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THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

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PAPER 2.07 – MALTA OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Profit	FTA	FTA	FTA	IPA	FIA	FIA	FIA	MTA	MTA
(a) Profits from Maltese Restaurant								50,000	
(b) Net Maltese Bank Interest	5,000								
(c) Gross Bank Interest BVI					10,000				
(d) Dividend from SICAV (gross)									38,461
(e) Dividend from manuf. company		50,000							
(f) Brokerage fee Valletta				200,000					
(g) Capital gain (Rome)						100,000			
(h) Capital Gain (Trademark)							150,000		
(i) Profits Attributable to Italian PE			150,000						
FRFTC					2,500	25,000	37,500		
Total	5,000	50,000	150,000	200,000	12,500	125,000	187,500	50,000	38,461
Tax at 0%	-	-	-						13,461
Tax at 35%				70,000	4,375	43,750	65,625	17,500	
Less FRFTC					2,500	25,000	37,500		
Less Full Imputation Credit									(13,461)
Tax due	-	-	-	70,000	1,875	18,750	28,125	17,500	-

(a) Profits attributable to a local restaurant are allocated to MTA.
(b) Net Maltese Bank interest is allocated is allocated to the FTA.
(c) Gross foreign source bank interest is allocated to the FIA.
(d) MTA dividends are allocated to the MTA but must be declared gross
(e) A net dividend from the FTA of a Maltese manufacturing company is allocated to the FTA
(f) A commission (brokerage fee) from the sale of an apartment situated in Malta is allocated to the IPA
(g) A capital gain from the sale of an apartment outside Malta is allocated to the FIA
(h) A capital gain received from a non-resident is allocated to the FIA.
(i) Assuming that the company will apply the Participation Exemption, Profits attributable to a foreign PE are allocated to the FTA.

Question 2

Part 1

a) Vasco & Sons will assign its letters of engagements with clients to Barra Brothers.

Income Tax Implications

This transaction amounts to the transfer of a business, which in principle is a taxable transfer. Nonetheless, the transfer will be made at a nil consideration in the context of a deemed transfer in a civil partnership, which in the context of this transaction, does not fall under the definition of 'partnership' for the purposes of income tax on capital gains. Consequently, there is a valid argument to treat this transfer as outside the scope of tax.

VAT Implications

In principle, the transfer is a taxable supply but, subject to a number of conditions, the transfer is to be treated as a transfer of a going concern falling outside the scope of VAT.

Duty Implications

None.

b) Vasco & Sons will assign all its intellectual property rights (including procedures manuals, marketing materials and all know how to Vasco & Sons).

Income Tax Implications

This transaction involves a taxable transfer (a donation constitutes a deemed sale at market value).

VAT Implications

In principle, the transfer is a taxable supply but, subject to a number of conditions, the transfer is to be treated as a transfer of a going concern falling outside the scope of VAT.

Duty Implications

None. Transfer does not involve dutiable documents.

c) Vasco & Sons will sell all its office furniture to third parties by public auction. Capital allowances had been availed of with respect to some of the furniture sold at auction.

Income Tax Implications

Should the company derive a gain from the sale of the furniture the gain would be treated as a capital gain derived from a non-chargeable asset (gain which is outside the scope of tax). Given that the company has availed itself of capital allowances, the transfer of the furniture creates an obligation to draw up a balancing statement. Any profit on disposal must be reported as a balancing charge (as a recapture of wear and allowances, and hence the balancing charge would be capped at the wear and allowances claimed in respect of this asset). Losses on disposal should be reported as balancing allowances.

VAT Implications

VAT is not to be charged on the transfer of the assets but VAT must be charged on the auctioneer's fees.

Duty Implications

None. Transfer does not involve dutiable documents.

d) The partners of Vasco & Sons will become partners in Barra Brothers.

Income Tax Implications

Given that the transaction involves a ‘deemed transfer’ in a partnership which, for the purposes of capital gains law, is not a partnership there will not be any income tax implications.

VAT Implications

None.

Duty Implications

None.

e) The Civil Partnership Barra Brothers will change its name to Barra Vasco.

Income Tax Implications

None.

VAT Implications

None.

Duty Implications

None.

Part 2

a) ML will distribute all its distributable profits to DH;

Distributable profits distributed from the FTA will not be subject to any further tax. Distributable profits distributed from the MTA are subject to the full imputation system and the 6/7 refund.

In addition, Malta tax chargeable with respect to the distributable must not exceed 15%, if the distributed profits consist of gains or profits earned in any year in respect of which that company is in receipt of any benefit under the provisions regulating aids to industries in Malta.

b) RL will distribute all its distributable profits to RL;

Distributable profits distributed from the MTA are subject to the full imputation system and the 6/7 refund.

c) After RL and ML will distribute their profits, DH will transfer its securities in RL and ML to a third party.

Under Maltese law the transfer will be a taxable transfer (transfer of securities) but Article 14 (4) of the Treaty prescribes that gains from the alienation of any Maltese property other than immovable property situated in Malta, movable property forming part of a Maltese business and ships and aircraft belonging to a Maltese business are taxed only in the State of which the alienator is a resident (the Netherlands, in this case).

(Note that under domestic law, the exemption provided by Article 12 (1) (c) (ii) ITA could potentially also be applicable, subject of course to the satisfaction of the relative conditions.)

PART B

Question 3

Part 1

The tax implications of the transfer of the apartment from Mr Y to CB ('the acquisition')

The transfer will be subject to tax under the ITA. Given that the property is situated in a Special Designated Area and that, for the purposes of the Treaty with the Netherlands, Mr X is a Dutch tax resident, the transferor may opt out of Property Transfers Tax under Article 5A ITA (8% of consideration) to pay tax on the capital gain (calculated in terms of the capital gains rules) under Article 5 ITA. The intra-group exemption will not apply because the transfer will not involve a transfer by a company to another company but a transfer from an individual to a company.

The transfer will be subject to DDTA at 5%. The intra-group exemption will not apply because the transfer will not involve a transfer by a company to another company but a transfer from an individual to a company.

No VAT will apply.

Whether the acquisition will impact on HL's right to avail itself of the participation exemption

The acquisition will not impact on HL's right to avail itself of the participation exemption.

Whether the acquisition will impact on the application of the refundable tax credit system to the distribution of CB's profits

The acquisition will impact on the application of the refundable tax credit system because CB's ownership of immovable property situated in Malta and the use of that property will create the need to effect an IPA allocation, reducing the profits that stand to be allocated to the MTA and FIA. Even the lease agreement with the related company will also give rise to IPA implications which would further impact on the applicability of the refundable tax credit system.

The VAT implications of the rental agreement between CB and HL

The rental agreement will be subject to VAT because it will be the letting of property by a limited liability company to a person registered under Article 10 for the purposes of its economic activity. VAT must be charged at 18%.

Whether the structure used by Mr Y gives rise to any Maltese income tax risks
There is a possibility that Mr Y may be considered to be ordinary resident in Malta because it transpires that he visits Malta regularly in the ordinary course of his life. There is a contingency that tax should be borne on the profits subject to the participation exemption and refunds paid in terms of the refundable tax credit system.

Part 2

Explain the concept of 'equity holding' in the Income Tax Act and its relevance in relation to the application of the participation exemption

A definition of the term 'equity holding' is contained in Article 2 ITA.

"Equity holding" shall mean a holding of the share capital in a company which is not a property company, when the shareholding entitles the shareholder to at least any two of the following rights (hereinafter referred to as "equity holding rights"):

- a right to votes;
- a right to profits available for distribution to shareholders; and

- a right to assets available for distribution on a winding up of that company, and "equity shares", "equity shareholder" and "equity shareholding" shall be construed accordingly.

Provided that the Commissioner shall be entitled to determine that an equity holding exists even where such holding is not a holding of the share capital in a company or does not consist solely of such a holding of share capital, but where it can be demonstrated that in substance there is at any time an entitlement to at least two of the equity holding rights.

The concept of equity holding is important for the purposes of the definition of 'participating holding', an entitlement which is linked to eligibility to the participation exemption.

Question 4

Part 1

Whether for Maltese tax purposes, Mr Smith is considered as ordinary resident in Malta

Mr Smith should be considered as being ordinary resident in Malta. Ordinary residence has been defined as meaning fixed regular presence that endures for some time. Mr Smith should be considered to be ordinarily resident in Malta because:

- He spends 200 days a year in Malta;
- He has a home in Malta;
- He has several connections with Malta; a place of work in Malta and, more recently, a girlfriend who is a Maltese resident.

Whether for Maltese tax purposes, Mr Smith is considered to be domiciled in Malta

Mr Smith should not be considered to be a Maltese domiciliary. Mr Smith's domicile of origin is British and his domicile has not changed because his not staying in Malta with the intention to continue living in Malta indefinitely (on the date of expiry of MrSmith's employment contract with the Maltese company, Mr Smith will return to the UK).

Mr Smith's residence for the purposes of Malta's double tax treaty with the UK

For the purposes of the UK Treaty, Mr Smith should be considered to a UK tax resident because he is a UK national (in his case, permanent home, centre of vital interests and habitual abode are not conclusive).

Whether Malta's double tax treaty with the UK permits Malta to tax Mr Smith's director's fees and salary

Mr Smith's income will be taxable both in Malta and the UK. Mr Smith's director's fees will taxed only in the UK.

Whether Mr Smith will be taxed in Malta on his director's fees, salary and bank interest

In Malta, Mr Smith will be taxed only on his salary

PART C

Question 5

Part 1

The tax accounts in which FAL and MCIS allocate their distributable profits to

FAL will allocate its profits to the MTA. MCIS will allocate its profits either to the UA.

The Income Tax treatment of FAL's Income

FAL's income from its management fee will be taxable in Malta at 35%. IT will be eligible to claim deductions with respect to expenditure that is wholly and exclusively incurred in the production of the income.

The Income Tax treatment of MCIS's income

Given that MCIS's income will be income other than income from immovable property situated in Malta, its income will be tax exempt.

The VAT treatment of the management fees charged by FAL to CIS

The services are VAT exempt.

The income tax treatment of the distribution of dividends from FAL to its non-resident and non-domiciled shareholders

No further tax will be charged on distributions. The refundable tax credit system will apply and the shareholders of FAL will be entitled to claim a refund of 6/7 of the tax paid by FAL.

The income tax treatment of the distribution of dividends from FAL to its non-resident and non-domiciled shareholders

No further tax will be charged on distributions from the UA.

The Maltese VAT treatment of MCIS's rental of office buildings in the UK and the Netherlands

The supply will be outside the scope of Maltese VAT.

Whether Malta's double tax treaties with the Netherlands and the UK allow the Netherlands and the UK to charge withholding tax on the payment of the rental income.

Article 6 of the Treaty with the UK does not exclude the UK's right to charge tax on rents of immovable property situated in the UK.

Article 6 of the Treaty with the Netherlands does not exclude the Netherlands' right to charge tax on rents of immovable property situated in the Netherlands. Nonetheless, Maltese SICAV is not eligible to benefit from the Dutch Treaty because during the negotiations it was finally acknowledged that a tax exempt open-ended corporation vehicle with variable share capital (SICAV), registered under the Investment Services Act does not qualify as a resident of one of the states for the application of the Agreement. In conclusion, even if the Treaty were to apply, the Netherlands would have a right to tax.

Question 6

Part 1

MFL's tax residence for the purposes of the Income Tax Act and for the purposes of Malta's double tax treaty with the Netherlands

For the purposes of the ITA, MFL is a Maltese resident company because all companies incorporated in Malta (regardless of their place of management and control) are considered to be Maltese tax residents.

For the purposes of Malta's double tax treaty, MFL may be considered to be a Dutch tax resident because it is effectively managed and controlled from the Netherlands (The Board of Directors meeting in the Netherlands, the maintenance of Dutch bank accounts, the brass-plate registered office address and the fact that books and records are being kept in the Netherlands indicate that the company is being controlled from the Netherlands).

The Maltese tax treatment of MFL's expected income from the rental of its high-end office space

MFL has a choice: either to pay tax on gross rental income at 15% or pay tax on its chargeable income (by availing itself of allowable deductions) at 35%.

The Maltese tax treatment of DC's interest income

DC does not have a PE in Malta and is a non-resident. Interest paid to DC would be tax exempt in terms of 12 (1) (c) (i) ITA. Accordingly, the restriction of Article 26 (h) would kick in and MFL would be unable to claim a deduction with respect to borrowing costs (subject to the non-discrimination clause in Article 24 (3) of Malta's Double Tax Treaty with the Netherlands.) The Treaty does not restrict Malta's right to charge withholding tax on interest income arising in Malta, albeit a maximum withholding tax rate of 10% is prescribed.

The tax Maltese treatment of DC's income from management fees

DC did not create a PE in Malta, therefore the management fee will not be taxable in Malta.

Whether DC may claim a tax refund with respect to the distribution of MFL's rental income

If MFL applies the 15% regime on its interest income or instead opts for the 'normal' tax regime, income from rental will either be allocated to the FTA or to the IPA respectively. In any case, the refundable tax credit system does not apply to distributions from the FTA and IPA.

Whether DC should be charging MFL VAT on interest income and management fees

The payment of interest is outside the scope of VAT.

Management fees are subject to VAT. In this particular case, the place of supply will be Malta (on the basis that the transaction is a B2B transaction where the customer is established in Malta).

Question 7

Part 1

In Malta, persons who fail to submit Final Settlement System returns and VAT returns used to be punished twice. Assessments incorporating substantial additional tax used to be issued automatically. In addition, recalcitrant taxpayers used to be criminally prosecuted too. Legal provisions contained in tax laws used to provide that the imposition of additional penalties does not exonerate taxpayers for any criminal liability. Criminal prosecutions for VAT offences were very frequent.

A number of challenges to the tax system were submitted and were eventually escalated to the Constitutional Court. The floodgates were opened in the case of John Geranzi Limited when the Constitutional Court held that additional tax (which was previously thought of as an administrative penalty which could be imposed over and above and criminal penalty) fell to be considered as a criminal penalty.

Subsequently, the argument was taken a step further in the income tax cases of Angelo Zahra v. PM and Pulizija v. Angelo Abela when, on appeal, the Constitutional Court held that a person who was punished with an administrative penalty for a tax offence could not be subsequently punished with a criminal penalty. Nonetheless, in Zahra and Abela, the Court limited itself to quashing criminal judgments declaring breaches of fundamental human rights without proceeding to declare laws unconstitutional.

The breakthrough came in the case of David Mifsud v. PM, a VAT case involving a person who had been punished both with an administrative penalty and a criminal penalty for failing to submit his VAT returns on time. David Mifsud challenged the whole tax penalty system on the basis of the non bis in idem principle. The issue in the case of David Mifsud was complicated by the fact that Mifsud had availed himself of a tax amnesty.

The Constitutional Court examined the penalties Mifsud had been subjected to. It found that Mifsud had been punished with an administrative penalty. According to the Court, the so called administrative penalty was, for the purposes of the ECHR, a ‘criminal penalty’ because it was both deterrent and punitive. Subsequently, Mifsud had been subject to criminal proceedings for the same infringement covered by the administrative penalty. The Constitutional Court found that the second penalty violated the non bis in idem principle. It held that Article 83 of the VAT Act providing for dual penalties was unconstitutional. It ordered a communication of the judgment to Parliament.