

Question 1

Part 1

PEL is tax resident in Malta and carries a business of commercial exploitation of immovable property situated both in Malta and in Italy. The distributable profits are the total profits of a Maltese Company which are available for distribution. The distributable profits shall be allocated to the following accounts: Final tax account (FTA), Immovable Property Account (IPA), Foreign Income Account (FIA), Maltese tax Account (MTA) and Untaxed Account (UA).

FTA is the taxed account to which the **profits which suffered tax** shall be allocated before allocation to any other tax account.

IPA is the taxed account to which the profits derived **directly or indirectly from immovable property situated in Malta** which suffered tax shall be allocated.

FIA is the taxed account to which the foreign source passive income, foreign source capital gains, foreign source dividends and, by way of derogation, profits derived from an overseas branch, agency or permanent establishment.

MTA the taxed account to which the profits not included in the FIA and suffered tax or have been exempt from tax under any Maltese law.

UA the taxed account to which the all other profits/losses are allocated. Considering that PEL holds immovable property with the purpose of commercially exploiting it, the rents received will be considered income of a trading nature.

- a) EUR 50,000 - the rent from Italy should be included in the FIA
- b) EUR 20,000 - the gross revenue from rent from residential property in Sliema, Malta should be included in the UA
- c) EUR 25,000 - the gross revenue from rent from the office block in Valletta, Malta should be included in the UA
- d) EUR 550,000 - the sales proceeds of the warehouse in Velledda

Considering that we are talking about a disposal of assets the property transfer tax rules (art. 5A ITA) apply. Therefore 12% PPT will apply on the transfer value and no exception applies and the profit (EUR 484,000) would have to be included in the FTA.

- e) EUR 650,000 - sales proceeds from the disposal of an office block in Malta

Considering that the disposal is carried on not later than 12 years from the date of acquisition, PEL can opt out of PPT. therefore, Capital Gains Tax will apply. The capital gain to be taxed will be EUR 650,000 sales proceeds less EUR 400,000 acquisition price paid, less EUR 50,000 improvement expenses, resulting in a taxable gain of EUR 200,000, taxable at a CGT rate of 7%.

The net gain of EUR 186,000 will be included in the IPA.

Part 2

Generally, the rental of real estate qualifies as a service under the VAT Act. Generally, these services are taxable where the immovable property is located. Therefore, if the immovable is located in Malta then the VAT rules of Malta will apply. According to Malta VAT Act, rental of immovable is a service VAT exempt without credit. However, certain exceptions apply. Services involving properties situated outside Malta are outside the scope of Maltese VAT.

- a) The rental of residential accommodation situated in Malta to tourists is VAT taxable at the reduced rate of 7% if the accommodation is registered with the Maltese Tourist Service. Otherwise, the general rule regarding the VAT exemption without credit will apply.
- b) The rental of residential property to individuals resident in Malta is VAT exempt without credit, therefore no VAT will apply.
- c) The rental of office premises in Malta to a Maltese VAT registered company is taxable at the standard VAT rate of 18%, therefore 18% VAT must be charged on the invoices issued for this service.

d) Services involving properties situated outside Malta are outside the scope of Maltese VAT. Therefore, the rental of office premises in Bulgaria to a Bulgarian VAT registered company is outside the scope of Maltese VAT and subject to Bulgarian VAT rules.

e) Services involving properties situated outside Malta are outside the scope of Maltese VAT. Therefore, the rental of office premises in China to a Chinese tax resident is outside the scope of Maltese VAT.

Question 2

Considering that Nikolai is living with a Maltese woman, in Malta, applied for Maltese citizenship and has made declarations what he intends to live in Malta for the rest of his life, Nikolai will be treated as resident in Malta for tax purposes. For the transactions which he intends to perform the following tax implications will arise:

1) Transfer of apartment in Russia to his son

Generally CGT applies to donations of any immovable property. However, a tax exemption applies in the case of donations to descendants (art. 5 (2) e) ITA). Therefore no CGT applies in this case.

The transaction is also outside the scope of VAT in Malta as the immovable property is located in Russia

The transaction is also outside the scope of Stamp Duty/Duty on Documents in Malta as the immovable property is located in Russia.

2) Transfer of rights over cash in a Russian bank to his mother

This is a transfer which is not subject to CGT and/or Income Tax

No VAT applies

No Duty on Documents applies

3) Transfer of shares in Russian company to his mother

This transaction would be subject to CGT at the provisional 7% rate applicable for transfer of securities generating a controlling interest. The exemption for donations to close relatives does not apply as the mother does not qualify. However, according to the DTRO between Russia and

Malta, the capital gains from the alienation of shares deriving their value directly or indirectly from immovable property situated in the other state may be taxed in the other state. In the present case therefore the capital gains derived by Nikolay from the transfer of shares in the Russian company having 90% of assets consisting in immovable situated in Russia will be taxable in Russia and not Malta.

No VAT applies

No Duty on Documents applies

4) Transfer of land and buildings in Spain to his son

Generally CGT applies to donations of any immovable property. However, a tax exemption applies in the case of donations to descendants (art. 5 (2) e) ITA). Therefore no CGT applies in Malta in this case.

The transaction is also outside the scope of VAT in Malta as the immovable property is located in Russia

The transaction is also outside the scope of Stamp Duty/Duty on Documents in Malta as the immovable property is located in Russia.

5) Transfer of image rights to his son

This transaction would be subject to CGT as a transfer of royalties. The exemption for donations to close relatives does not apply as the property transferred is not an immovable good. Therefore, 35% CGT will apply on the market value of the rights transferred.

No VAT applies

No Duty on Documents applies

6) Transfer of perpetual emphyteusis to his lover

Generally CGT applies to donations of any immovable property. No exemption applies as the emphyteusis is permanent. 35% CGT will be due on the gain calculated using the market value of the property.

No VAT applies

The transaction will be subject to Duty on Documents as it relates to immovable property situated in Malta, at the rate of 5%.

7) Transfer of works of art to Maltese Heritage Foundation

No CGT applies for donations of works of art to foundations.

No VAT is due

No Duty on Documents apply

8) Transfer to Maltese trust

No transfer will be considered to take place for CGT purposes (art. 5 (18) ITA)

No VAT is due

Duty on documents will apply at 5%

Question 3

S&A is tax resident in Malta the distributable profits are the total profits of a Maltese Company which are available for distribution.

The distributable profits shall be allocated to the following accounts: Final tax account (FTA), Immovable Property Account (IPA), Foreign Income Account (FIA), Maltese tax Account (MTA) and Untaxed Account (UA).

FTA is the taxed account to which the profits which suffered tax shall be allocated before allocation to any other tax account. No further tax is charged on the distribution of profit from FTA.

IPA is the taxed account to which the profits derived directly or indirectly from immovable property situated in Malta which suffered tax shall be allocated. Full imputation tax system applies to distributions of dividends from IPA.

FIA is the taxed account to which the foreign source passive income, foreign source capital gains, foreign source dividends and, by way of derogation, profits derived from an overseas branch, agency or permanent establishment. Companies pay 35% tax on the FIA but the tax paid by the company on these amounts can be recovered by the company's shareholders, under several types of refunds (full, 2/3, 6/7, 5/7)

MTA the taxed account to which the profits not included in the FIA and suffered tax or have been exempt from tax under any Maltese law. No further tax is payable by the company, distributions from this account are not taxable and shareholders can obtain refund (5/7 and 6/7)

UA the taxed account to which the all other profits/losses are allocated. 35% tax applies at the level of the company. 15% tax on the distribution from this account applies and can be credited against recipient's income tax liability.

- 1) Dividends subject to tax in Malta EUR 200,000 - FIA; Commonwealth relief can be obtained.
- 2) Dividends subject to tax in US according to art. 10 (2) of the DTR between US and Malta, EUR 5,000 allocable to FTA, tax paid in US can be used as credit against tax in Malta
- 3) Dividend subject to tax in Malta - EUR 500,000 FIA. 35% tax due by A&S,
- 4) Distribution of profit from the partnership in Ireland will be taxable in Malta EUR 100,000 will be allocated to the FIA
- 5) Business profits allocated from the diamond mine in South Africa will not be taxable in Malta. EUR 3,000 allocated to FTA
- 6) Net local bank interest on which tax was already withheld EUR 2,000 should be allocated to MTA
- 7) Gross local bank interest EUR 100,000 should be allocated to UA.

Question 4

Part 1

a) Spanish sub

Considering that according to the DTR between Spain and Malta a Permanent Establishment is generated only if the project lasts more than 12 months and the project is expected to last for 7 months no PE will be generated in Malta for the Spanish Subsidiary.

b) Russian sub

Given that the goods will be delivered directly from Russia to Malta, the income will be taxable under the business profits rule in the DTR between Russia and Malta. No PE will be generated in Malta for the Russian sub.

c) Italian sub

According to DTR between Italy and Malta, the furnishing of services through employees, where such activities continue for a period or periods aggregating more than 12 months within any 2 year period generates a PE in the contracting state where the activities are carried out. Therefore, a PE of the Italian Sub will be generated in Malta and the revenues allocated to this PE will be subject to income tax in Malta.

d) US IT Corp

No PE should be generated by the employees of IT Corp in Malta, as per the DTR between US and Malta, as they spend only a limited amount of time in Malta, performing only supervisory work, they will not have a fixed place allocated at the premises of the Maltese client.

Part 2

Pegasus qualifies as a prescribed fund as it has at least 85% of the assets in Malta. Investment income received from interest (point c - Maltese source bank interest) is taxable at 15% whereas any other type of income is taxable at 10% (rental income, other investment income, of Maltese source, dividends received).

Question 5

Part 1

The following are deductible expenses for Income Tax purposes

Promotional expenses

Market research

Interest on late payment of VAT

Acquisition of concession to excavate a mine salaries and wages

The following are not deductible expenses for Income Tax purposes

VAT penalty

Pre-trading expenditure

Part 2

Yes, the three are members of a group as the shareholding of HL in the other two companies exceeds 51%

The tax losses can be surrendered only between Maltese residents - infringement of EU legislation as per the ECJ decision in Marks&Spencer

Part 3

If the two will become married, they will have the right to opt for a joint computation, which should generate a reduction in the total tax to be paid.