



International Tax

Malta Tax Alert

17 May 2011

Guidance issued on hybrid loans

Contacts

Conrad Cassar Torregiani
ctorregiani@deloitte.com.mt

Astrid Vroom
avroom@deloitte.com.mt

Guidance issued by Malta's Inland Revenue Department (IRD) on 27 April 2011 on the tax treatment of hybrid loans was further clarified on 13 May 2011. The guidance was issued pursuant to ECOFIN's approval of recommendations concerning profit participating loans (PPLs) adopted by the EU Code of Conduct Group.

The guidance confirms Malta's treatment of income from hybrid loans as interest and not as income from share capital or from an equity holding. A hybrid loan is defined for these purposes as a financial instrument that has characteristics of both debt and equity and includes a PPL. As a result, income received by a Malta resident entity under a PPL typically will be taxed in Malta at an overall effective rate of 5%. This rate falls to 0% where the Malta resident entity is not incorporated under Maltese law, the income has a foreign source and is not physically received in Malta.

The IRD has further confirmed that:

- Amounts payable on a PPL are deductible as interest provided they otherwise satisfy the tests for the deductibility of interest; and
- Preference shares are not considered hybrid loans for purposes of the guidelines and their tax treatment follows their form regardless of how they are classified for other purposes or how they are treated for tax purposes in the country where the issuer is resident.

As a result, preference shares will continue to be characterized as equity under Maltese tax law. If the shares grant the holder two out of the three following rights: (1) voting rights, (2) dividend entitlement and (3) entitlement to liquidation proceeds, income or gains derived by a Malta resident entity from the preference shares will continue to be exempt from tax in Malta under the participation exemption regime provided the income is not directly or indirectly derived from immovable property situated in Malta and:

- The Malta company has made a qualifying investment, i.e. it holds at least 10% of the equity shares; or it has invested at least EUR 1.2 million; or any one of four supplemental, alternative tests is satisfied; and
- The issuing company is a qualifying company, i.e. it is resident or incorporated in the EU; or it is subject to a foreign tax of at least 15%; or it does not derive more than 50% of its income from passive interest or royalties that are not derived, directly or indirectly, from a trade or business; or it is not a portfolio investment.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 140 countries, Deloitte brings world-class capabilities and deep local expertise to help clients succeed wherever they operate. Deloitte's approximately 169,000 professionals are committed to becoming the standard of excellence.

This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or its and their affiliates are, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your finances or your business. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser.

None of Deloitte Touche Tohmatsu Limited, its member firms, or its and their respective affiliates shall be responsible for any loss whatsoever sustained by any person who relies on this publication.