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THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

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MODULE 2.07 – MALTA OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Profit Allocation

Profit	**FTA**	**FIA**	**MTA**	**UA**
Latvian royalty		500,000		
Profits from Italian PE	600,000			
Gain from transfer to Borg Holdings Limited				5,000,000
Gains from transfer to AF plc		6,000,000		
Income from French PE	200,000			
Income derived from Maltija Ltd			100,000	
Income from Italian services contract			250,000	
Income from non-competition agreement			400,000	
Interest paid by client			50,000	
Spanish tax refund				20,000
Spanish interest on late payment of tax		2,000		
Profits attributable to Spanish PE	200,000			
Total	1,000,000	6,502,000	800,000	5,020,000
Less:				
Salaries & Wages			(400,000)	
Interest paid			(20,000)	
Business travel		(50,000)		
Donations				(10,000)
Rental expense			(20,000)	
Net profit (before tax)	1,000,000	6,272,000	570,000	5,020,000

Reasons for Tax Allocation

1. The foreign-source royalty is allocated to the FIA. The fact that it was received in cryptocurrency as opposed to fiat currency is irrelevant.

2. Eligible to the participation exemption and allocated to the FTA.

3. Profits from this exempt intra-group transfer are allocated to the UA.

4. The conditions of the intra-group exemption (50%+1) are not satisfied; therefore, the foreign-source gain is allocated to the FIA.

5. Eligible to the participation exemption and allocated to the FTA (activities created PE in France).

6. Allocated to MTA (being Malta source trading income).

7. An Italian PE has not been created. Foreign source trading profits not linked to a PE to be allocated to MTA.

8. Treated as foreign source trading profits not attributable to PE. Therefore allocated to MTA.

9. Treated as part of the profit from the foreign trading activity not attributable to a foreign PE. Allocated to the MTA.

10. This non-taxable item is allocated to the Untaxed Account.

11. Interest on late payment of this tax refund is treated as passive foreign-source income and thus allocated to FIA.

12. Eligible to the participation exemption and allocated to the FTA.

13. All expenses other than the donation are tax deductible. An alternative allocation of deductible expenses between FIA and MTA would also be acceptable.

Tax consequences of distributions

AF plc will not suffer any further tax on the distribution of profits from the FTA. On the other hand, Borg Holdings Limited will suffer a further tax of 35%.

AF plc will not suffer any further tax on the distribution of profits from the FIA and MTA. In addition, AF plc will be entitled to tax refunds under the refundable tax credit system.

With the exception of the interest on the late refund of foreign tax, all profits are to be classified as 'trading' profits, thereby giving rise to the 6/7 refund.

Only 5/7 of the tax paid on the interest on the late refund of foreign tax is refundable.

Borg Holdings Limited will not suffer any further tax on distributions from the MTA and FIA, with the profits distributed from DL being allocated to Borg Holdings Limited's equivalent tax accounts. Borg Holdings Limited should not claim 5/7 and 6/7 tax refunds.

AF plc will not suffer any further tax on the dividend distribution. Borg Holdings Limited will allocate dividend to UTA without suffering any further tax. Mr. Borg will suffer a withholding tax of 15% when the dividend is ultimately distributed from Borg Holdings Limited to him.

Question 2

Part 1

The transfer by ISC of Sajjied MV to a Maltese resident fishing company

The transfer is out of scope of income tax on capital gains but a balancing statement should be drawn up, and a balancing allowance may be availed of.

Out of scope of duty on documents.

For VAT, the supply of vessels used for navigation on the high seas and carrying passengers for reward or used for the purpose of commercial, industrial or fishing activities is an exempt with credit supply.

The transfer of a pipe-laying ship

The transfer is out of scope of income tax on capital gains but a balancing statement should be drawn up, and a balancing allowance/charge should be reported as may be applicable.

Out of scope of duty on documents.

For VAT, the supply of vessels used for navigation on the high seas and carrying passengers for reward or used for the purpose of commercial, industrial or fishing activities is an exempt with credit supply.

The transfer of a self-propelled dredging vessel

The transfer is out of scope of income tax on capital gains but a balancing statement should be drawn up, and a balancing allowance/charge should be reported as may be applicable.

Out of scope of duty on documents.

For VAT, the supply of vessels used for navigation on the high seas and carrying passengers for reward or used for the purpose of commercial, industrial or fishing activities is an exempt with credit supply.

The transfer of a stationary ship

The transfer is out of scope of income tax on capital gains but a balancing statement should be drawn up, and a balancing allowance/charge should be reported as may be applicable.

Out of scope of duty on documents.

For VAT, the supply of vessels used for navigation on the high seas and carrying passengers for reward or used for the purpose of commercial, industrial or fishing activities is an exempt with credit supply.

The transfer to third parties of MSL's permanent berthing right

This transaction in principle gives rise to a taxable capital gain (cession of a right over an immovable property) in the hands of MSL, with the profit being charged to tax at the standard corporate income tax rate of 35% (property transfer tax will not apply because the property is situated outside Malta).

Out of scope of duty on documents.

For VAT, transfers of Immovable Property are classified as an exempt without credit supply (place of supply is in any case outside Malta since the property is not situated in Malta).

The transfer of MSL's fishing licence

This transaction gives rise to a chargeable event for capital gains purposes (transfer of a business). The gain should be taxed at 35% and provisional tax should be paid on the consideration.

Out of scope of duty on documents.

Should be VAT neutral assuming the conditions for the transfer of a business as a going concern are satisfied.

The transfer of MSL's fishing equipment physically situated in Malta

The transfer is out of scope of income tax on capital gains but a balancing statement should be drawn up, and a balancing allowance should be reported.

Out of scope of duty on documents.

Subject to VAT in Malta at the standard rate of 18%.

An interest-bearing loan of €20 million

The loan itself is not subject to income tax. Ongoing tax implications will be discussed below.

Duty on Documents

Out of scope of duty on documents.

The loan is not subject to VAT.

The secondment of 50 ISC employees

Given that Malta does not have a tax treaty with Liberia, there is a contingency that the tax authorities will apply the activities test, resulting in ISC's income from the secondment of its staff potentially being taxable in Malta at 35%.

Out of scope of duty on documents.

The place of supply is Malta and VAT at the standard rate of 18% must be accounted for, typically via reverse charge.

Use of ISC's intellectual property by MSL

In principle, ISC would be taxable in Malta on the royalty. In the absence of a tax treaty, tax is asserted on the source basis and the source of royalty income is deemed to be where the payor is resident. Nonetheless, the Article 12(1)(c) ITA exemption should apply.

Out of scope of duty on documents.

The place of supply is Malta and VAT at the standard rate of 18% must be accounted for, typically via reverse charge.

<u>Part 2</u>

MSL is eligible to apply the tonnage tax regime to income derived from the operation of Pipe MV.

Similarly, MSL can apply the tonnage tax regime with respect to income derived from the operation of Dredger MV because all relevant conditions are met.

Conversely, Stationary MV does not meet the conditions of the exemption, and income derived from its operation is likely taxable in Greece (since a PE is established), while the income is from the foreign PE should qualify for the participation exemption in Malta.

Interest payable by MSL will generally be tax deductible to the extent that it is incurred on capital employed in acquiring its income.

In principle, interest received by ISC would be taxable in Malta, but should be tax exempt under Article 12(1)(c) ITA.

MSL will generally be eligible to claim expenses incurred on staffing costs as a deductible expense to the extent that these costs are wholly and exclusively incurred in the production of its income.

ISC will be taxed in Malta on income derived from the supply of staff. MSL would generally be obliged to withhold tax in terms of Article 73 ITA.

MSL will be allowed to deduct the royalty expense to the extent that this expense is wholly and exclusively incurred in the production of its income.

ISC will in principle be taxable on the royalty income, but the Article 12(1)(c) ITA exemption should apply.

PART B

Question 3

Base salary paid by bank transfer

The base salary is taxable in full and tax is withheld via the FSS. The employee may be eligible to opt for the 15% favourable tax rate contemplated by the HQPR if the relevant criteria (including nature of the employee's position, e.g. CEO or CFO) are satisfied.

Additional salary paid in virtual currency

The salary's equivalent in normal currency (if any) is brought to charge to tax. If the virtual currency is devoid of commercial value, there would not be any receipt to tax.

Coupons entitling employees to consume meals at the GEL canteen

This qualifies as a tax exempt fringe benefit because the meal is served in a staff canteen.

Bonus paid to employees who do not avail themselves of their entire leave entitlement.

This item is taxed as a cash allowance.

Free access to GEL's in-house gym

Assuming that the gym is made available for free for the exclusive use of employees and is part of the workplace facilities offered by the employer, the benefit should be treated as a tax exempt benefit.

Free annual 'teaming vacation' in Greece

The nature of the event does not seem to fall under the definition of 'business purpose' contained in the FBR because the definition refers only to 'marketing' and 'concluding business'. In the absence of approval from the Commissioner for revenue, the full costs of the vacation (lodging and airline tickets) are to be added to the salary and taxed accordingly.

Free health insurance

This benefit meets the conditions to be considered to be a tax exempt fringe benefit.

Private pension plan

The annual payments are to be treated as a taxable fringe benefit.

Virtual equity token

A taxable fringe benefit would need to be reported if and when the option contemplated by the virtual token is exercised.

Performance bonus calculated on GEL's annual turnover

Taxable in full.

Use of a car owned by GEL

Falls to be considered as a taxable (Category 1) Fringe Benefit wherein value of the benefit is calculated via a formulary approach. Fuel value is to be taken at 0 because employee bears fuel expenses.

Free accommodation in the condominium flat

This benefit falls to be considered as a taxable fringe benefit (use of immovable property). The value of the fringe benefit is taken at 5% of cost/market value of the property.

Free use of the childcare centre

Qualifies as a tax exempt fringe benefit provided employee does not claim a deduction.

Reimbursements for primary school fees

An amount equivalent to the School fee is to be treated as a taxable cash allowance. Employee would be entitled to a deduction for school fees (capped at law).

Reimbursements for elderly care home fees

An amount equivalent to the fee is to be treated as a taxable cash allowance. Employee would be entitled to a deduction for the fee (capped at law).

PART C

Question 4

Part 1

Mr Gomes established a residence in Malta which he will be visiting regularly, implying that he is to be treated as ordinarily resident in Malta. Conversely, it seems that Mr Gomes will not be staying in Malta with the intention to live in Malta permanently. The fact that Mr Gomes plans to move to France implies that he did not acquire Maltese domicile. Consequently, Mr Gomes should be treated as a non-dom elegible to the remittance basis of taxation.

Of course, Mr Gomes will lose eligibility to the remittance basis if he acquires a Maltese domicile. Should Mr Gomes change his intentions (i.e. resolving to stay in Malta permanently) he would acquire a Maltese domicile of choice, thereby forfeiting the remittance basis of taxation.

Recently, a number of rules providing for circumstances that would lead to 'imputed domicile' have been introduced.

An important rule governing the remittance basis of taxation was introduced in 2015, namely the proviso to Article 4(1) ITA added by Act XIII of 2015. This rule prescribes that the remittance basis of taxation shall not apply to an individual whose spouse is ordinarily resident and domiciled in Malta.

Furthermore, Act VII of 2018 also amended Article 4 ITA so as to reflect the rules previously introduced via Legal Notices. More specifically, Act VII added the following proviso to Article 4(1) ITA:

"Sohowever that items (i) and (ii) of this proviso shall not apply to an individual who is a long-term resident, or who holds a permanent residence certificate or a permanent residence card, in respect of any income derived by such individual in the year of being granted long-term resident status or the right of permanent residence and in subsequent years. The terms "long-term resident", "permanent residence certificate" and "permanent residence card" shall have the meaning assigned to them respectively in the Status of Long-Term Residents (Third Country Nationals) Regulations and the Free Movement of European Union Nationals and their Family Members Order."

Part 2

Eligible persons are not taxed on foreign source capital gains and foreign source income that is not received in Malta.

Part 3

Eligible persons must pay tax in Malta on income arising in Malta and foreign source income received in Malta.

An income tax return must be filed, generally by the end of June of every year. A EUR5,000 minimum tax charge applies.

Question 5

Part 1

The general rule is that research and development expenditure is of a capital nature and is consequently not tax deductible.

Nonetheless, Article 14 makes exceptions. Research and development costs meeting the conditions to be considered scientific research are tax deductible (amortised over 5 years).

Similarly, expenditure on market research is allowed.

Lastly, R&D expenditure aimed at creating IP is subject to capital allowances in a similar manner to scientific research.

Costs incurred on feasibility studies are normally not tax deductible but expenses incurred in feasibility studies falling under the definition of scientific research and market research and obtaining market information is tax deductible.

Trading tosses are carried forward indefinitely.

Part 2

In the VAT Act, the supply of pharmaceutical goods is classified as exempt with credit implying that if the product sold by the company is classified as a 'pharmaceutical' in terms of the VAT Act (as defined by reference to specified tariff codes), VAT is not to be charged. If any of the goods do not qualify as a 'pharmaceutical' as defined in the VAT Act, a supply taking place in Malta would in principle be subject to VAT in Malta unless it qualifies for another VAT exemption, for example an exempt intra-Community supply or an export sale.

IAL would generally be eligible for credits of input VAT.

Part 3

Given that IAL's profits will prevalently consist in products cultivated in Malta, it is unlikely that such profits will be allocated to the MTA and FIA, implying that such profits will neither be subject to tax refunds nor the FRFTC.

IAL's employees do not qualify under the HQPR.

Part 4

IAL should be able to claim capital allowances on the greenhouses (classified as other plant).

Given the short lifespan of the compost, the compost does not satisfy the conditions necessary to be treated as plant and machinery, implying that capital allowances may not be availed of – although the cost would typically be deductible as a normal business expense instead.

Capital allowances may be claimed on laboratory equipment.

Such costs qualifying as intellectual property are eligible to tax amortisation.

Capital allowances may not be claimed on the land, but as explained previously may be availed of with respect to the greenhouses.

Question 6

USDC

For the purposes of Malta's Double Tax Treaty with the USA, USDC did not establish a permanent establishment in Malta, implying that its activities are not subject to Income Tax in Malta.

If the place of supply of its services is not Malta, it should not charge Malta VAT to its customers. However, to the extent that the services provided by USDC qualify as electronically supplied services (ESS) for VAT purposes, then USDC would be liable to charge Malta VAT on its supplies to its non-taxable customers which are established in Malta.

Irlandiza Ltd

The company is not liable to the worldwide basis of taxation because it is resident in Malta (managed and controlled from Malta) but not domiciled in Malta (incorporated outside Malta). The company is subject to the remittance basis of taxation.

The Company's revenue should be classified as passive, because the company was established as a holding company and the way the assets have been booked and the level of activities performed are not commensurate to a trade (most badges of trade, the badge of trade incidence of transactions especially, are absent).

The classification of the company's income is very relevant for the purposes of the remittance basis because active income is deemed to arise where there is management and control. If the company's revenue would have been classified as active income, it would have been taxable in Malta regardless of remittance. The classification of the income may also affect the type of refundable tax credit entitlement of shareholders in the event of a dividend distribution.

Given that all the company's foreign source income arises outside Malta, only income which is received in Malta is taxed in Malta, implying that interest income received in Mata will be taxed in Malta but royalty income transferred to the Swiss bank account will not be taxed in Malta.

In principle, the company is a resident of Malta that is liable to tax in Malta, implying that it is eligible both to tax treaty recognition and tax treaty benefits. For the purposes of the Treaty, the company is treated as a resident of Malta (where effective management and control resides).

The remit of the participation exemption is circumscribed to dividends, capital gains from a participating holding and branch profits. The prevailing view is that the participation exemption may not be availed of with respect to any interest income (even when such interest income is paid by a participating holding).

Question 7

The concept of a 'formal' tax ruling is contemplated primarily in the following Maltese tax laws:

- The Income Tax Act (Article 52 ITA);
- The Cooperation with Other Jurisdictions on Tax Matters Regulations; and
- Rulings (Income Tax and Duty Treatment of Mergers and Divisions) Rules.

In addition, both the wording of the VAT Act (in Article 43) and the wording of the ITA (in several articles referring to the Commissioner for Revenue's power to determine) seem to recognise the Commissioner's power to issue informal rulings/letters of understanding.

Article 52 ITA provides for the issue of Advance Tax Rulings. In brief, Article 52 ITA provides that:

1. The Commissioner shall, on the application of *a company* which is a party to any transaction, notify his ruling that the provisions of Article 51 (providing for disregard when there is tax avoidance) shall not apply to that transaction provided that the Commissioner is satisfied that the transaction is to be effected for bona fide commercial reasons.

2. The Commissioner shall, on the application of *any person*, confirm that a particular investment falls to be classified as a participating holding.

3. The Commissioner shall, on the application of any person which is *a company*, notify his ruling on the tax treatment of any transaction which concerns any financial instrument or other security.

4. The Commissioner shall, on the application of *any person*, notify his ruling on the tax treatment of any transaction which involves international business (the determination of what constitutes international business is at the discretion of the Commissioner).

Article 52 provides for the form applications for tax rulings must take, binding the Revenue to issue rulings within 30 days. If any particulars furnished at application stage do not fully and accurately disclose all facts and considerations material for the ruling of the Commissioner, any resulting ruling shall be void.

An Article 52 ruling remains binding on the Commissioner for a period of two years from the time of any relevant change in statutory provisions subsequent to such ruling, or for a period of five years from the time of such ruling, whichever is the lesser. A ruling by the Commissioner may, at the option of the applicant, be renewed for a further period of five years.

The Cooperation with Other Jurisdictions on Tax Matters Regulations refers to tax rulings several times. The Regulations provides for exchange of information relating to "advance cross-border rulings" (any agreement communication, or any other instrument or action with similar effects). The Regulations prescribe that the competent authority in Malta, where an advance cross-border ruling or an advance pricing arrangement was issued, amended or renewed after 31 December 2016 must, by automatic exchange, communicate information thereon to the competent authorities of all other EU Member States as well as to the European Commission. The information to be communicated by the competent authority in Malta must include:

- an identification of the person, (other than a natural person) and where appropriate the group of persons to which it belongs;

- a summary of the content of the advance cross-border ruling or advance pricing arrangement, including a description of the relevant business activities or transactions or series of transactions provided in abstract terms, without leading to the disclosure of a commercial, industrial or professional secret or of a commercial process, or of information whose disclosure would be contrary to public policy;

- the dates of issuance, amendment or renewal of the advance cross-border ruling or advance pricing arrangement;

- the start date of the period of validity of the advance cross-border ruling or advance pricing arrangement, if specified;

- the end date of the period of validity of the advance cross-border ruling or advance pricing arrangement, if specified;

- the type of the advance cross-border ruling or advance pricing arrangement;

- the amount of the transaction or series of transactions of the advance cross-border ruling or advance pricing arrangement if such amount is referred to in the advance cross-border ruling or advance pricing arrangement;

- the description of the set of criteria used for determination of the transfer pricing or the transfer price itself in the case of an advance pricing arrangement;

- the identification of the method used for determination of the transfer pricing or the transfer price itself in the case of an advance pricing arrangement;

- the identification of the other EU Member States, if any, likely to be concerned by the advance cross-border ruling or advance pricing arrangement;

- the identification of any person, other than a natural person, in the other EU Member States, if any, likely to be affected by the advance cross-border ruling or advance pricing arrangement (indicating to which EU Member States the affected persons are linked); and

- the indication whether the information communicated is based upon the advance cross-border ruling or advance pricing arrangement itself or upon request.

The Rulings (Income Tax and Duty Treatment of Mergers and Divisions) Rules are linked to a number of tax exemptions associated with company reorganisations. The Rules empower the Commissioner to issue a formal ruling overriding the provisions of several articles in the ITA (Article 51 ITA dealing with tax avoidance especially). In essence, it empowers the Commissioner to declare transactions forming part of a reorganisation (mergers, divisions and amalgamations) as tax exempt. The remit of the rules is limited to Income Tax and Duty.

The Commissioner is, in his absolute discretion, empowered to issue a ruling exempting a transaction if he is satisfied that the transaction or transactions are to be effected for bona fide reasons and do not form part of a scheme or arrangements of which the main purpose, or one of the main purposes is avoidance of liability to duty or tax.

'Formal' rulings issued in terms of the legislative instruments discussed above have not been the subject of tax controversy but recently the Administrative Review Tribunal (ART) and Court of Appeal delivered an important judgment (Appeal Number 236/2012) dealing with a determination issued by the VAT Department.

Taxpayer (and at least another company in its same line of business), a shipping/travel agent company, entered into an ad hoc arrangement with an officer of the VAT Department. The arrangement (evidenced by a determination in writing) provided that the company was entitled to claim VAT refunds with respect to the provision of services to military vessels.

In 2011 there was change in the administration and when the claim reached a new administration, the claim was rejected.

Taxpayer filed an appeal (Form B/reference) incorporating two requests:

1. A reintegration of the agreement previously reached with the Department; and

2. A declaration that the taxpayer was not indebted to the Department (i.e. no clawbacks of VAT refunds were due).

Both the first-tier Tribunal and the Court of Appeal decided in favour of the VAT Department; however, taxpayer protection principles established in this judgment have very far-reaching effects.

Both Courts acknowledged that determinations created vested rights and the principle of non-retrospectivity had to be respected. The Courts held that an informal determination could not grant rights over a tax exemption that was incompatible with the VAT Directive. Both Courts did not express themselves with respect to matters involving fundamental human rights.