THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2023

MODULE 2.07 – MALTA OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

On the basis that Mr Riches is ordinarily resident and domiciled in Malta, he will be taxed in Malta on a worldwide basis on his income and capital gains irrespective of where such income is derived and whether it is remitted to Malta or not.

Assets held by Mr Riches in his own name

Villa in Malta which is rented out to an individual who is not domiciled in Malta

Rental income is brought to charge either under article 4 or article 31D of the Maltese Income Tax Act (ITA).

Under article 4 of the ITA, rental income may be taxed at the marginal tax rate of the individual either in terms of article 4(1)(a) as trading income or in terms of Article 4(1)(e) as passive income. To assess which one applies in the case of Mr Riches one would have to look at the badges of trade. Normally if there are few properties being rented, long term leases and there isn't much involvement of Mr Riches in the activity itself, one would expect that this type of income to be categorised as passive income. Specific deductions apply with respect to passive rental income:

a) Interest payable on capital employed to generate the respective rental income;
b) Any rent, ground rent or similar burden;
c) License fee payable for the purpose of the Malta Travel and Tourism Services Act;
d) And a further deduction equivalent to 20% rental of the income remaining after deducting items b) and c).

Under article 31D, a 15% final withholding tax applies on the gross rent. This method of taxation is optional and when the taxpayer elects for it during a particular year, it applies to all tenements rented out by the person for that year. The election may be different each year according to the circumstances of the taxpayer.

The above taxation applies irrespective of the domicile of the individual renting out the property.

Chalet in Switzerland which is rented out to an individual who is both ordinarily resident and domiciled in Malta

Rental income is brought to charge either under article 4 or article 31D of the Maltese Income Tax Act (ITA).

Under article 4 of the ITA, rental income will be taxed at the marginal tax rate of the individual either in terms of article 4(1)(a) as trading income or in terms of Article 4(1)(e) as passive income. To assess which one applies in the case of Mr Riches one would have to look at the badges of trade. Normally if there are few properties being rented, long term lease and there isn't much involvement by Mr Riches in the activity itself, one would expect that this type of income to be categorised as passive income. Specific deductions apply with respect to passive rental income:

a) Interest payable on capital employed to generate the respective rental income;
b) Any rent, ground rent or similar burden;
c) License fee payable for the purpose of the Malta Travel and Tourism Services Act;
d) And a further deduction equivalent to 20% rental of the income remaining after deducting items b) and c).

Under article 31D, a 15% final withholding tax applies on the gross rent. This method of taxation is optional and when the taxpayer elects for it during a particular year, it applies to all tenements rented out by the person for that year. The election may be different each year according to the circumstances of the taxpayer.

Given that the property generating this rental income is situated in Switzerland, one would also need to refer to the double tax convention between Malta and Switzerland to determine how such income is going to be taxed. The treaty states that income derived by a resident of a Contracting State from immovable property situated in the other Contracting State may be taxed in that other State. So, this rental income could potentially be taxable in both Switzerland and Malta. Consequently, if certain conditions are met, double tax relief will need to be provided in Malta in terms of article 22 of the same convention.

<u>Cash at a Maltese bank which yields annual interest</u>

Interest income generated from a Maltese bank would generally have a 15% tax withheld at source and then such income is not subject to any further taxation irrespective of his marginal tax rates. However, the taxpayer may elect to be paid gross, in which case the interest income would be taxed in the hands of the taxpayer at his marginal income tax rates.

For the 15% final withholding tax regime to apply, the applicable provisions laid out in article 32-42 of the ITA need to be adhered to. One of the main conditions is that the income needs to be investment income which amongst others include bank interest payable by Maltese bank (except for interest payable under a bearer account).

<u>Shares in Riches Holdings Limited that yield annual dividends</u>

<u>Dividend from the Untaxed Account representing dividends derived from the untaxed account of another company</u>

On the basis that Mr Riches is ordinarily resident and domiciled in Malta, this dividend income from the untaxed account of RHL will be subject to a withholding tax of 15%, which is withheld by RHL. Mr Riches is not obliged to declare this dividend in his personal income tax return, however he has the option to do so, in which case the income gross of withholding tax will need to be captured in the tax return of Mr Riches and taxed at his marginal income tax rate. Subsequently, a tax credit is given for such withholding taxes paid.

<u>Dividend from the Untaxed Account representing dividends that were exempt from tax in terms of the Participation Exemption</u>

On the basis that Mr Riches is ordinarily resident and domiciled in Malta, this dividend income from the untaxed account of RHL will be subject to a withholding tax of 15% which is withheld by RHL. Mr Riches is not obliged to declare this dividend in his personal income tax return, however he has the option to do so, in which case the income gross of withholding tax will need to be captured in the tax return of Mr Riches and taxed at his marginal income tax rate. Subsequently, a tax credit is given for such withholding taxes paid.

<u>Dividend from the Final Tax Account representing profits originally derived from the Rental Income subject to Article 31D ITA</u>

This income will not be subject to further taxation in Malta, and it does not need to be reported in the tax return of Mr Riches.

<u>Dividend from the Immovable Property account representing a market rent allocation</u>

This income would have already been subject to 35% tax at the level of the RHL. Mr Riches may choose to declare this income in his tax return if his marginal tax rate is below 35%. Through the applicability of the full imputation system Mr Riches, may be entitled to a refund on the difference between the 35% tax rate paid at the level of RHL and his marginal tax rate.

<u>Assets held by RHL</u>

<u>Ordinary shares held in an Italian Property Leasing Company; RHL holds 6% of the shares in the Italian company</u>

This income will in theory be subject to tax in Malta, but the Participation Exemption (PE) may apply. In order for PE to apply, the holding held in the Italian company needs to qualify as a participating holding. This should be the case if the shares which RHL holds in the Italian company:

i) represents a holding of share capital in a company which is of a nature similar to a company incorporated in Malta and which does not own, directly or indirectly, any immovable property situated in Malta or any real rights thereon;
ii) entitles RHL to at least 5% of any two of the following 3 equity rights:
   a) Right to vote;
   b) Right to profits available for distribution;
   c) Right to assets available for distribution on a winding up.

Given that in this instance the PE will be applied vis-à-vis dividend income, the application of the PE is also conditional on meeting the anti-abuse conditions, which in this case are met by virtue of the fact that the holding is in a EU country.

This income will be allocated to the Untaxed Account of RHL.

<u>Preference shares held in a tax-exempt company incorporated in Vanuatu, a company which holds cash held in a bank account in the Cayman Islands; RHL holds 100% of the shares in the Vanuatu Company</u>

The holding RHL has in this Vanuatu company may qualify to be considered as a participating holding. Having said that, on the basis that Vanuatu as at 23rd February 2023 was included in the EU List of non-cooperative jurisdictions, pursuant to changes made to the Maltese participation exemption regime in 2021, this exemption cannot be availed of on any income (excluding capital gains) derived from this company. Consequently, this dividend income will be taxed as part of the chargeable income of the Maltese Company and a 25% Flat Rate Foreign Tax Credit can be applied (assuming that RHL is duly empowered to do so in terms of its Memorandum of Association).

This income will be allocated to the Foreign Income Account of RHL.

<u>Preference shares held in a German trading company; RHL holds only 0.1% of the shareholding of the company but the preference share carries an entitlement to a special preferential dividend</u>

The holding in this German trading company from the information provided does not satisfy any of the conditions to be considered as a participating holding. Consequently, this dividend income will be taxed as part of the chargeable income of the Maltese Company and a 25% Flat Rate Foreign Tax Credit can be applied (assuming that RHL is duly empowered to do so in terms of its Memorandum of Association).

This income will need to be allocated to the Foreign Income Account of RHL.

<u>Preference shares held in a Spanish Holding Company; RHL holds only 3% of the shareholding in the Spanish Company but the preference shares entitle RHL to appoint a non-executive director on the board of directors of the Spanish Company</u>

This income will in theory be subject to tax in Malta, but the Participation Exemption (PE) may apply. In order for PE to apply, the holding held in the Spanish company needs to be in the form of a Participating holding. This would be the case if the shares which RHL holds in Spanish company:

i) represents a holding of share capital in a company which is of a nature similar to a company incorporated in Malta and which does not own, directly or indirectly, any immovable property situated in Malta or any real rights thereon;
ii) RHL holds equity shares in the Spanish company i.e. shares which give any two of the following 3 equity rights (this may not be satisfied in view of the fact that the shares under consideration are preference shares rather than ordinary shares):
  a) Right to vote;
  b) Right to profits available for distribution;
  c) Right to assets available for distribution on a winding up
iii) entitles RHL to appoint a non-executive director on the board of directors.

Given that in this instance the PE would be applied vis-à-vis dividend income, the application of the PE is also conditional on meeting the anti-abuse conditions, which in this case are met by virtue of the fact that the holding is in Spain i.e. EU country.

In the event that the PE applies, this income would be allocated to the Untaxed Account of RHL.

Question 2

Sale of FL's shareholding (90% shareholding) in an Indian Manufacturing Company

Any gain realised from the disposal of the shares in the Indian Manufacturing company can potentially qualify for the participation exemption (PE). In order for the PE to apply, the 90% shareholding held in this company needs to be in the form of a participating holding. This should be the case if the shares which FL holds in Indian company:

i) represents a holding of share capital in a company which is of a nature similar to a company incorporated in Malta and which does not own, directly or indirectly, any immovable property situated in Malta or any real rights thereon.
ii) FL hold equity shares in the Indian company i.e. shares which give any two of the following 3 equity rights:
   a) Right to vote;
   b) Right to profits available for distribution;
   c) Right to assets available for distribution on a winding up

Such profits will be allocated to the Untaxed account of FL and will be not be subject to a withholding tax of 15% upon the distribution on the basis that the UBO is not ordinarily resident and domiciled in Malta.

Donation of FL's shareholding (10% shareholding) in a Swedish Manufacturing company to Ms A

In terms of article 5 of the Income Tax Act, chapter 123 of the Laws of Malta (ITA), the transfer by FL of the shares in the Swedish Manufacturing company to Ms A by means of a donation would fall within the purview of income tax. The chargeable income will be computed by deducting the cost of acquisition from the transfer value. It is assumed that the 10% holding is not considered a controlling interest and therefore the transfer value will be considered as nil. On this basis, no gain will be recognised for tax purposes.

Donation of FL's shareholding (50% shareholding) in an Italian trading company to Mrs A's son

In terms of article 5 of the ITA, the transfer by FL of the shares in the Italian Trading company to Ms A's son by means of a donation would fall within the purview of income tax. Given that here we have a transfer of controlling interest, the transfer value will be the market value. Having said that, any deemed realised capital gain can potentially qualify for the participation exemption (PE).

In order for the PE to apply, the 50% shareholding held in this company needs to be in the form of a Participating holding. This should be the case if the shares which FL holds in the Italian company:

i) represents a holding of share capital in a company which is of a nature similar to a company incorporated in Malta and which does not own, directly or indirectly, any immovable property situated in Malta or any real rights thereon; and
ii) FL holds equity shares in the Italian company i.e. shares which give any two of the following 3 equity rights:
   a) Right to vote;
   b) Right to profits available for distribution;
   c) Right to assets available for distribution on a winding up.

Donation of FL's shareholding (1% shareholding) in a company listed on the New York Stock Exchange to the son of FL's sole shareholder

In terms of Article 5(6)(b) of the ITA, the transfer of shares listed on a stock exchange recognized by the Commissioner is not subject to the tax contemplated in article 5(1)(a)(ii), which basically taxes the gains or profits arising from the transfer of the ownership in securities. We are here assuming the New York Stock Exchange is a recognized stock exchange by the

Maltese Tax Commissioner. In any event there should be no gain or profit on this transfer, it being a donation of a non-controlling interest. Any resulting negative distributable profits will be allocated to the Untaxed Account of FL.

Transfer for consideration of FL's temporary emphyteutical grant over its office premises in Malta to a company owned by the Government of Malta

This transfer will be subject to tax in terms of Article 5A of the ITA, which brings to charge any gains or profits derived from the transfer of immovable property - which also includes the transfer of emphyteusis. Assuming the grant is for less than 50 years, the transfer value is the higher of the capital sum received and the market value of the temporary emphyteutical grant after taking into account ground rent and periodical payments. No deduction will be allowed for the cost of acquisition.

Any income derived from such transfer will be allocated to the Final Tax Account of FL.

Transfer for consideration of FL's fixed assets (comprising electronic equipment, furniture and fittings) to a Maltese private foundation

In terms of article 24 of the ITA, when a company sells an asset in respect of which capital allowances have been claimed, a balancing statement would need to be prepared. The balancing statement essentially compares the tax written down value to the consideration received for each of the fixed assets. The consideration received for each of the fixed asset is capped at the original cost of the asset. If the consideration is more than the tax written down value, it will result in a taxable gain (balancing charge). On the other hand, if the tax written down value is more than the consideration received, it will result in a deductible allowance (balancing allowance).

Transfer for consideration of all FL's registered trademarks to a non-Maltese resident company which is wholly owned and controlled by Ms A

No gain is deemed to arise on this intra-group transfer in terms of article 5(9) of the ITA. This is on the basis that FL and the non-Maltese resident company, to which the assets are transferred, are owned and controlled by the same individual. This income will be allocated to the Untaxed Account of FL.

Redomiciliation of FL's Dutch subsidiary from the Netherlands to Sweden

No Maltese Income Tax implications envisaged since the redomiciliation of this subsidiary falls outside the scope of the ITA.

Cross-border merger of FL's Italian subsidiary with FL's subsidiary in Sweden

Any gain realised by FL upon the merger will typically be eligible for the participation exemption under article 12(1)(u)(ii) of the ITA.

Liquidation of FL's German subsidiary in Spain

No Maltese Income Tax implications envisaged since the liquidation of this subsidiary falls outside the scope of the ITA.

Donation of FL's patents to Malta Limited, a Maltese company owned and controlled entirely by Ms A's son

Pursuant to article 5(1)(a)(ii) of the ITA, gains or profits arising from any transfer of ownership in patents are in principle chargeable to tax. Donations are also considered as a transfer. In computing the gain on a transfer of patents, one would need to take into account the cost of acquisition of these patents but would need to exclude any amount that has been claimed as a deduction under article 14(1)(m) of the ITA. However, given that this is a donation, the transfer value will be nil and therefore no gain will be recognized for tax purposes.

Donation of FL's cryptocurrency holdings to Ms A's son

From capital gains perspective (i.e. Article 5 of ITA), this asset is out of scope and therefore this transfer will not have any Maltese Income Tax implications. We are here assuming that FL is not actively trading in cryptocurrencies and therefore there is no case to be made that FL can potentially be chargeable under article 4 of the ITA for any gains derived from the transfer of this cryptocurrency to Ms A's son.

PART B

Question 3

The Double Tax Treaty between Malta and Italy states that business profits of an enterprise of a contracting state shall, as a general rule, be taxable only that State. In this case, Shell Ltd (SL) is a company incorporated in Malta and therefore from a Maltese Tax perspective it is automatically considered to be tax resident in Malta. However, all directors are Italian and all board meetings are held in Italy, which may suggest that the place of effective management of SL is in Italy rather than Malta, in which case its fiscal domicile in terms of Article 4(3) of the Treaty would be in Italy.

In December 2018, Malta transposed into local legislation the EU Council Directive which set forth rules against tax practices that directly affect the functioning of the internal market - namely ATAD I.

ATAD I mainly provides for the following:

- Interest Deductibility Limitation Rule
- GAAR Rule
- Exit Taxation
- CFC Rule

Interest Deductibility Limitation Rule

This rule prescribes a limit on the interest deductibility at the level of the Maltese company. The rule states that exceeding borrowing costs shall be deductible in the tax period in which they are incurred only up to 30% of the taxpayer's earnings before interest, tax, depreciation and amortization (EBITDA). Malta applied for two specific derogations in this regard. Exceeding borrowing costs may be deducted up to EUR 3,000,000, and a taxpayer may fully deduct exceeding borrowing costs if it is a standalone entity. Malta also excluded from the remit of this rule loans which were concluded prior to June 2016, however such exclusion does not extend to loan modifications after that data.

SL seems to have a loan which falls within the purview of this rule because even though the loan was entered into in 1995, subsequent to that there was a modification in 2020. Having said that, this rule is still not expected to have a tax impact on SL on the basis that the annual interest deduction will not exceed EUR 3,000,000, and therefore will fall within one of the specific derogations that Malta has applied for.

GAAR Rule

ATAD I also introduces a GAAR Rule which overlaps with the GAAR as provided for in the Maltese Income Tax Act. The GAAR rule basically prescribes that in calculating the corporate income tax liability, there shall be ignored an arrangement or a series of arrangements which have been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law and are not genuine having regard to all relevant facts and circumstances. An arrangement or a series thereof is regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

In the case of SL, reaching a conclusion on whether the GAAR rule will apply will most likely require further information. Having said that, there are certain facts which will not help SL to defend its position if a tax authority challenges the current structure. The fact that all board members are Italian and the fact that board meetings are taking place in Italy while relying on a Maltese CSP to do the administrative work will most likely indicate that there is insufficient substance in Malta, and this could lead to the application of the GAAR Rule.

Exit Taxation

These rules provide for an imputed taxable gain that is triggered whenever certain transfers occur. The rules provide that the taxpayer shall be subject to tax on certain transfers, at an amount equal to the market value of the transferred assets at the time of exit of the asset, less their value for tax purposes. This does not only apply on transfer of assets but also applies on transfer of tax residence from Malta to another country, and on transfer of business carried on by its permanent establishment from Malta to another Member State or to a third country in so far as Malta no longer has the right to tax the transferred assets due to the transfer. Depending on the route Mr X will take to shut down the company in Malta, exit tax considerations need to be taken into account.

CFC Rule

This rule essentially provides that an entity or a permanent establishment whose profits are not subject to tax or are exempt from tax shall be treated as a CFC where a certain ownership threshold is met and when the tax paid abroad is below a certain threshold as stipulated by the rules. Malta has opted for option B when it comes to the CFC Rule, and as per this option, if the significant people functions (SPF) are not taking place in Malta, no CFC taxation should arise.

From the fact pattern described in our case, no SPF seem to be taking place in Malta and therefore if SL does hold subsidiaries in foreign jurisdictions, CFC taxation in Malta should in principle not be an issue.

Redomiciliation of SL to Italy

In relation to the redomiciliation of a Maltese company to Italy, Maltese legislation allows a company registered under the Companies Act to continue outside of Malta. A requirement for this to be possible is that the laws the foreign country (in this case, Italy) will permit such continuation and upon obtaining the consent of the Maltese Registrar of Companies, SL would need to apply to the competent authority in Italy to have the company registered as continued as if it had been incorporated under the laws of Italy. Certain compliance obligations will apply.

Question 4

Ms Dalia should be treated as being ordinarily resident in Malta but not domiciled in Malta implying that she will be subject to the remittance basis of taxation.

Will Ms Dalia be liable to pay tax in Malta on her salary from her Dutch Holding Company?

Given that this income is foreign source income that was not received in Malta, the income is not subject to tax in Malta.

Will Ms Dalia be liable to pay tax in Malta on dividends distributed by her Dutch Holding Company?

Given that this income is foreign source income that was not received in Malta, the income is not subject to tax in Malta.

In the event that Ms Dalia will eventually manage to open a Maltese bank account in which she would be receiving her annual salary and annual dividend from his Dutch Holding Company will she be taxable in Malta?

Foreign source income remitted to Malta would become taxable in Malta.

Should Ms Dalia be liable to tax on her income from her annual salary and dividend from the Dutch Holding Company, would she be able to claim the Participation Exemption and/or Flat Rate Foreign Tax Credit with respect to her income from the Dutch Holding Company?

Only companies registered in Malta are eligible to FRFTC and the Participation Exemption.

Will Ms Dalia be subject to pay some minimum tax in Malta?

Given that Ms Dalia's income exceeds EUR35,000, her income will be subject to a minimum tax of EUR5000 per annum.

Will Ms Dalia be liable to pay tax on capital gains derived from the transfer of her shareholding in the Dutch Company? How will the tax be computed?

The foreign source capital gain will not be taxed in Malta because Ms Dalia is a non-dom.

What will the Maltese tax implications of shifting the management and control of the Dutch Holding Company to Malta be? How would Ms Dalia be taxed in Malta on dividend distributions from the company managed and controlled from Malta?

The Dutch Holding Company will become taxable in Malta on worldwide income and capital gains.

Dividends distributed to Ms Dalia will be considered to be income arising in Malta and taxable in Malta.

Ms Dalia does not exclude that she would have to severe his links with Malta at short notice. What will be the tax implications of an eventual exit from Malta, including application of exit tax, if any, taxation of the sale of her home in Malta?

Given that Ms Dalia is not a company, her exit from Malta will not trigger liability to exit tax. The sale of the Maltese home is subject to Income Tax. Ms Dalia could opt out of property transfers tax to instead be taxed under the standard regime of income tax on capital gains. Eligibility to the own residence exemption should be considered too.

Explain the Maltese tax implications that would arise if Ms Dalia will become a long-term resident of Malta

Should Ms Dalia become long-term resident, she would no longer be treated as a non-dom and therefore would become taxable in Malta on a worldwide basis.

Explain how Ms Dalia will be taxed in Malta on her realised gains from the transfer of crypto-assets

Gains realised from the transfer of cryto-assets in the course of a trading activity should be treated as local source trading income and therefore the resulting chargeable income taxed in Malta as a trade or business under article 4(1)(a) of the Income Tax Act at her applicable personal marginal rate of income tax.

PART C

Question 5

The ECtHR Case in De Le Legé v. The Netherlands (Application no. 58342/15) involved a request for information made during a tax investigation. De Legé argued that the request breached his right to protection from self-incrimination. Previously (in Chambaz, Abbas, Van Wereelt and JB), the ECtHR had decreed that the right to nemo tenetur se ipsum accusare applied in a tax context without articulating limitations.

In de Legé, the ECtHR tweaked conclusions reached earlier on limiting the scope of protection from self-incrimination during a tax investigation. In de Legé, the ECtHR did not find a violation concluding that:

a) Protection from self-incrimination does not extend to the use in criminal proceedings of materials obtained from an accused through methods of coercion when these materials have an existence independent of his will.
b) The use of documentary evidence obtained under threat of penalties in the context of financial law matters use does not fall within the scope of protection of the privilege against self-incrimination where the authorities are able to show that the compulsion is aimed at obtaining specific pre-existing documents (i.e. documents that have not been created as a result of the very compulsion for the purpose of the criminal proceedings, which documents are relevant for the investigation in question and of whose existence those authorities are aware).

Maltese tax laws, including the articles mentioned, contemplate several instances when recipients of requests for information under threat of penalties do not benefit from freedom from self-incrimination. Certain articles in the VAT Act are particularly draconian. The validity of these articles is questionable and ECtHR judgments determined before de Lege indicated that such articles were clearly unconstitutional.

Whilst the de Legé judgment does shield some of the aforesaid articles from future challenges, the fact that that the articles do not even provide for the red lines dotted by the de Legé case suggests that such articles need to be amended. It must be emphasized, in a local context especially, that de Legé still acknowledged the application of the right to protection from self-incrimination in a tax context. Thus, articles providing for requests of information, under threat of penalties, relating to non-pre-existing documents existing dependently of the taxpayer's will would still be in breach.

Question 6

Both the Income Tax Acts and the VAT Act provide for the lifting of the corporate veil and, in several cases, directors of limited liability companies are personally liable for tax infringements.

A number of legal provisions must be singled out. Thus, Article 7 ITMA prescribes that the manager or other principal officer (a director included) of every body of persons shall be answerable for doing all such acts, matters and things as are required to be done by virtue of the Income Tax Acts for the assessment of such body and payment of the tax. Every such principal officer shall pay the tax out of the property of the body of persons. They shall, however, be liable for payment personally, and jointly and severally with any other person responsible therefor, if at any time they had in their possession or control any property belonging to the body of persons which could have been used to pay the tax then due.

Article 21(2) ITMA prescribes that where an employer is a body of persons, the manager or other principal officer shall be deemed to be the employer for the purposes of this article, and any director of a company, or person engaged in the management of a company, shall be deemed to be a person employed - implying that the obligations of the employer entity inure onto the director.

Article 40(2) ITMA prescribes that when a tax liability is enforceable against a body of persons in virtue of an executive title, the Commissioner may, without the need of any other act, proceed with such enforcement against every officer thereof who is personally liable therefor in terms of article 7 ITMA.

Article 66 of the VAT Act prescribes that any secretary, manager, director, liquidator or other principal officer of an entity or of a body of persons, any heir and any testamentary executor and any curator of the vacant inheritance of a deceased person, and any person who is a tutor, curator, administrator or trustee of any other person or of any trust, fund or other entity shall, for the purposes of law, be a representative of that body of persons, deceased person, other person, trust, fund or other entity, as the case may be.

A representative who has under their management or control any funds or property belonging to or due to the person of whom they are a representative shall not dispose of such funds or property unless they have made adequate provision for any tax due.

A representative shall be jointly and severally liable with the person of whom they are a representative for the tax due by that person: provided that where the representative has acted in good faith and is not knowingly in breach of the law or of any other obligation, their liability shall be limited to the funds or to the value of any property under their management or control which belongs or is due to the person of whom they are a representative.

Article 82 of the VAT Act prescribes that where anything is done or omitted to be done by a body of persons, the act of commission/omission is imputed to every director, manager or other principal officer of that body of persons: provided that a director, manager or other principal officer of a body of persons shall not be guilty of an offence if they prove that they were unaware and could not with reasonable diligence be aware of such act or omission and that they did everything within their power to prevent that act or omission.

Where anything is done or omitted to be done by an employee in the course of their employment, or by any person acting on behalf of the registered person, whether such other person is an employee or not, enforcement provisions shall apply as if such thing were done or omitted to be done both by the said employee or other person and by the employer or registered person: provided that such an employer or registered person shall not be guilty of an offence in virtue of the law if they prove that they were unaware and could not with reasonable diligence be aware of such an act or omission and that they did everything within their power to prevent that act or omission.

Question 7

Rental payments referring to a residential apartment occupied by Mr Vella

Article 26 of the Maltese ITA prohibits the deduction of rent of any premises or part of premises not paid for the purpose of producing the income. In these circumstances this an expense would need to be added back in the tax return of ABC Limited as a non-deductible expense for tax purposes.

Wear and tear allowances with respect to furniture and fittings inside the residential apartment occupied by Mr Vella

Furniture and fittings inside the residential apartment occupied by Mr Vella constitutes private expenditure and as such in terms of Article 26 of the Income Tax Act shall not be tax deductible. Such assets cannot be capitalized for tax purposes because there are not being used wholly and exclusively in the production of the income.

Fuel costs, maintenance expenses and capital allowances relating to the luxury automobile used by Mr Vella for work and pleasure

The Maltese Income Tax Act and subsidiary legislation allow for the capitalisation of expenditure incurred on the purchase of motor vehicles, and subsequently the taxpayer may claim capital allowances on such assets. In the case of non-commercial motor vehicles, the legislation stipulates a capping on the maximum cost that can be capitalized for tax purposes, which amounts to EUR14,000. Capital allowances on motor vehicles can then be taken over a minimum period of 5 years.

Now given that Mr Vella is using the car for both work and pleasure and assuming that the car has been bought by ABC Ltd, then Mr Vella would be deemed to be earning a fringe benefit as a person deemed to be holding an office within the company by virtue of his shareholding therein. A specific formula would be applied to calculate the fringe benefit in relation to the use of such motor vehicle, and this formula is based on specific elements, namely the vehicle use value, the maintenance value, the fuel value, and the private use element. The vehicle use value is equivalent to 17% of the car value (10% if the car is more than six years old). In respect of both the maintenance and fuel value, the basis of valuation is 3% of the car value if the latter does not exceed EUR 28,000 and 5% of the car value in any other case. The fringe benefit is equal to the aggregate of these three elements multiplied by a percentage representing the private use of the car. The private use percentage varies depending on the vehicle's value.

In principle, one would need to pro rate the expense being incurred on fuel, maintenance, and the use of the motor vehicle between the percentage being used for business purposes and the percentage being used for private use. The part being used for private purposes would need to be disallowed for tax purposes. However, it may be possible to argue that a deduction is allowable at the level of ABC Ltd subject to the fringe benefit being taxable in the hands of Mr Vella.

A management fee charged by a company incorporated in a tax haven

For a management fee to be tax deducible at the level of ABC Ltd, it needs to be incurred wholly and exclusively in the production of the income. In order to assess whether this management fee expense is tax deductible or not, one would need to conduct a functional analysis of the company incorporated in the tax haven, in terms of transfer pricing principles. Such analysis would basically lay out the functions being performed by this company and help in assessing whether the management fee being paid is justified as a legitimate tax deductible expense for ABC Ltd.

School fees paid in respect of Mr Vella's daughters

School fees incurred with respect to Mr Vella's daughters consist of private expenses and as such in terms of Article 26 of the Income Tax Act shall not be tax deductible. It may be relevant to note that the Maltese Income Tax Act and its subsidiary legislation allows for a deduction with respect to private school fees at the level of the private individual. This means that Mr Vella can deduct the school fees in his personal tax return against his personal income. A capping on such deduction applies and vary between whether the fees relate to kindergarten, primary and secondary education. However, a deduction at the level of ABC Ltd. cannot be allowed.

<u>Interest expenditure charged by an Italian company. The Interest expense is charged by an Italian resident company. Investigations have revealed that the expense was claimed with respect to the refurbishment of ABC Limited's office and it transpired that the Italian company is owned and controlled by Mr Vella</u>

Interest expenditure incurred wholly and exclusively to finance the working capital of a company is normally tax deductible at the level of ABC Ltd. Having said that, Article 26(h) of the Maltese Income Tax Act stipulates that any interest paid to a person not resident in Malta where the interest is derived from a loan granted to finance the acquisition, development, construction, refurbishment, renovation of immovable property situated in Malta or any right thereon, shall not be tax deductible insofar as the payor and payee of the interest are related persons and the recipient benefits from the exemption from tax in terms of Article 12(1)(c) of the Income Tax Act. It may be pertinent to note that the Italian company should not have been eligible to avail of the said exemption since this exemption presupposes that the beneficial owner of the interest is not owned and controlled by, directly or indirectly, nor acts on behalf of an individual or individuals who are ordinarily resident and domiciled in Malta.

In the scenario here, we understand that the interest expense is being claimed with respect to funds used to refurbish ABC Ltd's office. The interest expense is being paid to an Italian company which is owned and controlled by Mr Vella which may have (incorrectly) availed of the abovementioned exemption applicable to interest payments made to non-residents. Therefore, in this event, such interest expense will not be tax deductible from a Maltese tax perspective.

<u>A salary paid to Mr Vella's wife. It transpired that Mr Vella's wife was not really doing any work for the company</u>

A salary paid would normally be a tax deductible at the level of ABC Ltd and taxable in the hands of Mr Vella's wife. The salary expense would need to satisfy the usual conditions in order to be deductible at the level of ABC Ltd, i.e. it needs to be incurred wholly and exclusively in the production of the income and it also needs to be declared under the Final Settlement system.

The situation portrayed above is an abusive practice that basically seeks to erode the profitability of ABC Ltd. If the marginal tax rate of Mr ABC's wife is lower than the marginal tax rate ABC Ltd, such abusive practice would mean that the total tax burden is being artificially reduced. In addition to this, such abuse might also have wider implications vis-à-vis other legislation namely the Social Security Act and The Employment and Industrial Relations Act. Only the arm's length portion of the salary should be allowed as a deduction.

Question 8

The notions of Fixed Establishment (FE) and Permanent Establishment (PE) serve similar purposes, namely that of creating jurisdiction to tax.

Income Tax legislation contemplates the concept of PE in Articles 2 (definition of FIA), 12 (1) (c) (1) and 12 (u) ITA and virtually all of Malta's double tax treaties, Subsidiary Legislation 123.176 Notional Interest Deduction rules, Subsidiary Legislation 123.127, Cooperation with other Jurisdiction on Tax Matters Regulations, Subsidiary Legislation 123.183 Multilateral Convention (Implementing Tax Treaty related Measures to Prevent Base Erosion and Profit Shifting) Order, Subsidiary Legislation 123.187 European Union Anti-Tax Avoidance Directives Implementation Regulations, Subsidiary Legislation 123.189 Consolidated Group (Income Tax) Rules and Subsidiary Legislation 123.207 Transfer Pricing rules.

Nonetheless, it is only the Double Tax Treaties which seek to define the term. Because treaty definitions of the term are not always aligned, the term is meant to comprise a fixed place of business through which the business of an enterprise is wholly or partly carried on, an installation site enduring for a determinate amount of time and a dependent agency. It is unclear whether for domestic tax purposes the concept of PE incorporates Stock PE and Consultancy PE.

Maltese VAT law uses the term FE in the VAT Act in S.L. 406.10 Refund of Value Added Tax to taxable persons not established in Malta but established in another Member State Regulations and S.L. 406.11 Refund of Value Added Tax to Taxable Persons not established in the Territory of the Community Regulations. The principal VAT Act also refers to the equivalent concept of a fixed place of establishment in Article 2(2). However, domestic VAT law (nor indeed the EU VAT Directive) does not expressly define this term.

Instead, reference is made to Article 11 of Council Implementing Regulation 282 of 2011 (CIR 282/2011), which defines a FE for VAT purposes as any establishment (other than the place of establishment of a business referred to in Article 10 of the Regulation), characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to receive and use the services supplied to it for its own needs. The interpretation of the concept of fixed establishment for VAT purposes has been left largely to the pronouncements of the Court of Justice of the EU.

The place of establishment (main establishment) for VAT purposes is defined in Article 10 of CIR 282/2011 as the place where the functions of the business's central administration are carried out. A FE is therefore a VAT establishment that is different from the primary place of establishment.

Clearly there are certain overlaps between the VAT and tax definitions. For example, both concepts refer to an "establishment", connoting a form of fixed place or other presence, and in both instances there is an expectation of a certain degree of permanence that is not merely transitory. However, in both instances there is no definitive guidance as to the minimum duration expected for this criterion to be satisfied, and this remains a contentious issue in both direct tax and VAT.

However, ultimately the two definitions have a different basis. For direct tax purposes, the PE concept is aimed primarily at allocating taxing rights in relation to business profits between contracting states through international double tax treaties. In VAT, one the key consequences of a FE is the determination of the place of supply of services for VAT purposes, especially as concerns cross-border procurement of services by businesses (i.e. B2B), which are generally taxable on a reverse charge basis and therefore it is important to identify the relevant establishment (primary establishment or FE) which receives the services, as well as determining the place of supply of services provided to non-business customers (B2C).

In conclusion, besides similarities there are also differences and there may well be instances where a VAT FE will not qualify as a tax PE and vice versa.