



THE TAX ADVISER

**AN IN-HOUSE NEWSLETTER FOR MEMBERS OF THE MALTA
INSTITUTE OF TAXATION: ISSUE NO 2: APRIL 2015**

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FROM THE PRESIDENT'S DESK

Dear Members,



Following its successful launch last February, the TAX ADVISER carries on with its function of drawing tax practitioners closer to each other and the Institute, without forgetting to provide useful information to our members.

Few of us could have been in any way involved in the first version of the Income Tax legislation which was enacted as Act XIV of 1948, and came into force on 1st January 1949. Only a few more seem to be aware that the text of the law (now embellished and supported by subsidiary legislation, and divided into two separate laws) has grown by some 2,000 per cent since 1948 -- without counting the array of double taxation treaties which, strictly speaking, are also subsidiary legislation. The original seed planted in 1948 has indeed given a flourishing harvest: but how did the original seed come to be planted in our obviously very fertile soil, where did it come from, and what fertilisers were applied? The article in this number on 'Migration of Tax Law to Malta' seeks to give some answers. Perhaps the law has now become somewhat of a bloated whale, but that is an argument to be considered further in the future.

Many of us, however, have been involved directly or indirectly, in developments since then -- and certainly all of us are currently involved in its application and administration. By its very nature taxation is bound to create difficulties, problems, anomalies and other issues which can be debated endlessly, but also usefully and perhaps fruitfully. The feature SNIPPETS which starts from this number is intended to give a start to this debate which members are encouraged to carry forward.

We are also keen to start a link of information and opinion between the Council of the Institute and the membership. How do the members feel that the Institute is performing? Are there projects which the Institute should be launching? What problems do the members feel we should bring to the attention of the authorities, and what are the proposed solutions? Do let us know.

BUDGET 2015: M.I.T. SEMINAR

A very well attended seminar was held by the Institute on 9th March to review the Budget 2015 tax proposals. The seminar was open to the public and a fair number of non-members joined members for a very informative afternoon on the Budget Implementation Measures as affecting tax matters.



Conrad Cassar Torregiani pointed out that the Budget measures comprised two significant areas of focus: changes to the taxation of transfers of real estate, and changes to the regime applicable to the taxation of partnerships. These were dealt with by the two other speakers at the seminar. Conrad listed six less significant, though still very important, areas of focus in the Budget, namely:-

- *Modification in the rates of tax: the usual changes in personal rates, but also including a new 7.5% rate for waterpolo players.*
- *Modification to certain definitions: 'company', 'dividend', 'married individual' and 'spouse'.*
- *Modification to certain powers of the Commissioner for Revenue.*
- *Modification to the qualifying threshold for tax exemption applicable to women returning to work.*
- *Modification to the methodology for computing the dutiable value upon the transfer of shares: eliminating the concept of 'controlling interest'.*
- *Modification of the stamp duty payable on life insurance policies, and an increase to EUR 150,000 regarding exemption of first home purchases.*

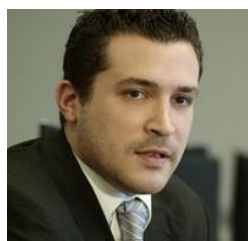
Other issues mentioned by Conrad referred to deductions granted in respect of contributions to 3rd Pillar Pension Funds, and the limitation to 30% of the tax rate on withdrawals from funds. As regards VAT, Conrad mentioned the unexpected cancellation of exemption from registration of small businesses with an annual turnover of less than EUR 7,000, and the reduction of tax-rates on e-books from 18% to 5%. Conrad finally reviewed progress in the E.U. consideration of such issues as

rates of tax, exemptions, state aid, tax transparency and harmful tax regimes, including company taxation.



Neville Gatt dealt with the latest round of amendments concerning taxation on the occasion of immovable property transfers. These appeared to meet certain requirements of taxpayers, but were bound to make life even more difficult for practitioners. The changes reduced fixed tax rates, but had severely limited opportunities of opting out from the fixed rate regimes to normal taxation. This could result in taxation even where the transaction had yielded a loss. Other benefits had also been curtailed: e.g. in connection with property owned for less than 12 years, and transfers in Special Development Areas. New rates of 8% and 10% had also been introduced for certain transactions, and safeguards put in place regarding transfers originating from a *konvenju* filed with the Revenue before 17 November 2014. Neville advised that further changes were possible following discussions with Government. Non-residents transferring property were being given the option of rendering the 7% provisional tax the final amount due, and were being helped in claiming double taxation relief in their home territory by making this tax more clearly an income tax charge. The new regime would also be tackling de-grouping problems, and would ensure that exemptions already available would still be enjoyed.

Neville also reviewed the new arrangements for a final withholding tax regarding rental income. This would be levied at 15%, while an amnesty for undeclared rents over the period 2005/2013 was being made available which would essentially mean a final 15% charge on the rents for two years.



Craig Schembri reviewed the revamping of the provisions relating to partnerships. Up to a few years ago these had largely remained unaltered since the inception of income tax in Malta, but a few years ago the law's capital gains provisions were extended to cover transfers of partnership interests which have essentially been aligned with the tax treatment of transfers of company shares.

As a result of the 2015 amendments, partnerships may now opt to be treated as companies for Malta taxation. This required some changes to the article in the I.T.M.A. dealing with partnerships, and Craig listed the main other relevant implications as follows:

- *Compliance considerations.*
- *'Re-characterisation' of income at partner level.*
- *Computational considerations.*
- *Group loss relief.*
- *Tax Accounting.*
- *Dividend distributions.*
- *Malta tax payment and refund system,*
- *Participation exemption.*
- *Conversions/election/De-election.*
- *'De-grouping'.*
- *Flat Rate Foreign Tax Credit.*
- *Duty on Documents and Transfers*

INTEREST DEDUCTIONS - GROUP STRUCTURES - VAT

Article 14(1)(a) of the Income Tax Act provides that:

For the purpose of ascertaining the total income of any person there shall be deducted all outgoings and expenses incurred by such person during the year preceding the year of assessment to the extent to which such outgoings and expenses were wholly and exclusively incurred in the production of the income, including – (a) sums payable by such person by way of interest upon any money borrowed by him, where the Commissioner is satisfied that the interest was payable on capital employed in acquiring the income.

This wording is essentially a reproduction of the relevant part of the Model Income Tax Ordinance, with the addition of the words 'to the extent to which' in the middle 1970s to allow apportionment more readily where expenses are incurred for a dual purpose. Another addition which had been made to the Model to cater for interest deductions in respect of the value of home-ownership was long ago dropped together with the taxation of this value.

This provision gives the Revenue a certain measure of discretion in determining whether a sum paid by way of interest is deductible from one's income. The reported cases show that this discretion is rarely insisted upon by the Revenue who clearly prefer to stick to the facts of each case to determine whether interest was actually paid, and whether there exists a link with declared income. The tribunals have followed suit, while the Court of Appeal has, in any case, pointed out that discretion could not be invoked on a matter of principle or interpretation, but only in specific cases where a deduction is claimed. It appears, therefore, that a suitable *modus vivendi* is well in place.

From time to time, however, the tribunals have had to rule on basic issues of interpretation. Thus, the Court of Appeal has been somewhat ambivalent about the importance of money having actually to be borrowed before the deduction becomes due. In cases nos 18 and 91, the Court felt that where interest becomes payable even though money is not borrowed, the deduction was still due on the basis that legal principles and accepted practice in Malta were to the effect that the existence of indebtedness leading to the payment of interest was equivalent to borrowing. On the other hand, one of the arguments which led to the rejection of a deduction in respect of interest payable on unpaid death duties was precisely that the heirs of the income producing estate had in fact not borrowed anything from Government when failing to pay duty when due, and hence incurred interest thereon. Various stratagems were attempted by taxpayers to get round this disallowance, but they all failed: *cfr* Board of Special Commissioners cases no 115 and 116. In practice, deductions will also be allowed in cases of interest on unpaid purchase price, such as interest payable on hire purchase arrangements, though in many such cases interest paid is in fact capitalised.

A rather unacceptable decision was that given by the Board in case no 220, where it confirmed a Revenue decision that no deduction could be given for expenses, including interest, on a bank loan which was intended to buy equipment that was capital in character. In actual fact, however, the deduction for interest was accepted in that particular case as it could be proved that the loan had been taken for current trading purposes, but the argument that no deduction would have been due if the loan had been clearly taken to acquire capital equipment was sustained. It appears that this argument was misplaced, since the claim was not connected with the capital amount of the loan itself, but with the expense incurred in servicing the capital in question. This is a pure trading expense and should be quite normally deductible like all other expenses. In any case, the deduction formula above set out states that the allowance for interest is in respect of interest paid on capital employed in acquiring the income, and equipment is surely capital so employed.

An important point first made by the Court of Appeal in case no 31, and thereafter repeatedly upheld at all levels, is that there has to be a clear and visible link between the money borrowed on which the interest claimed as a deduction is payable and the specific income which the money borrowed has helped to produce. The same basic principle is evident in most other reported cases dealing with deductions for interest, and it must be agreed that this requirement does seem to emerge from a reading of the text of the law as above set out. In other words, the Revenue can be fully justified in requiring the identification of the income which the borrowed money has helped to produce, before allowing a deduction claimed for the interest paid. On the other hand, how far and to what extent can, or should, this rule be applied in practice? To some extent it may be argued that the strict link between income and deductions for interest is overridden by the law itself in making provision for the transfer of trade losses from one source to another: both laterally, i.e. during the same year against other sources,

and vertically, i.e. carried forward to subsequent years. Moreover, it is specifically stated that 'losses' are to include all deductions available against income, therefore including interest. The same argument can be used in the case of group relief where losses move outside an individual corporate structure to be set off against income of other corporations in the same group. The difficulty of insisting upon visible links is perhaps more evident in such cases as banks and public companies which issue bonds. Both banks and companies must pay interest on the finance so raised: by the banks to eventually generate profits by lending the money deposited with them to other persons at a higher rate of interest, and by companies for use in capital projects which can take years to finalise and may not easily be seen to produce income separately from the general income-yielding operations of the company. Can in such cases the interest be tied down to specific income before being allowable as a deduction? Surely not.

No deduction is allowable in respect of any interest paid unless it falls within the above formula, so that other interest paid would seem to fall under the prohibition set out in article 26(b) of the ITA, and possibly also under article 26(a) as an expense of a domestic or private nature. This prohibition in effect brings about economic double taxation of the interest: firstly in the hands of the payer when the relative amount is deemed to constitute part of his chargeable income and, secondly, in the hands of the recipient as part of his income in terms of article 4(1)(c) of the ITA. This is really inevitable and happens in the case of all private expenditure which creates taxable income in the hands of its recipient, and the consideration does not seem to create a valid argument for deduction.

It may be noted that in many foreign jurisdictions a much wider range of interest payments is allowable as a deduction. Some such arrangements may seem to us to be too liberal, but they do remove the incidence of economic double taxation referred to above. The position in Malta is at the other extreme end, while that in the United Kingdom is somewhere in between. The U.K. situation emerges from the general deduction formula in that country which simply says that deductions are not allowable if not incurred "for the purposes of the trade". This negative formula is less rigorous than the positive local deduction formula set out above: the difference between the two is examined at greater length in the Direct Taxation Manual prepared by the Malta Institute of Taxation (Progress Press: Vol I, page 242).

Problematic decisions regarding interest appear to have been delivered by the Board of Special Commissioners in cases nos 209 and 239. Appellant in case 209 was the holding company of a large group of companies. It used to borrow bank finance which it then distributed to members of the group according to their current requirements. In the particular case of one such transaction, it could be shown that appellant had paid interest to the bank, but had not charged anything to its subsidiary. In the circumstances, the Revenue declared that they could not be satisfied that the expenditure was incurred in the production of the income as in fact there was no

income. The Board upheld the Revenue's point of view, quoting Court of Appeal decisions regarding link between income produced and deduction of interest, including case no 31. Board case no 239 followed much the same line of argument as in case no 209. Appellant company also acted as the holding and financing company within its group. It claimed deductions for interest payments, but only reported 'management fees' as income. The Board came to the conclusion that no link had been shown to exist between the income reported and the expense claimed.

It could possibly be admitted that the Board decisions were correct in both cases, but one cannot but feel that group structures should be given more elbow room. These cases highlighted, however, the importance which must be given to proper structuring of group transactions. In both cases it seems that the required deductions could have been obtained had the transactions been structured somewhat differently. It must be noted that in neither case was reference made to the group provisions now long enshrined in the Income Tax Act, though it might have been felt (probably correctly) that no benefit could be obtained from their invocation.

Decisions delivered by the European Court of Justice indicate that VAT problems could also arise for holding companies in group structures, though not in connection with interest. In Case C-60/90 *re Polysar Investments Netherlands* (decided on 20th June 1991), appellant company held shares in various foreign companies. It received dividends from its subsidiaries, and paid dividends to its own parent company Polysar Holding Ltd, a company incorporated in Canada. Appellant was not engaged in trading activities, but it did receive some services on which it was charged VAT. This was subsequently refunded to it. The authorities later decided that this repayment was not due and issued an assessment to claw it back. The main question raised in the appeal to the ECJ was whether Polysar Investments Netherlands, as a holding company, could be declared a taxable person. The ECJ held that article 4 of the Sixth Directive had to be interpreted as meaning that a holding company whose sole activity is to acquire holdings in other undertakings without involving itself directly or indirectly in the management of those undertakings (not including, of course, its rights as shareholder) does not have the status of a taxable person for the purposes of VAT, and it therefore had no right to claim back tax as above indicated. The fact that the holding company belonged to a world-wide group of undertakings operating under a single name was not relevant to its possible classification as a taxable person.

Case no C-333/91 *re Sofitam SA* (decided on 22 June 1993) was complicated but mostly concerned with the method of computing partial attribution of input VAT in a case where a company received dividends from subsidiaries in addition to goods and services. Input VAT was not payable on the dividends received, but was chargeable in the normal way on the goods and services acquired. The question referred to the ECJ was whether, in calculating partial attribution for the purpose of claiming deductions, the dividends received by appellant were to be inserted in the

denominator of the relevant fraction or not. The ECJ noted that the mere acquisition of financial holdings in other companies did not constitute an economic activity for VAT purposes and that, consequently, the receipt of dividends is not the consideration for any such activity. It was concluded that the Directive must be interpreted as meaning that dividends received by appellant who was not subject to VAT in respect of all its transactions must be excluded from the denominator of the fraction used to calculate the deductible proportion.

DINNER MARKING THE INSTITUTE'S 20TH ANNIVERSARY



The Institute marked its 20th Anniversary with a dinner held on the 14th March 2015 and attended by the surviving Founder Members, members who had served on the Council over the years, and lecturers at the courses organized by the Institute. The photo shows the President, Dr. Renald Micallef addressing guests at the dinner.

DIPLOMA COURSE IN TAXATION 2014 – 2015

The themes below have been set for Assignment II in the course.

Theme A

Arrangements regarding the source (or locality of origin) of income play an important part in establishing the extent of Malta's jurisdiction to subject income to tax under the Income Tax Act. Review the law's provisions in this respect, making also reference to Malta's Double Taxation Agreements, case law and practice in this matter.

(Note: students are encouraged to consult on this subject two of the of the text books prepared by the Malta Institute of Taxation: the Direct Taxation Manual and the Digest of Tax Cases).

Theme B

The Income Tax Act contains several provisions purporting to be defences against unjustifiable tax planning that borders on tax avoidance and evasion. Set out the general context in which this is done, and explain why the original acceptance of tax planning as set out in the U.K. case of *Duke of Westminster v C.I.R.* (at 9 T.C. 490) and later adopted by the Court of Appeal in Malta, may not today be altogether favourably looked upon.

Theme C

How far, and to what extent, do the stamp duty provisions of the Duty on Documents and Transfers Act impinge on the economic life of the country. Is the tax charged thereunder appropriate in the context of the 21st century and its requirements, considering that a levy of this nature was first imposed in the days of the Roman Empire?

Theme D

Financial Services and Insurance are "..... generally exempt from VAT, but while the exemption dates from 1977, the legislation has not kept abreast of developments since then. Today, the exemption is not applied uniformly by member states, and the European Court of Justice has consequently been asked to fill the legislative gap and to clarify the correct interpretation". Discuss with reference to the judgements of the ECJ, illustrating the Court's role in the development of the interpretation of the exemptions available for financial services and insurance.

Scripts had to be submitted by the 8th April 2015. Forty seven students submitted scripts.

MIGRATION OF TAX LAW TO MALTA

CULTURAL CONSIDERATIONS

Fiscal law is often held not to be culturally specific and, consequently, to be readily transferable between different cultures and societies. This may well be correct, but it is inevitable that tax legislation in any country has to be based on specific notions regarding such matters as family and family groupings, corporate organisation, and the private/public divide in that particular country. Hovering above, and behind everything will be the basic nature of the general legal system in the country. Three of the main worldwide legal systems are those based on Civil Codes (originating from Roman Law), Common Law and Sharia Law. Can legislation, particularly fiscal legislation, first conceived and constructed in a country under one of these systems be readily (not to say painlessly) transferred to another country falling under one of the other systems? In particular, what has been our experience in Malta as regards direct taxation?

Major direct taxation laws in Malta have levied death duties or income tax. Death Duties as such were abandoned over two decades ago, though a fairly important vestige is still extant as part of a wider stamp duty charge¹. This charge achieves tax neutrality between transmissions *causa mortis* and transfers *inter vivos* in respect of immovable property and rights thereon, as well as in respect of certain corporate business structures.

The last full system of death duties in Malta was that levied under the Death & Donation Duty Act². This had replaced the old Succession and Donation Duties Ordinance of 1918. The latter law was essentially an adaptation of Italian legislation of the late nineteenth century and was closely aligned with the provisions of Malta's Civil Law which had also been largely borrowed from Italian and other similar continental legislation. Leaving aside its financial repercussions, introduction of the S.D.D.O. was consequently little hampered through cultural impact. In fact it appears that apart from problems caused by the original proposals which had ignored the Church's position (attended to before enactment), no cultural obstacles to the introduction of the new tax appear to have been raised. The transformation of the S.D.D.O. into the D.D.T.A. some sixty years later was mostly an updating and modernisation exercise, and again no cultural difficulties were apparent.

The introduction of the S.D.D.O. in 1918 had become necessary due to a major government financial crisis in the aftermath of the Great War of 1914 – 1918. The Colonial Office in London felt that this had to be made good by the introduction of new fiscal measures in Malta itself, and the introduction of a death duty or a tax on income was suggested. Relevant local public opinion (inside and outside the Council of Government) was then very much represented by the landed classes who realised that the burden of a death duty would have to be mostly borne by them, as land and other immovable property essentially represented the only taxable values in Malta. On the other hand, it was a fact that there was too little earned income to

¹ The Duty on Documents and Transfers Act, Cap 364 of the Laws of Malta.

² Technically still extant as Cap 239 of the Laws of Malta, though dropped from the published list of Malta's Laws.

render income tax legislation a viable proposition. Earnings were too low to cope with a tax charge as an additional expense. To their credit, the landed classes opted for the introduction of a death and donation duty.

This attitude contrasts with what happened over a long period in Palestine, which was a British mandated territory under the League of Nations following the dissolution of the Ottoman Empire after the Great War³. One of the main problems for the introduction of a rational system of taxation in Palestine was the opposing cultural stands taken by the two principal communities in the country: the Jewish owners of trade, commerce and productive enterprises on one side, and the Arab owners of landed property on the other. The Jewish community fiercely opposed the introduction of income tax, while the Arab community would not hear of a death duty. In the end, the British authorities imposed both measures at the beginning of the Second World War. Not much is known about reactions to death duty, but the British officials entrusted with the implementation of income tax reported that one of the main problems they encountered was the difference between their own cultural background, and the cultural background in which they had to operate. Thus, they were used to the notion that one's style of life represented his wealth (the basis of all 'back duty' exercises) as understood in the West, while the situation in Palestine was that known wealthy persons would walk rather than pay for a bus ticket, while sheiks who seemed not to own five pounds could be seen purchasing luxury carpets with thick wads of notes extracted from their voluminous robes. As later happened in Malta, the new income tax law was based on the Model Income Tax Ordinance which had been prepared in London in 1922 as a one-size-fits-all model for use by colonies in the then British Empire which desired to introduce their own income tax legislation. Clearly, the underlying principles had their origin in a Common Law context.

The result of the hasty introduction of the income tax law was not very happy: "The wealthy beggars of Haifa, the cafe owners of Jerusalem, and the challenges that both the former and the latter posed to the British officials who were supposed to tax them, illustrate an obvious point. Law does not operate in a vacuum: it is related to society. This is true even of tax law, which is often perceived by laymen and lawyers alike as a relatively universal area of law. The study of the history and transplantation of colonial tax law⁴ may prove especially interesting in this respect, because the disjunction between foreign law and local society in colonial settings has the potential of exposing more clearly the ways in which tax law and society are related"⁵.

This issue was very relevant when income tax came to be introduced in Malta in 1948 following the election of the first Labour Government in the previous year. The preparation of a new tax law was assigned to an official provided by the so-called Imperial Government side of the constitutional arrangements then prevalent in the country. This official made no secret that the text he produced was based on the income tax law of Palestine which was itself

³ See article by Assaf Likhovski in *Tax Inquiries* 2001, Israel, on whether tax law is culturally neutral or specific.

⁴ The Model Income Tax Ordinance prepared in London in 1922. This leading article on the introduction of income tax in Palestine is important because the eventual draftsman of Malta's Income Tax Act, 1948, based his draft on the tax law of Palestine.

⁵ Likhovski, *supra*

based on the Model Income Tax Ordinance, but with some additions that had originated mostly from East Africa (Kenya and Tanganyika).

As the Model Ordinance had obviously been created in a common law context and based on principles of United Kingdom tax law⁶, the question immediately arose whether the new income tax legislation could be successfully grafted into the Civil Law context of Malta. There were no known precedents where a law based on the Model Ordinance had been successfully introduced in a Civil Law context⁷. It may be noted that Stamp Duty legislation which had been implemented in Malta since the late nineteenth century had also been based on British legislation (and still is to a great extent⁸), without any problems in this regards apparently ever arising. That tax, however, had its origin elsewhere than in Britain and the basic principle of subjecting certain legal documents and documentation to tax harked back to Roman times⁹. It was essentially an administrative decision to be taken by each country as to which documents to render subject to tax, and how to enforce payment. The principal safeguard in all countries against evasion or avoidance since Roman times was always that such documents could not be enforced unless they were stamped.

The question seems to have been raised in the Legislative Assembly when the proposed law was being debated by a member from Gozo who, rather timidly, pointed out that, in his opinion, the text being debated showed some conflict, or at least non-alignment, with Civil Law. The point, however, does not seem to have been taken up or followed, and the debate resolved itself into largely political wrangling. That it was realised that some cultural and other problems could arise is however evident from the introduction into the law of an unusual definition which textually reads as follows:

*'Words and expressions used in this Act which are not known to the law of Malta but are known to English Law, shall, so far as may be necessary to give effect to this Act and consistently with the provisions thereof, have the meaning assigned to them in the English law and be construed accordingly'*¹⁰.

The precise intendment of this provision does not seem to have ever been discussed at length and has only been specifically referred to in one reported case¹¹, though it still forms part of the law. Possible use can perhaps be best illustrated by reference to two terms used in the new law: namely 'trusts' and 'exhibition'. The first term was used in the I.T.A. decades before it formed part of Maltese legislation on the enactment

⁶ There were certain major differences, including the dual test for deductions which is still very evident in Malta's Income Tax legislation: the positive and negative tests as against what still exists in U.K. law where the only expressed test is in the negative to disallow certain items as a deduction. Another major difference was the taxation of both 'trade' and 'business', with the latter term replacing the additional U.K. provisions regarding 'adventures in the nature of trade'.

⁷ No data is available regarding the introduction of the legislation in South Africa where Dutch Roman Law was an important ingredient in the legal structure of the country. Curiously, the local Inland Revenue Department only obtained a South African income tax text-book, Silke, decades later. A text-book on Dutch Roman Law was however available, but it is not clear whether this was in practice ever used.

⁸ See: Indirect Taxation Manual prepared by the Malta Institute of Taxation. Progress Press, 2013.

⁹ See: Indirect Taxation Manual, *supra*.

¹⁰ Section 2(2) of the Income Tax Act, 1948, now also article 2(2) of Cap 123.

¹¹ Case no 5 decided by the Board of Special Commissioners on 18 December, 1950: a very early case.

of what is now the Trusts and Trustees Act¹². Everybody knew what constituted a trust in 1948, though the term could not even be translated in the Maltese text of the law, but the expression was not known to the law of Malta in the sense of forming part of its basic Codes of Law. The term ‘exhibition’ may or may not have been known to the law of Malta – but certainly not in the sense in which it was used in the new fiscal law where it was linked to the concept of a scholarship or bursary¹³. Moreover, it is not clear whether the reference to ‘the law of Malta’ in the above provision is restricted to the Income Tax Act, or to the general codified legislation of Malta. So also, is ‘the English Law’ limited to the income tax legislation, or does it extend to U.K. law in general? It may here be noted out that where the new Income Tax Act wanted to make a specific reference to the U.K. tax legislation it did so when providing for double taxation relief in respect of U.K. tax suffered¹⁴. Probably, therefore, the reference is to general law, both in the case of Malta and in the case of the U.K. Though this provision appears to be awkward and somewhat unusual, it is far weaker than certain provisions contained other ‘colonial’ legislation to the effect that the courts, in interpreting the local tax legislation, specifically had to do so following British principles of interpretation¹⁵.

Apart from the above matters, it is evident that, following initial drafting as set out above, local draftsmen then set about making such adjustments they deemed necessary to adapt the draft law to Maltese requirements. Specific adjustments made to the Model Income Tax Ordinance for this purpose included:

- a. the term ‘incapacitated person’ in the Model Ordinance was defined to include ‘a married woman’: this was clearly not the case under Maltese legal concepts, and the reference was dropped;
- b. the income of a married woman which stood to be considered to be income of her husband for tax purposes was expanded to include income which fell under the local institute of the ‘community of acquests’;
- c. discrimination against ‘illegitimate children’ evident in the Ordinance was removed;
- d. what is known as a ‘judicial sequestrator’ under Maltese law was added to the list of taxable persons, joining agents, trustees etc;
- e. power was granted to the appropriate Government authority to grant exemption from the tax as it deemed fit: no such powers existed under the Ordinance where exemption was strictly limited to the cases specifically indicated, but this power appears to be traditional in Malta;
- f. a provision in the Ordinance allowing the acceptance of late appeals on the same basis as late notices of objection was struck out from the new law,

¹² Cap 331 of the Laws of Malta.

¹³ Section 8(1)(g) of the Income Tax Act, 1948.

¹⁴ Proviso to section 68(1) of the I.T.A.

¹⁵ For the use of U.K. case law in Malta see below.

presumably to safeguard the inflexible theory of 'public policy' favoured in Malta (leading to many eventual clear miscarriages of justice);

- g. a limited personal deduction was granted in respect of medical and similar expenses incurred: this matter was not contemplated by the Ordinance;
- h. profits arising from so-called '*mezzadria*' arrangements in the agricultural sphere were specifically brought to charge as a separate head of income though already clearly taxable under the head of trade or business, and were normally charged accordingly (this useless provision in the law survived for some forty years);
- i. the income accruing to the Bishops of Malta and Gozo by reason of their respective offices was declared exempt: this referred to the '*mensa*' of the two bishops which were finally dismantled through church-state arrangements many decades later;
- j. an addition was made to the provision allowing a deduction for interest payments on sums borrowed and used in the production of the income: this introduced, in the case of owner used properties, hypothecary requirements, and limited the amount to be deducted to the amount of the taxable value of such properties (this provision was removed when these properties no longer remained taxable);
- k. the income of ecclesiastical institutions was exempt altogether, while in the Ordinance there was a reservation for any income accruing to such institutions from a trade or business: this matter was revamped in the mid-1970s;
- l. provisions for earned income relief were removed: this concept has never been accepted in Malta and, as a matter of fact, the many systems of taxing certain items at source via a straight reduced rate of tax may be said to be directly opposed to the concept;
- m. no relief was granted for employment income earned abroad where this was taxable because of the world-wide taxability of individuals who were both domiciled and ordinarily resident in Malta: this relief was a late addition to the Model Ordinance, but provisions in Malta had to wait for administrative action in the mid-1970s, which were later replaced by amendments to the Income Tax Act itself.

Some of the provisions contained in the Model Ordinance were retained even though they seemed to clash with the general law of Malta. Most of these have been eliminated over the years, but the law still speaks about the 'legal representatives' of a deceased individual¹⁶, when the reference should probably be to 'testamentary executors' as known to the law of Malta. Other issues have been the subject of court rulings: thus a problem had arisen as to whether alimony payments made between spouses where the community of acquests has not been dissolved could, under local law, constitute chargeable income in the hands of the recipient. The matter was resolved by the Court

¹⁶ See: Cap 123 (Income Tax Act), article 71.

of Appeal¹⁷ in the sense that the normal laws of Malta could not be invoked to remove liability which fell under the fiscal legislation that had been inherited from the Model Ordinance. This notwithstanding that it has been repeatedly held by all tribunals that tax legislation has to be construed in accordance with the underlying general law of the country¹⁸. Another point which can be mentioned is the difficulty which has been faced by the tribunals in applying the income tax legislation to concepts concerned with property leases and/or sales and other transfers under the title of emphyteusis. But case law indicates that this has been successfully achieved.

The local draftsmen, in aligning the new law with the basic laws of Malta were not only concerned with the original provisions of the Model Ordinance, but also with additions thereto borrowed from the law of Palestine by the original draftsman made available by the Imperial Government. Some of these additions had indeed themselves been borrowed by the Palestine law from other Commonwealth countries. Among these measures may be mentioned the arrangements regarding deemed distribution of company profits, the taxation of bonus shares, the implementation of additional (penal) tax in case of 'fraud, art, contrivance, or gross or wilful neglect', the taxation of receipts from insurance when the insurance had been taken out against loss of profits, and the provisions relating to loans made by companies to their shareholders. A curious case is that regarding the sale of trading stock together with other assets of a business¹⁹. This provision had been clearly borrowed by the drafters in Palestine from East African law where a judge is however recorded as grumbling that the law he was interpreting on the subject had been copied from existing U.K. law, but that essential parts of the original U.K. legislation had been left out.

An addition to the law which seems to have arrived in Malta from East Africa via Palestine concerns what the Income Tax Act calls 'dispositions to children'. The origin of this provision is certainly the law in the U.K. which had made almost identical provisions in this respect of what were there called 'settlements'. The latter term was not known to the law of Malta and it was replaced with the neutral term 'dispositions'. In effect, 'dispositions' turned out to be 'donations' made to children and the neutral term appears to have been chosen in view of certain technical requirements of the Civil Code regarding donations. Incidentally, the application of this provision led to the suppression for tax purposes of a rule of law in Malta that interest is not automatically chargeable on indebtedness, but must be expressly stipulated. The case concerned a person who loaned money to his children at a very low rate of interest, enabling the children to make a profit by relending the money at a higher rate. The Board of Special Commissioners had held that there could be no disposition in such a case since interest had to be stipulated in terms of the Civil Code, but the Court of Appeal disagreed as in actual fact there could be no doubt that a benefit had accrued to the children in view

¹⁷ Case no 55, judgement dated 4 June 1964, and case no 64 dated 3 April 1967.

¹⁸ Commencing from case no 10 before the Board of Special Commissioners, decided on 11 February 1951.

¹⁹ Now article 48 of Cap 123.

of this transaction and this tax planning was precisely what the law was intended to counter²⁰.

On the basis of what is set out above, it may be concluded that the migration of tax law from the U.K. Common Law context to that of Malta's Civil Law context has been successfully carried out with few real problems arising. This is evidenced not only by the day to day working of income tax in Malta, but more so by the decisions of the tribunals. Both the Board of Special Commissioners and the Court of Appeal (mostly in its Higher Jurisdiction) have found no difficulty in following principles set out in the leading United Kingdom text books on the subject. More important is the familiarity shown by tax practitioners with case law originating from that country. This has extended itself to case law from other countries of the Commonwealth which had also based their own legislation on the Model Income Tax Ordinance, so that it today surprises nobody if cases from South Africa, India, Australia, New Zealand and the West Indies are quoted by and in our Tribunals. At the same time, the tribunals have often pointed out that shades of meaning which may depend on the particular context from which they originated may have to be discarded. At no point, however, does there appear to have been an out and out rejection of clear points of general interpretation and principles²¹. Having said so, it must be noted that as time moves on and more tax legislation is implemented to meet new situations and requirements particular to Malta's needs, it is inevitable that reference to U.K. precedents and case law diminishes in importance and relevance. The basic principles have however long been definitely established and these are all a reflection of what had originally been determined in a Common Law context²². At no point does it appear that reference has been made to income tax legislation or practices of any country which has a Civil Law structure as its basic law, and it does not appear that the law and practice of income tax in Malta has suffered any consequential problems. Indeed, it can fairly be claimed that both are more advanced in Malta than in several much bigger countries which also have as their basic law classical codified legislation. It must be concluded that the infusion of common law into a Civil Code background has been successfully effected in our country.

²⁰ Court of Appeal case published as no 51.

²¹ The only known somewhat contrary line taken in this respect concerns unusual decisions by the Board of Special Commissioners to the effect that the simple preparation of plans for the sale of inherited property could of itself constitute an act of trade. The Court of Appeal refused to interfere, considering this matter to be purely a point of fact. This unfortunate addition to the traditionally accepted 'badges of trade' goes against several decided cases, and the concept should be dropped. On 28 July 1984, the Board and the Court of Appeal also refused to apply the principle regarding application of employment income after it has arisen in the case of a professional partnership (Case no 110 before the Court). The reason given was that what had been done was in accordance with established local practice.

²² The Model Income Tax Ordinance is itself now only a historical document. The latest version available dates back to 1955, and it is not thought that there are further Commonwealth countries which still have to introduce income tax legislation.

SNIPPETS

PRODUCTIVE UNDERTAKINGS

One of the lesser known, and surely lesser used (if ever!) anti-avoidance provisions in the Income Tax Act is that contained in article 4(3) of the law. This article refers to persons who carry out a 'productive undertaking' in Malta and from which they then export overseas. The provisions were inserted in the ITA on its enactment in 1948, but their origin is not known as they did not form part of the Model Income Tax Ordinance. They almost certainly could not have formed part of the additions made to the draft law before its implementation in Malta, as they are by far too sophisticated for that time: both in terms of local economics and foreseeable future efforts at tax avoidance. They must have originated in some other country producing raw materials or other basic materials – probably East Africa – and were carried forward to our law through the immediate draft used in its formulation, which is known to have been the law then currently in force in the British mandated territory of Palestine.

This is not a detailed technical analysis of the provisions, but a cursory reading reveals, *inter alia*, rules regarding transfer pricing, location of source of income, and annulment of efforts at circumvention through disposal otherwise than by sale. The expression 'productive undertaking' does not seem to be very clearly defined.

Questions are often asked by practitioners, and in particular by students, as to the thrust of these arrangements: are they in conflict with other provisions of the ITA, or with the normal rules contained in the Malta's Double Taxation Agreements, or with the incentives legislation? Have these provisions ever been used, what was the outcome of any relevant Revenue challenge?

Have members ever come across problems in this respect? What is their view on the provisions: are they obsolete and can be jettisoned along with other dead wood in the ever expanding tax code?

We would like to hear from you.

'DATIO IN SOLUTUM'

From time to time this particular phrase turns up in legal documents. There are two known tax cases where this expression was used to define transactions that had taken place. In the first case, the Court of Appeal (case no 151) did not accept a Revenue contention that property had come to what was clearly a bank through its normal activities, and that therefore any profit made on resale was taxable in the normal way. The Court noted that the bank's business had eventually devolved to another entity

in a complicated series of transactions, while the immovable property in question had passed on to yet another entity. Receipts from sales of the property had to be passed on to the entity which had taken over the bank's business. This entity was held by the Court to have received the property by title of *datio in solutum* in respect of its rights regarding the property, so that its eventual disposal was not an act of trade. In the second case, the Board of Special Commissioners (case no 259) held that when a company received a valuable immovable property on the liquidation of another company in which it had shares, this was done by way of *datio in solutum* in respect of any claims or rights it might have had against the liquidated company. This transfer of land was held not to fall under any head of charge under the ITA. Unfortunately, in neither case was an attempt made to explain what the expression really meant beyond stating that fairly old Italian text books indicated that this was a *sui generis* transaction not falling within any of the recognised taxable heads under the law.

Subsequent amending legislation may have removed the possibility of a repetition of these two cases, but it is thought that this grey area of the law could require attention.

TOPPING UP OF RELIEF FOR DOUBLE TAXATION

It is well known that the workings of double taxation relief will in practice often leave some foreign tax unrelieved: that is to say, a taxpayer will not only pay the higher of the rates of taxation in the two countries concerned, but he will be left with some extra tax after the application of what are essentially arithmetical formulae for the granting of relief. The numerous double taxation agreements to which Malta is a party, and the wide variety of reliefs now available has reduced substantially the possibility of this happening, but it is still possible.

When at the end of 1961 the provisions of the Income Tax Act relating to double taxation relief were revised in anticipation of the introduction of the first of Malta's D.T.A., that with the United Kingdom, a provision was entered in the law to the effect that a deduction was to be allowed for: "any amount by which the foreign tax in respect of the income (*that is, the doubly taxed income*) exceeds the credit (*granted in Malta*) therefor". This provision had appeared in the Model Income Tax Ordinance some years before, and it required for its application a sort of complicated grossing up process which nobody liked working! It seems that little benefit was obtained through this device with which few people were familiar both in and out of the Department, and the provision was eventually quietly written out of the Income Tax Act.

Is there any need for the re-introduction of a similar device, or can we just go along with what we have?

TEXT OF THE INCOME TAX ACT

The division of the income tax legislation into two separate laws in 1994 was carried out in a rather unusual way. Various articles (then still called sections) were plucked from the existing text of the Income Tax Act and lumped into the Income Tax Management Act, leaving gaps in the old text which were filled up with assorted new measures then being introduced. Obviously, neither of the two new texts was set out in logical sequence, and it is still debateable whether some provisions are now found in the wrong law. The yearly addition of several pages of legislation (a process begun some 20 years before the advent of the I.T.M.A.) has not helped the clarity of either law, and much time is often lost in tracing measures which one knows to exist but are 'hidden' away somewhere. Moreover, there are several provisions which have served their time and are just dead wood: one need only mention the so-called Special Concession and the tax free year, both of which concerned one-off events of the early 1970s, now forty and more years in the past. Cannot at least a start be made to clearing up the law by removing such anachronisms?