



Malta's Tax System

November 2019

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Malta has enjoyed a strong and consistent growth in its financial services industry and is fast becoming the jurisdiction of choice for a number of multinational companies seeking to relocate their business interests or looking for an ideal market within the EU. An efficient work force, English as a business language and a strong legal and fiscal framework have all contributed to this growth.

Malta's Tax system

Maltese tax Law finds its origins in the UK tax system and is based on UK tax principles. The Income Tax Act levies a tax on income and not on capital, and the distinction between items of income and capital is fundamental in Maltese tax law. Certain gains are now subject to tax, however, unless specifically taxable, capital receipts are not subject to income tax.

A fundamental pillar of Malta's tax system is full imputation tax system which completely eliminates the economic double taxation of company profits. Shareholders in receipt of dividends are entitled to a tax credit equal to the tax borne on the profits out of which the dividends are paid.

Since the tax rate of 35% applicable to companies is also the highest tax rate in Malta, shareholders will not suffer any additional tax on the receipt of dividends. Where the shareholder's tax on the dividend is lower than 35%, the amount by which the tax credit exceeds the tax on the dividend will be refunded to the shareholder if the shareholder includes the dividend in his tax return.

The imputation tax system has always applied to resident and non-residents alike. Therefore, non-residents may also claim a refund of the underlying tax paid by companies operating in Malta.

Basis of taxation

A person's liability to tax in Malta hinges on the twin concepts of residence and domicile. Persons that are both ordinarily resident and domiciled in Malta are subject to income tax on their worldwide income and certain capital gains.

Companies incorporated in Malta are both resident and domiciled in Malta, irrespective of where the control and management of the business is exercised.

Companies that are not incorporated in Malta are considered to be resident in Malta only when the control and management of their business is exercised in Malta, in which case they would be taxed as a resident non-domiciled company.

Companies not resident in Malta

A company not resident in Malta but deriving income which arises in Malta as a consequence of an activity carried out in Malta is subject to the same tax rules as are applicable to companies resident in Malta. Such companies are therefore subject to tax at 35% unless there are any applicable double tax conventions restricting the taxing right of Malta. No further tax is levied when profits are remitted to the head office of the company. When the non-resident company distributes its profits to its shareholders, the tax refunds, as explained hereunder, will apply.

Persons resident but not domiciled in Malta are taxable on any income and certain capital gains arising in Malta and on income arising outside Malta that is received in Malta. Such persons are not taxable on any capital gains arising outside Malta, whether received in Malta or not.

Double taxation relief

Maltese tax law provides for three main forms of double taxation relief ('DTR') of foreign-source income. These are available in the following order:

- Treaty relief;
- Unilateral relief; and
- Flat rate foreign tax credit (FRFTC).

Treaty relief takes the form of a tax credit granted for foreign tax paid on income received from a country with which Malta has signed a tax treaty. The amount of the credit is the lower of Maltese tax on the foreign income and the foreign tax paid.

Unilateral relief operates in a similar way to treaty relief, but it only applies where treaty relief is not available.

The rationale of the full imputation tax system is also extended in relation to foreign companies by extending the unilateral relief to the underlying tax borne by the foreign company on the profits out of which dividends are paid to a Maltese resident. Relief for such underlying tax is available to both individuals and companies and is available in respect of dividends received from any shareholding in a foreign company and also in respect of the underlying tax paid by any subsidiaries in which the foreign company holds, directly or indirectly, at least 10% of the voting rights.

The effect of the application of treaty relief and unilateral relief is that where the foreign taxes are equal to or exceed the 35% Malta tax, no tax is payable in Malta. In the case of dividends, no tax in Malta will be suffered when the foreign dividend withholding tax and the underlying taxes are equal to or exceed the Malta tax at 35%.

The FRFTC is another form of unilateral relief which is however only available to companies. It takes the form of a notional tax credit for foreign taxes deemed to have been suffered on qualifying income. The FRFTC is equal to 25% of the net amount received and is to be added to such amount. Attributable expenses are deducted from this aggregate amount to arrive at the taxable income.

Taxable income is subject to tax at the 35% rate and the amount of the FRFTC is deducted from the tax charge. The credit is limited to 85% of the Maltese tax due before deducting the credit itself.

By way of example:

	EURO
Net foreign income received	1,000
FRFTC (25% of 1,000)	<u>250</u>
	1,250
Less: Expenses	<u>(350)</u>
Taxable income	<u>900</u>
Tax thereon at 35%	315
Less: FRFTC (lower of: 250 and 85% of 315)	<u>(250)</u>
Net Maltese tax payable	<u><u>65</u></u>

Malta's Tax Refund System

Upon a distribution of profits by a company registered in Malta (i.e. a company resident in Malta or a non-resident company with a branch in Malta), its shareholders may claim the following tax refunds of the Malta tax charge of the distributing company:

- The most common tax refund is of 6/7ths, i.e. 30% (6/7ths of 35%) of the taxable profits. Where no double taxation relief has been claimed, the effective tax suffered in Malta on distributed profits will be 5%. On the other hand, provided the income is not allocated to the Foreign Income Account ('FIA'), where the Malta tax charge has been reduced by DTR, the tax refund will still be computed by reference to the Malta tax charge before DTR, but cannot exceed the amount of the Malta tax paid. Therefore where the foreign taxes are 5% or more, the effective Malta tax after the tax refunds will be nil.
- Where the income is allocated to the FIA and DTR has been claimed, the tax refund is 2/3rds of the Malta tax charge after deducting FRFTC but before deducting other types of DTR. The Malta tax suffered on FIA income after the tax refunds will generally be as follows:
 - * Where the FRFTC has been claimed, the effective Malta tax suffered will be between 2.49% and 6.25%;
 - * Where another DTR is claimed the Malta tax incidence will depend on the extent of the foreign taxes suffered and where these are 11.67% or more, the Malta tax suffered is nil.



- Where the distributed profits are derived from passive interest and royalties, the tax refund is reduced to 5/7ths of the Malta tax charge. Interest and royalties are considered to be of a passive nature when they are not derived directly or indirectly from a trade or business and have suffered a foreign tax of less than 5%. In such cases the Malta tax suffered after the tax refunds will generally be 10%, reduced by any foreign taxes suffered below the 5% threshold. The 5/7ths tax refund is also applicable when the distributed profits consist of dividends received from a participating holding (see definition below) and the participation exemption, or 100% tax refund, is not applicable.

Malta's tax refunds system is applicable to both resident and non-resident shareholders in respect of the tax borne on profits derived from both domestic and international activities, with the exception of profits derived, directly or indirectly, from immovable property situated in Malta. Such profits include a notional amount for the use of property for business purposes. The effect of this on any particular structure involving the significant use of immovable property situated in Malta will need to be assessed individually. Applications for tax refunds should be made within four years from the date of the distribution of profits.

Malta has recently introduced new tax consolidation rules allowing groups of companies to elect to form a fiscal unity in Malta.

Further information regarding the conditions, the election, the benefits and the compliance requirements can be viewed in Tax Consolidation in Malta.

Malta's participation exemption and 100% tax refund

Malta's participation exemption provides for a 100% exemption with respect to profits (namely dividends) derived from a participating holding or from the transfer thereof (namely gains on transfer).

Where the participating holding is a holding in a non-resident company, an alternative to Malta's participation exemption is the full (100%) refund. The relative dividends and capital gains will be taxed in Malta (subject to DTR), however, upon a dividend distribution, the shareholders are entitled to a full refund (100%) of the tax paid by the distributing company.



Participation holding

A participating holding is the holding of equity shares by a company resident in Malta in another company (or other entities as described below) where the former:

- Holds directly at least 5% of the equity shares of the company whose capital is wholly or partly divided into shares, which holding confers an entitlement to at least 5% to any two of the following rights:
 - Right to vote;
 - Right to profits available for distribution;
 - Right to assets available for distribution on a winding up; or
- Is an equity shareholder which holds an investment, having a value at time of acquisition, of at least €1.164 million (or the equivalent sum in another currency) in the company and such investment is held for an uninterrupted period of at least 183 days; or
- Holds the shares in the company for the furtherance of its own business and the holding is not held as trading stock for the purpose of a trade.

As indicated above, a participating holding may also be held in a partnership or European Economic Interest Grouping irrespective of whether such entity elects to be treated as a company for tax purposes in Malta, or a collective investment vehicle that provides for limited liability of investors, provided the above conditions for the application of Malta's participation exemption are satisfied.

For a holding in a company to be a participating holding, such holding must be an equity holding, i.e. a holding in a company, not being a property company (a company having, directly or indirectly, any rights over immovable property situated in Malta – subject to some exclusions), that confers any two of the three rights in (a) above.

With respect to dividends, Malta's participation exemption is applicable if the company (or other entity) in which the participating holding is held:

- is resident or incorporated in a country or territory which forms part of the European Union; or
- is subject to tax at a rate of at least 15%; or
- has 50% or less of its income derived from passive interest or royalties; or
- is not held as a portfolio investment and it has been subject to tax at a rate of at least 5%.

In terms of the amended Parent-Subsidiary Directive, participation exemption will not apply where the dividends were deductible for the subsidiary.

The conditions for the application of Malta's participation exemption with respect to dividends do not apply in the case of gains derived from the transfer of a participating holding.

An exemption also applies to any income or gains derived by a company registered in Malta which are attributable to a permanent establishment situated outside Malta or to the transfer of such permanent establishment (certain conditions apply).

Malta's Notional Interest Deduction ('NID')

Malta's NID was introduced with the purpose of achieving an equal treatment of debt and equity financing, by granting an additional deduction for the return on equity financing. Malta's NID can be claimed by companies and partnerships resident in Malta (including Maltese permanent establishments of foreign entities) against their chargeable income for the year.

Malta's NID is calculated by multiplying the deemed notional interest rate (comprised of a fixed premium rate of 5% and a risk free rate of return based on Malta Government Stocks) by the balance of risk capital that the undertaking has at year end. Further, the maximum deduction in any year cannot exceed 90% of the chargeable income before deducting the NID.

Risk capital includes share capital, share premium, reserves, interest free loans and any other item that is shown as equity in the financial statements.

Further information regarding the conditions can be viewed in the Notional Interest Deduction.

Malta's New Patent Box

Malta has introduced a Patent Box Regime in line with the OECD recommendations.

Further information regarding the conditions, the election, and the benefits can be viewed in Malta's New Patent Box.

The Anti-Tax Avoidance Directive

In 2018 Malta transposed the provisions of the EU Anti-Tax Avoidance Directive, in their majority with effect from 1st January 2019. This new Legal Notice has introduced new concepts to the Maltese tax system such as controlled foreign company rules, exit taxation and an interest limitation rule. Further legislation implementing the new anti-hybrid rules is expected to enter into force as from 1 January 2020.

Further information regarding these rules, their scope and application can be viewed in the Maltese Implementation of the Anti-Tax Avoidance Directive.

Investment Funds

Malta is increasingly becoming an attractive jurisdiction for setting up investment funds, be they retail funds or professional investor funds (including hedge funds). Besides the fact that funds invested overseas are completely exempt from tax, Malta does not impose any tax on the net asset value of the fund. In addition, the licensing procedure which is based on EU norms is mindful and reactive to clients' needs.

For tax purposes, investment funds (a.k.a. collective investment schemes), including sub-funds, are classified as either prescribed or non-prescribed funds. A prescribed fund is defined as a fund resident in Malta, which has declared that the value of its assets situated in Malta amount to at least 85% of the value of its total assets. If a fund does not satisfy this latter requirement, it falls to be classified as non-prescribed.

A non-prescribed fund is exempt from tax on both its income and capital gains in Malta.

Furthermore the Malta tax that will be suffered by the fund manager on his fees may benefit from Malta's refund system described above.

The distribution of income of a fund to foreign investors is not taxed in Malta. There are also no Maltese capital gains taxes imposed on the disposal of units in both prescribed and non-prescribed funds.

Highly Qualified Expatriates

Expatriates are generally taxed at progressive rates of tax up to 35%. However, expatriates employed in the senior-most positions with companies licensed or recognised by the

Malta Financial Services Authority, the Authority for Transport in Malta (for undertakings holding an air operators' certificate issued in terms of Maltese law) and the Lotteries and Gaming Authority and in receipt of a minimum annual salary of €84,991, may benefit from a flat rate of tax of 15% for a determined number of years, subject to the fulfilment of certain conditions.

In addition, investment services expatriates and insurance expatriates who do not qualify for, or opt not to benefit from, the 15% flat rate of tax, may benefit from an exemption from tax on certain fringe benefits, including a monthly subvention of €600, accommodation and vehicle expenses.

Transfer duties

A duty on documents and transfers applies on certain transactions where the document is executed in Malta or a document executed outside Malta is made use of in Malta. The most significant of these is a duty of 5% on the transfer of immovable property. The duty of the transfer of company shares holding principally immovable property is also of 5%. In other cases the transfer of company shares is dutiable at 2%, but numerous exemptions apply making such duty applicable only in specific circumstances.

Capital taxes

Malta has no net worth tax or similar taxes on capital.

Withholding Taxes

Malta does not impose any withholding taxes on interest, royalties, dividends and proceeds from liquidation.

Transfer Pricing

There is no transfer pricing legislation in Malta but certain anti-abuse provisions may be applicable.

Company formation and re-domiciliation

Incorporation of Maltese companies

The incorporation process is relatively swift provided that all the necessary information and documentation is in place.

The minimum issued share capital is of Euro1,165 or equivalent in foreign currency. 20% of the share capital has to be paid up on incorporation. The number of shareholders is normally two; however, a "single member company" may also be registered.

Re-domiciliation

Maltese company law provides for the re-domiciliation of foreign companies to Malta and of Malta companies to foreign jurisdictions without the need to dissolve the entity and set up a new company. Re-domiciliation is currently permitted to and from all jurisdictions, other than those on the Financial Action Task Force (FATF) black list. For a company registered in Malta to be continued outside Malta, the laws of the approved jurisdiction must also allow this procedure.

Step-up in income tax basis

Persons transferring their residence and/or domicile to Malta may claim a step-up in the tax basis of assets situated outside Malta which were acquired prior to their transfer of residence and / or domicile.

The taxpayer may therefore elect that, for Maltese tax purposes, the cost of acquisition of the assets held outside Malta prior to their transfer of residence and / or domicile be the market value of such assets at the time of the transfer, as proved to the satisfaction of the Commissioner of Inland Revenue.

This implies that the appreciation in value of assets arising prior to the transfer of residence and / or domicile is not subject to tax in Malta.

This election may also be made by a company registered in Malta which consequent to a cross-border merger in terms of the EU Merger Directive comes to own assets previously owned by a merging company which was not domiciled and / or resident in Malta prior to the merger.

Such election must be made within the year of assessment following the basis year in which the transfer of residence and / or domicile occurs.



Tax treaties

Successive Maltese governments have sought to conclude double taxation treaties with important trading partners as well as with emerging countries. This policy is expected to continue in the future.

Further information can be found on Malta's Double Tax Treaties.

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Printed in Malta.