acquisitions or disposals of marketable securities by the CIS;
  - any acquisitions or disposals of marketable securities by investors in the CIS