



Changes to Malta Income Tax Legislation 2007

INTRODUCTION

Changes to Malta income tax legislation were yesterday approved by the Maltese Parliament. These changes have brought the said legislation in line with the agreement reached with the EU in March 2006. The **MAIN HIGHLIGHTS** of the changes can be summarised as follows:

- A **participation exemption** has been introduced in relation to dividends and capital gains derived by a Malta company from participating holdings.
- However, certain anti-abuse provisions have been introduced with respect to *dividends* received by Malta companies from participating holdings.
- Where the conditions for the participation exemption are not satisfied, the refund system, as modified, would apply. The level of refund would depend on the nature and source of the income of the Malta company.
- The refund system/participation exemption may now be availed of by both Malta residents and non-Malta residents.
- Any distinction formerly existing between different types of Malta companies has been removed.

- Refunds are calculated on gross dividends distributed before deducting any credits under treaty relief, unilateral relief or commonwealth relief, and are limited to actual Malta tax paid.

- Companies registered as International Trading Companies before 31 December 2006, may retain their status as such until 31 December 2010.

- The full imputation system has been retained.

1. TAX TREATMENT OF INCOME STREAMS OF MALTA COMPANIES

All companies registered in Malta on or after 1 January 2007 may carry out international activities whether 'trading' or 'holding' in nature. The tax treatment applicable would depend on the allocation of income to the different taxed accounts depending on its nature and source. The five taxed accounts are:

- the Final Tax account;
- the Immovable Property account;
- the Foreign Income account;
- the Maltese Taxed account; and
- the Untaxed account.

- The income tax rate of 35% applicable to Malta companies has remained unchanged.

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2. DIVIDEND INCOME and CAPITAL GAINS

A Malta company in receipt of dividends deriving from a participating holding or capital gains from the disposal of such holding may, at its option, have this income treated in any one of the following manners:

- apply the **participation exemption** whereby the dividends or capital gains received by the Malta company are **exempt** from tax in Malta;

OR

- declare the income or gains as part of its chargeable income, and pay tax thereon, at the rate of 35%. Upon a distribution of a dividend by the Malta company, its shareholder/s may claim a **full refund (100%)** of the Malta tax suffered on such dividends.

▪ The definition of **participating holding** has substantially remained unchanged. The main qualifying criterion is a holding of at least 10% of the equity shares in a foreign body of persons.

▪ However, a holding period of 183 days has been introduced where an investment (by the Malta company) qualifies as a participating holding on the sole basis of a minimum investment value in the foreign body of persons of Lm500,000 (approx. Euro 1,165,000).

▪ A participating holding may also exist where the Malta company has a holding in a body of persons constituted, incorporated or registered outside Malta, which is not resident in Malta, and is of a nature similar to a partnership en commandite the capital of which is not divided into shares.

2.1 Anti - Abuse Provisions

The anti-abuse provisions introduced apply only with respect to *dividends* received by a Malta company and deriving from a participating holding, irrespective of whether the company chooses to apply the participation exemption or to pay tax as set out in 2. above.

Where a Malta company holds a **participating holding** in a foreign company, and none of the following three criteria are met, namely:

- The foreign body of persons is registered or resident within EU territory; **or**
- The foreign body of persons is taxed at a rate not less than 15%; **or**
- Less than 50% of the income of the foreign body of persons constitutes passive interest or royalties,

Then,

Two further conditions should be satisfied for any of the two tax treatment options (participation exemption/full refund) set out above to apply:

- The holding by the Malta company must **NOT** be a portfolio investment; **AND**
- The foreign body of persons or its passive interest or royalties must have been subject to any foreign tax at a rate of at least 5%.

▪ In the absence of a **participating holding**, or where the above conditions are not satisfied, the shareholder/s of the Malta company may claim a refund of 6/7ths or 2/3rds of Malta tax suffered depending on whether or not double taxation relief is claimed by the Malta company.



3. PASSIVE INTEREST OR ROYALTY INCOME

▪ Where the Malta company's income constitutes "passive interest or royalties", its shareholder/s may, following receipt of dividends, claim a refund of 5/7ths of the Malta tax suffered at company level on the dividends distributed from this income stream. This treatment would apply to dividends distributed from the Foreign Income Account only where the Malta company would not have claimed double taxation relief on the same (see 5. below).

▪ "Passive interest or royalties" is defined as interest or royalty income which is not derived, directly or indirectly, from a trade or business, where such interest or royalties have not suffered any foreign tax, directly, by way of withholding, or otherwise, at a rate of tax which is less than five per cent (5%).

4. TRADING INCOME

Where the Malta company's income arises from trading activities (where trade is widely interpreted to include both actual buying and selling of goods, and also the provision of services), its shareholder/s may, following receipt of dividends, claim a refund of 6/7ths of the Malta tax suffered at company level on the dividends distributed from this income stream.

5. TAX TREATMENT WHERE DOUBLE TAXATION RELIEF IS CLAIMED

Where double taxation relief is claimed by the Malta company on income allocated to the Foreign Income Account, its shareholder/s may, following receipt of dividends, claim a refund of 2/3rds of the Malta tax suffered at company level.

The mechanisms for relief of double taxation under Malta law have remained unchanged.

6. TRANSITORY PROVISIONS

Companies registered as International Trading Companies before 31 December 2006, may retain their status as such until 31 December 2010. However, such companies may opt to renounce to their status before the said date. Following renunciation to the status, or after 31 December 2010, whichever is the earlier, the said companies would fall to be regulated under the new system as indicated above.

The contents of this newsletter are for information purposes only and may not be construed or be relied upon as advice. For specific queries, kindly contact: Mr. Francis J. Vassallo - francis@fjvassallo.com; Ms. Adriana Camilleri Vassallo - adriana@fjvassallo.com; Dr. Ruth Agius Scicluna Buttigieg - ruth@fjvassallo.com

