

Taxation of Maltese Companies

Malta, an independent democracy and an EU Member State since May 2004, has developed into a reputable financial centre of choice and offers an attractive and competitive environment for international business and investment. A favourable tax system compounded with excellent infrastructure, state of the art telecommunications, an extensive treaty network, highly qualified professionals, and an English speaking and business friendly atmosphere have raised Malta's reputation beyond its relative small size.

Companies, registered or resident in Malta, are subject to income tax on chargeable income at a standard rate of 35%. However, in view of Malta's full imputation system of taxation any income tax paid by the company is credited in full to the shareholder upon a distribution of profits, so as to avoid any double taxation of corporate profits.

The full imputation system, which has been utilised since 1948 and which is fully compliant with EU directives and ECJ case law, ensures that both resident and non-resident shareholders are entitled for a refund of any tax paid by the company which is in excess of the shareholder's income tax liability.

Tax accounting and tax refunds

The income tax system utilises different tax accounts for different sources of income namely the Final Tax Account (FTA), the Immovable Property Account (IPA), the Foreign Income Account (FIA), the Maltese Taxed Account (MTA) and the Untaxed Account (UA).

The attribution of chargeable income to the different tax accounts is an important aspect of the Maltese tax system as this determines the possibility of tax refunds upon a distribution of profits. Distributions from the FTA, the IPA and the UA do not give rise to any tax refunds in the hands of the shareholders, however, a distribution from the FIA and MTA entitles the shareholder to claim a refund which is equivalent to either 2/3rds, 5/7ths, 6/7ths, or 100% of the company income tax. The examples illustrate the mechanics of the full imputation system and these tax refunds.

Profits attributed to the FTA include income that has been subject to a final withholding tax, profits arising from capital gains on immovable property which has suffered the property transfers tax, certain investment income and certain tax free profits. Profits attributed to the IPA are those profits resulting from the use of immovable property situated in Malta and which have not suffered the final withholding tax, profits from the rent, accommodation revenue by hotels and similar establishments, management fees and annual rental value of immovable property in Malta.

A company's trading or passive income which is not attributable to the FTA and IPA, is attributed to the FIA or the MTA depending on the source of such income. A distribution from the FIA or MTA enables the shareholder to apply for a tax refund of the company tax. The refund is equivalent to 6/7^{ths} in the case of trading income and to 5/7^{ths} in the case of certain passive interest and royalties. A company deriving foreign source income may also utilise the Flat Rate Foreign Tax Credit (FRFTC) by increasing the net foreign source income or gains by 25% and then deducting the FRFTC from the Malta tax. Upon a distribution of such foreign source income a shareholder may avail himself of a 2/3rds refund of the Malta tax.

Income tax is paid in the same currency as the company's

share capital, which is also the currency in which the company prepares and submits its audited financial statements. The tax refund is also paid in the same currency, thus eliminating any currency exchange risks. In terms of the provisions of the income tax legislation, a tax refund must be paid by the Inland Revenue Department within 14 days from the end of the month in which it falls due.

A tax refund is considered to fall due when the company's audited financial statements (showing the dividend distribution) and a complete and correct income tax return are submitted to the tax authorities, the tax liability is paid in full and an application for refund on a prescribed form, together with the dividend certificate is submitted by the shareholder or his attorney or representative.

The tax refund system and the application of the tax accounting is applicable to both companies incorporated in Malta as well as foreign companies resident in Malta and registered as such with the tax authorities.

Holding companies and the participation exemption

Holding companies that derive dividend income or capital gains from a 'participating holding' may apply for a participation exemption. Alternatively, the Maltese holding company may elect to be subject and pay income tax and upon a distribution of profits the shareholder is entitled to claim a full refund of the company income tax.

'Participating Holding'

A shareholding in a non-resident company qualifies as a participating holding if the Maltese company holds equity shares in a non-resident company or a qualifying body of persons and it:

- (i) has at least 10% of the equity shares in the non-resident company; or
- (ii) is an equity shareholder in the non-resident company and is entitled to purchase the balance of the equity shares of the non-resident company, or it has the right of first refusal to purchase such shares; or

- (iii) is an equity shareholder in the non-resident company and is entitled to either sit on the Board or appoint a person on the Board of that subsidiary as a director; or
- (iv) is an equity shareholder which invests a minimum in the non-resident company of Eur 1,164,000 (or the equivalent in a foreign currency) and such investment is held for a minimum interrupted period of 183 days; or
- (v) holds the shares in the non-resident company for the furtherance of its own business and the holding is not held as trading stock for the purpose of a trade.

Furthermore the non resident company in question must either satisfy any one of the following three conditions:

- it is resident or incorporated in the EU,
- it is subject to foreign tax of a minimum of 15%,
- it does not derive more than 50% of its income from passive interest and royalties,

or must satisfy both of the following conditions:

- (a) the shares in the non-resident company must not be held as a portfolio investment; and
- (b) the non-resident company or its passive interest or royalties have been subject to tax at a rate which is not less than 5%.

A 'portfolio investment' is an investment in securities held as part of a portfolio of similar investments for the purpose of risk spreading and where such an investment is not a strategic investment and is done with no intention of influencing the management of the underlying company. Furthermore, it is important to note that the holding of shares by a Maltese company in a foreign body of persons which derives more than 50% of its income from portfolio investments is deemed a portfolio investment.

Trading Companies

Shareholders in receipt of dividend income emanating from trading activities and whose profits are allocated to the FIA or MTA may apply for a tax refund equivalent of 6/7ths of the company tax paid. The example illustrates the mechanics of the full imputation system and the tax refunds.

Advance Revenue Rulings

Certainty can be sought on important aspects through the request of an Advance Revenue Ruling from the International Tax Unit of the Inland Revenue Department. Such ruling is valid for a period of five years and is renewable for a further five-year period. The ruling is not mandatory however it not only confirms the tax authorities' interpretation but also serves to preserve the same tax treatment for two years should there be a change in legislation which may affect the company or its tax treatment.

Other important benefits

- Malta does not levy any withholding taxes;
- Malta has no thin capitalisation rules or debt-to-equity ratios;
- Malta has no specific transfer pricing rules;
- Malta has no capital duty and wealth taxes;
- No stamp duties on share transfers in companies owned by non-residents;
- Non residents are exempt from any capital gains on certain share transfers;
- Malta has an extensive treaty network with 45 treaties in force and 12 initialled but not yet ratified;
- As an EU Member State Malta has adopted the EU's Parent-Subsidiary Directive and the Interest and Royalties Directive;
- Under the re-domiciliation provisions it is possible to migrate companies into and out of Malta without the need of winding up;
- No exchange control regulations and business may be conducted freely in any currency;
- Malta's financial services legislation and tax laws are compliant with EU directives;
- Malta's has strong and effective Money Laundering Laws and Regulations
- Malta's legislation offers regulated professional trustees which may provide fiduciary and trust services.

The following table illustrates and summarises the tax treatment and possibilities for companies having passive or trading income and the tax refunds available to shareholders:

Company	Passive Income				
	Having PH ¹	Having PH ¹ claims FRFTC	No PH Claims FRFTC	Passive Interest and Royalties	Trading Income
Profit before tax	EUR 1,000.0	EUR 1,000.0	EUR 1,000.0	EUR 1,000.0	EUR 1,000.0
Gross up for the FRFTC ²	-	250.0	250.0	-	-
	1,000.0	1,250.0	1,250.0	1,000.0	1,000.0
Tax thereon at 35%	350.0	437.5	437.5	350.0	350.0
Credit for FRFTC ²	-	250.0	250.0	-	-
Tax Payable	350.0	187.5	187.5	350.0	350.0
Shareholder					
Gross dividend received	1,000.0	1,000.0	1,000.0	1,000.0	1,000.0
Tax charged at 35%	350.0	350.0	350.0	350.0	350.0
Credit for tax at source	350.0	350.0	350.0	350.0	350.0
	full	full	2/3rds	5/7ths	6/7ths
Refund to shareholders	350.0	187.5	125.0	250.0	300.0
Effective tax rate	0%	0%	6.25%	10%	5%