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Tax Update

Act to Implement Budget Measures for 2009

Introduction

Act 1 of 2010, called the Budget Measures Implementation Act was published on the 16th April 2010. As its name implies, this Act brought into force the measures announced on the 9th November 2009 during the Budget Speech for 2010. In addition, a number of important changes to Malta's tax laws have been enacted, most of which are aimed at curbing possible abuses of the tax system.

This Tax Update briefly outlines the more important changes to the tax laws brought about by this Act. Due to the complexity of the subject and the wide scope of the changes, this Tax Update cannot and is not intended to be an exhaustive review of all the new rules.

Tax on transfer of shares listed on the Malta Stock Exchange

The general exemption from tax on the transfer of shares listed on the Malta Stock Exchange has been retained. However, a 15% tax has been introduced on the gain realized upon a transfer of shares that were listed after 1st January 2010, where the transferor held those shares before they were admitted to listing. The gain is computed by reference to the difference between the cost of acquisition of the shares that were acquired before being admitted to listing and the market value of the shares immediately upon being admitted to listing.

Transfer of business permit

A business permit has now been included in the list of capital assets the transfer of which is subject to tax on any eventual capital gain realized by the transferor.

New definition of 'property company'

The Income Tax Act now contains a definition of 'property company', the relevance of which will be evident later on in this Tax Update. A 'property company' is defined as a company that owns, directly or indirectly through its shareholdings in other bodies of persons, immovable property situated in Malta.

However, a company or body of persons carrying on a trade or business may own a factory, warehouse or office in Malta without qualifying as a "property company" provided that the immovable property situated in Malta constitutes less than 50% of the company's or body of persons' assets and provided also that it does not derive income from immovable property.

Tax exemption on an intra-group transfer of a capital asset

Article 5(9) of the Income Tax Act provides for an exemption from tax on the transfer of capital assets between group companies. Whilst in general terms this exemption has been retained, new conditions have been introduced to restrict its applicability in the case of transfers of immovable property or

shares in a property company (refer to definition above).

For the tax exemption to apply, the new rules require that the ultimate beneficial shareholders of the transferor and transferee companies have to be substantially the same, with only a 20% variance being allowed in each individual's shareholding in the two companies.

Stamp duty on transfers of immovable property between group companies

The Duty on Documents and Transfers Act provides for exemptions from duty when immovable property is transferred between two companies that form part of the same group of companies. Although the definition of 'group of companies' has remained unchanged, the duty exemption on transfers of immovable property between group companies has been restricted and now only applies where the ultimate beneficial shareholders of the transferor and transferee company are substantially the same, with only a 20% variance being allowed in each individual's shareholding in the two companies.

Income tax on a change in a company's shareholding or voting rights

Act 1 of 2010 has introduced new provisions whereby a change in a company's shareholding (nominal or voting rights), such as a change brought about by an allotment of shares to new shareholders or to some but not all existing shareholders, or by a reduction in the share capital of a company affecting some but not all shareholders, may be deemed to be a transfer of shares and taxed accordingly.

In such instances, the shareholder who, as a result of a change in a company's shareholding, has suffered a reduction in the market value of his shares in the company, is taxed in like manner as if he has transferred such value to the other shareholders that have, as a result of the said change in the company's shareholding, benefited from an increase in the market value of their shares. Such transfer of value normally arises on the allotment of shares to new or some, but not all, of the existing shareholders for a consideration that does not adequately reflect the underlying value of the company or a reduction in the share capital of a company where one or more shareholders receive/s a return that does not reflect the value of the company.

These provisions do not apply where the change in shareholding is made in a company whose shares are listed on the Malta Stock Exchange or where the deemed transferor and transferee are members of the same family who, in terms of other provisions in the Income Tax Act, benefit from a tax exemption on donations of shares between them.

Finally, these new provisions do not apply to changes in the shareholding of a company that is not a property company but in such cases the deemed transferor must be able to show to the satisfaction of the Commissioner of Inland Revenue that the change in shareholding was made for bona fide commercial reasons and is not part of a scheme the main purpose of which is the avoidance of tax.

Stamp duty on a change in a company's shareholding or voting rights

New rules introduced by Act 1 of 2010 provide that any change in a company's issued share capital or voting rights that result in a reduction in the real value of shares held by a shareholder and the consequent transfer of that real value to other persons, is subject to duty in like manner as an actual transfer of shares in a company.

Where the change referred to above takes place in a company that is not a property company, the above provisions do not apply if it can be shown to the satisfaction of the Commissioner that the change in shareholding or voting rights was made for bona fide commercial reasons and is not part of a scheme the main purpose of which is the avoidance of liability to duty.

No liability to duty arises where the transferor and transferee are members of the same family as defined in the Income Tax Act and the change consists of a change in the voting rights attached to the shares.

Change in the shareholding of a company following an intra-group transfer of a capital asset

As stated above, the tax exemption on the transfer of a capital asset between group companies has been retained, even if with some added restrictions. In 2009, new rules had been introduced to the effect that if, within a period of five years from the date of an exempt intra-group transfer of an

immovable property, the shareholding in the companies changed to such an extent that they no longer satisfied the group relationship, the transfer of the immovable property which had, in the first instance been exempted from tax, became taxable immediately.

The amendments introduced through Act 1 of 2010 have extended this provision to those situations where the intra-group tax exempt transfer consisted of a transfer of shares in a property company. Moreover, the time period within which a change in shareholding gives rise to a tax claw back has been extended from five to six years.

It is to be noted that if the tax exempt intra-group transfer of immovable property or shares in a property company took place before 1st January 2010, the group relationship between the transferor and transferee companies would only terminate if the conditions under which the original intra-group exemption was granted, no longer subsist.

Finally, a provision has been introduced such that the company that becomes chargeable to tax upon the change in shareholding referred to above may transfer the gain or loss, as the case may be, to a related company.

Reduction in the share capital of a company

A reduction in the share capital of a company has always been treated, ever since capital gains tax was introduced in Malta's tax laws in 1992 as a deemed transfer of shares. The current amendments provide that if the share capital reduction results in a proportionate reduction in each shareholder's holding in the company, no gain or loss is deemed to result for tax purposes. This provision will negatively affect bona fide company restructurings involving a reduction in share capital to offset accumulated losses, as the shareholders will now no longer be able to benefit from the resulting capital loss to which they were entitled before the new provisions came into force.

Duty on restructurings of shareholdings

Before the recently enacted amendments, no duty exemption applied on restructurings of shareholdings involving groups of companies that owned immovable property. This outright inapplicability of the exemptions has been relaxed but a rule similar to the one on intra-group transfers of immovable property has been introduced whereby the duty exemption would apply only if the ultimate beneficial owners of the companies before and after the restructuring do not vary by more than 20%.

Rate of duty on transfers of shares in a property company

The Duty on Documents and Transfers Act provides that where shares in a property company are transferred, the rate of duty increases from the default rate of 2% of the higher of the consideration received or value of the shares transferred, to 5%. A property company, for the purposes of this rule, is one in which immovable property represents more than 75% of the value of the total of its fixed assets and immovable property classified under current assets. Before the recently enacted amendments, the 2% duty rate would still have applied if the company whose shares were transferred did not own immovable property itself but owned shares in other companies that owned immovable property.

The changes to the law that were enacted by Act 1 of 2010 have introduced a look-through provision by virtue of which the rate of duty is determined by taking into account not only the immovable property owned by the company whose shares are transferred but also the immovable property owned by companies in which it is a shareholder. Under the new rules, if the value of immovable property owned by the company whose shares are transferred and by any property company in which it is a shareholder, exceeds 75% of the total of the relevant companies' fixed assets and immovable property classified under current assets, the rate of duty chargeable shall be 5% of the real value of the shares or consideration received, whichever is the higher.

Determining the real value of shares in a company for duty purposes

Whilst for capital gains tax purposes, the market value of shares in a company is determined on the basis of specific rules contained in the Capital Gains Rules (Subsidiary Legislation 123.27), no such rules exist in determining the real value of shares for duty purposes and the computation was made on the basis of unwritten and non-prescribed departmental practice. By virtue of forthcoming amendments to the Capital Gains Rules, the two computations should be aligned. More importantly, Act 1 of 2010 has determined that the real value of shares is to be computed on the basis of the higher of the

percentage of the nominal share capital and the voting rights represented by the shares being transferred. Thus, for example, if a shareholding represents 30% of the nominal share capital but entitles the shareholder to 90% of the voting rights, the real value of the shareholding would be deemed to be 90% of the value of the company.

Definition of 'transfer' for the purposes of duty on documents

In terms of the Companies Act, a declaratory public deed is required to be published upon a division of a company, where the divided company owns property that is transferred to one or more of the recipient companies upon the division. The declaratory public deed is subject to duty at 5% of the property's value unless an exemption in terms of the Duty on Documents and Transfers Act applies. The Companies Act will soon be amended in order to introduce a requirement for a declaratory public deed to be published even in the case of a merger of companies. In terms of the amendments to the Duty on Documents and Transfers Act the transfer of property upon a merger of companies will be subject to duty at 5% of the property's value unless an exemption applies.

Tax exemption on transfer of shares by non-residents

Non-residents were, up to the enactment of Act 1 of 2010, exempt from tax on the transfer of shares in a company resident in Malta provided that the assets of the company did not consist wholly or principally of immovable property situated in Malta. The amendments now clarify that the exemption will continue to apply but only if the company whose shares are being transferred is not a property company, thus effectively restricting the exemption only if no property is owned by the company whose shares are being transferred or by any company in which the said company holds shares.

Period within which to opt out of 12% tax on property transfers

The period within which a person can opt out of the 12% tax on property transfers has been extended from five years to seven years from the date of acquisition of the property to the date of its transfer.

Property services

An anti-abuse provision has been introduced with respect to services that are in any way connected with immovable property situated in Malta where such services are provided by a person to a related person. For the purpose of these new provisions an individual is deemed to be related to a body of persons (e.g. a company) if the individual is directly or indirectly a shareholder, partner or member of that body of persons. Two bodies of persons are deemed to be related to each other if they are directly or indirectly controlled or beneficially owned as to more than 25% by the same persons.

In terms of the new rules, where a person provides services consisting of brokerage, professional services, construction work or work of tradesmen, or the granting of loans to a related person, and such services or loan relate to the acquisition, development etc. of immovable property owned by the related person, the person providing the services or the loan may not make a tax deductible loss on the provision of such services.

Similarly, the owner of the property cannot make a tax deductible loss on the sale of property where such loss arises as a result of the services or interest payable on the granting of loans by a related person, unless such loans have been made at a rate of interest similar to the rate of interest that would have been charged if the persons were not related.

These provisions were introduced with the objective of curbing possible abuses resulting from charges between related persons that do not necessarily reflect the real value of the services rendered. The scope for manipulating the level of charges for such services had increased with the introduction in 2005 of the 12% tax on the transfer value of property. The cost of acquisition of properties sold under this tax regime became irrelevant, thus possibly giving rise to situations where the person providing the services had the incentive to reduce the price for the services rendered to a related person.

Definition of "recipient" under the investment income provisions

Since the enactment of the investment income provisions in 1994, allowing for a beneficial 15% final withholding tax on investment income, banks, insurance companies and their subsidiaries couldn't benefit from this reduced tax rate, for obvious tax base protection reasons.

An amendment that was introduced by Act 1 of 2010 extends this beneficial tax rate, backdated with

effect from the year of assessment 2009 (financial year ending in 2008) to subsidiaries of banks and insurance companies that do not undertake banking or insurance business and whose shares are listed on the Malta Stock Exchange. It is not envisaged that several companies will benefit from this beneficial tax rate on their investment income. In fact, only one listed company, which is a subsidiary of a bank, currently satisfies these criteria.

Distributions from the 'untaxed account' during liquidation

Distributions of profits by a liquidator in the course of a winding up of a company, where such profits were allocated to its tax reserve called 'untaxed account' (in general terms consisting of profits that were not taxed at the level of the company) were, up to the enactment of the current amendments, not subject to any tax, whether by withholding or otherwise. Such distributions have now become subject to 15% withholding tax, that could be treated as final tax, like any distribution from the untaxed account not made in the course of a company's winding up.

Tax deduction on tertiary education fees

As from the year of assessment 2011, a tax deduction shall be granted, subject to conditions that have not yet been published, on fees paid in respect of studies at a recognized tertiary education institution, whether locally or abroad.

Personal Separations

A tax deduction is granted under the Income Tax Act on alimony payments as determined by the Courts of Malta or as agreed by a public deed of personal separation under the authority of the Courts of Malta. The tax deduction, as from the year of assessment 2011, has been extended to apply also to alimony payments determined by, or under the authority of, a foreign court as may be approved by the Commissioner of Inland Revenue.

Financial assistance received in respect of the maintenance of a child following a personal separation is exempt from tax if the financial assistance has been determined by the Courts of Malta or agreed by a public deed of personal separation under the authority of the Courts of Malta. The tax exemption, as from the year of assessment 2011, has been extended to apply also to the receipt of financial assistance determined by, or under the authority of, a foreign court as may be approved by the Commissioner of Inland Revenue.

Tax on employment outside Malta

The beneficial tax rate of 15% on income earned from overseas employment has been retained but has been made slightly less beneficial through an amendment that provides that such income is to be treated as the first part of that person's income rather than the last part. Thus any other income that the person may earn will not fall within the lower tax brackets under which it would be taxed at zero or low rates of tax but would most probably fall to be taxed at the maximum 35% tax rate.

Expatriates Tax

The Malta tax payable by a person who is not ordinarily resident or not domiciled in Malta on income derived from an employment exercised in Malta is computed by reference to the salary received by such person, irrespective of whether he/she is employed with a Maltese or a foreign company. The applicable rates until the year of assessment 2010 were the graduated rates of income tax, the maximum of which is 35%.

As from the year of assessment 2011, persons who are not ordinarily resident in Malta and who derive employment income in respect of work or duties carried out in Malta may opt to be taxed at a flat rate of 15% on their emoluments, subject to the satisfaction of certain conditions that have yet to be published, amongst which is the minimum tax that such persons would be required to pay.

Definitions of "equity holding" and "participating holding"

In terms of Malta's 'participation exemption' rules, dividends and capital gains are exempt from tax if they are derived by a company from an 'equity holding' in a company or body of persons resident outside Malta, where such holding constitutes a 'participating holding'.

Prior to the amendments, an 'equity holding' subsisted where the holder was entitled to a right to (i)

votes; (ii) profits available for distribution and (iii) surplus assets on a winding up. The amendments have widened the application of the participation exemption by requiring the satisfaction of only two out of the abovementioned three criteria.

In addition, a shareholding in a Maltese company (but not in a Maltese body of persons) can now qualify as a participating holding. Prior to the amendments, only holdings in non-resident companies or bodies of persons could qualify as a participating holding. However, the application of this new provision and hence the tax exemption, is restricted to the disposal of a participating holding in a Maltese company and has not been extended to dividend income received from such Maltese companies.

Moreover, following the introduction of the term “property company” (see above) it has now been determined that a shareholding in a property company cannot constitute a participating holding.

Tax provisions on shift of residence or domicile and cross-border mergers of companies

With effect from 1 January 2009:

- persons transferring their residence and/or domicile to Malta; and
- companies resulting from a merger in terms of the EC Directive 2005/56/EC on cross-border mergers;

are entitled (but not obliged) to claim a step up in the tax base cost of assets situated outside Malta without any adverse Malta tax consequences. The said persons may opt to, for Malta tax purposes, revalue the assets from their historic cost to their fair market value at the time of shift of residence/ domicile to Malta or at the time of the merger, as the case may be. The revaluation will apply for the purpose of determining the taxable gain upon a subsequent disposal of the assets and serves to ensure that any unrealized increase in the value of such assets before the shift in residence / domicile or merger would be exempt from Malta income tax. The new value will also be used in computing the wear and tear allowances that are deductible in determining the chargeable income.

Persons electing for a step-up in base cost must not have been resident or domiciled in Malta prior to their transfer of residence and/or domicile to Malta and, in the case of a merger, the assets must not have been owned by a merging company which was a company resident/domiciled in Malta prior to the merger.

Tax exemption on royalties

A new tax exemption, specific details of which have yet to be announced, relates to income from royalties and similar income derived from patents in respect of inventions whether in the course of a trade, business, profession or vocation or otherwise.

Duty on insurance policies

In general terms, duty is chargeable under the Duty on Documents and Transfers Act on documents that are executed in Malta and on documents which, though executed outside Malta are made use of in Malta, such as when they are produced before a Court as evidence or before any authority in Malta for their enforcement or registration.

The amendments to the Act now provide that in the case of insurance policies, duty is chargeable in all cases where the policyholder is an individual resident in Malta or, in the case of a legal person, where such policyholder is incorporated or otherwise created in Malta, even if the document is executed outside Malta and not made use of in Malta.

Duty on banking credit cards

The annual duty of €16.31 payable on banking credit cards has been removed.

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