



THE TAX ADVISER

**AN IN-HOUSE NEWSLETTER FOR MEMBERS OF THE MALTA
INSTITUTE OF TAXATION: ISSUE NO 3: JUNE 2015**

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FROM THE PRESIDENT'S DESK

Dear Members,



This is an exciting and challenging year for the Malta Institute of Taxation, where we will be focusing on a number of important developments on the education front.

I am pleased to inform you that we are working hard, together with the Faculty of Laws at the University of Malta, to launch our Masters Degree in International Tax. This will be a two year Masters programme offered on a part time basis. Our aim is to launch this programme in October 2016.

We are also in the final stages of having our popular Diploma in Taxation course accredited with the NCFHE. Thirdly, we are revamping our Foundation in Taxation course to ensure that this course looks at the theory of tax legislation at a basic level, with a particular emphasis on the personal and corporate level, and covers all compliance issues. This Foundation course will also be accredited with the NCFHE. We aim to launch this simplified course will be towards the end of this year. We will keep you constantly updated on all three programmes.

We will also continue to host our regular seminars, on particular aspects of tax law, throughout the course of this year. We have already held, earlier this year, a seminar on the new legislation enacted by the Budget 2015. This seminar was very well attended and the speakers, Dr Neville Gatt, Dr Conrad Cassar Torregiani and Dr Craig Schembri, encouraged a discussion of the relevant issues with the audience.

Meanwhile, I am pleased to briefly announce the Seminar Calendar of Events which we will be holding throughout the rest of this year, where we distinguish ourselves on the caliber of our speakers:

THE NEXT ISSUE OF THE 'TAX ADVISER' IS TARGETTED FOR OCTOBER 2015

Speaker: Dr Rachel Galea. Topic: Recent developments within BEPS Date: 7th July

Speakers: Mr Marvin Gaerty and Dr Neville Gatt. Topic: The New Property Tax Date: 3rd August

Speaker: Ms Jeanette Calleja Borg. Topic: Direct Tax Issues affecting International Businesses Date: 10th September

Speaker: Mr Matthew Zampa. Topic: VAT Practical Session Date: 15th October

Speaker: Dr Robert Taylor East. Topic: Aspects of Taxation of Trust Law Date: 5th November

Speaker: Dr Hans Mortier. Topic: Theoretical aspects of VAT Law Date: 11th November

Speaker: Dr John Ellul Sullivan. Topic: International Tax Planning Date: 2nd December

SNIPPETS

VOCATION

Article 4(1)(a) of the Income Tax Act brings to charge gains or profit arising from 'any trade, business, profession or vocation'. All these sources of income have their own problems of interpretation and application: not least the fourth sub-head 'vocation'. A dictionary definition is: "the action of God in calling a person to exercise some special (especially spiritual) function, or to fill a certain position; divine influence or guidance towards a definite career; the fact of being so called or directed towards a special work in life; a natural tendency or fitness for such work" (Oxford Universal Dictionary). By and large this is what the term means to most persons, but this understanding is at a much higher level than what was preferred in an old U.K. tax case *Partridge v Mallandine* (2 T.C. 179) where it was stated that: 'a man may employ himself to earn profits in many ways the word vocation is analogous to calling, a word of wide significance meaning the way in which a man passes his life'. In Malta a so-called 'variety artiste' who was essentially a high class call-girl, was subject to tax on what the Board of Special Commissioners in published case no 21 clearly felt were the gains or profits from her 'vocation', and in a later case the same Board tried to classify a low ranking Government employee under this heading because he astonishingly had to provide his own truck for the purposes of his work, and this classification was the only way in which he could be granted capital allowances for the truck. (At the time, capital allowances could only be granted in respect of a 'trade, business, profession or vocation'). The Court of Appeal, perhaps somewhat unwillingly, had to accept a Revenue appeal because clearly this was assigning too high a definition to taxpayer's work – and, in any case, he still remained an employee. (It is understood that, soon after, this absurd sort of employment was eliminated from Government practice). It appears that, since then, the term has been correctly applied within the dictionary meaning set out above, rather than within the very wide meaning assigned to it in the mentioned U.K. case.

FOREIGN INVESTMENT INCOME

By Ordinance XXIV of 1961 (dated 1 September 1961) a withholding tax of 25% was imposed on income from overseas investment received through and paid by financial intermediaries. The method of deduction and subsequent refund where the marginal rate payable by taxpayers did not reach this rate was rather cumbersome. As the tax so payable was not a final withholding tax, there inevitably was a rush to get a refund of the excessive tax so paid, and some hardship was being caused to persons on a low fixed investment income. This created somewhat of a bottleneck which, linked with the fear that unwelcome details were being made available to the Revenue, gave rise to a lot of disquiet which soon became politicised. In fact, the measure was dropped by Act XIV of 1963. The ill success of this scheme contrasted with the success of the current final withholding tax of 15% which was introduced some 30 years later. This not only brought in a large amount of tax (and still does so), but eventually paved the way for various measures which enabled the repatriation of a large volume of capital that had been tucked away overseas by the Maltese. This has been pumped into the Maltese economy, whereas these funds had formerly been enjoyed by foreign economies. The 1961 scheme had perhaps been introduced in the wrong way and at the wrong time.

FACT AND LAW: RIGHT OF APPEAL

Essentially all tax legislation gives the right of appeal from decisions of the authorities. The first right of appeal is usually to an administrative tribunal, now generally the Administrative Review Tribunal. This right is not limited in any way (saving the usual procedural issues), but any further right of appeal to the courts from the tribunal's decision is normally limited to points of law (except under the Duty on Documents & Transfers Act) thus effectively excluding appeals on points of fact. Though probably nobody would wish to have the Court of Appeal (whether in its higher or lower jurisdiction) having to ponder and deliberate on whether a grocer has earned EUR 3,000 as declared, or EUR 10,000 as claimed by the Revenue and confirmed by the lower appellate tribunal, the blanket exclusion of appeals on points of fact does not seem to be quite right. The quantum of the tax in dispute has no bearing on this issue: a look at the decided cases shows that a 'point of principle' involving just EUR 5 tax, which often might interest or affect only the taxpayer concerned, can be taken to court with impunity, but an issue of fact involving EUR 5 million cannot. Of course, the courts of both the United Kingdom and of Malta have found their own formula to get around this prohibition, but this usually involves somewhat arbitrarily labelling the decision of the lower tribunal as one which no reasonable person could have arrived at. It will also probably be recalled that a question regarding the VAT lottery could (and was) taken up to the Court of Appeal, while the Court has thrown out innumerable VAT cases on the grounds that the subject matter of the appeal was a point of fact, irrespective of the amount of tax involved. One must again ask: is this quite right? Incidentally, the right of appeal from **any** decision of the Administrative Review Tribunal to the Court of Appeal is not limited to points of fact under the Administrative Justice Act (Cap 490) which set up the said tribunal. This could involve an interesting case of conflict of laws.

COURTESY VISITS TO THE MINISTER FOR FINANCE AND TO THE INLAND REVENUE DEPARTMENT



On Wednesday 15th April, the President of The Malta Institute of Taxation, Dr. Renald Micallef, accompanied by Vice President, Mr. George Farrugia, Dr. Conrad Cassar Torregiani and Mr. George Portanier CEO, paid a courtesy visit to the Honourable Minister for Finance, Prof Edward Scicluna.

The two Advisors to the Hon, Minister, Dr. Paul Debattista and Mr. Robert Ducker, as well as Mr. Marvin Gaerty, the Commissioner for Revenue, were also present during this meeting.

Dr. Micallef expressed his thanks to the Hon. Minister for having accepted the invitation of the Institute for this formal courtesy visit. He gave a short introduction explaining the role played by the Institute, with its particular emphasis on higher education through its popular Post Graduate Diploma Course as well as its planned Masters degree in International Taxation.

Dr. Micallef advised Prof Scicluna that Council had nominated him, as the Minister for Finance, as Honorary member of the Institute. During this meeting, a discussion was held as to the advantages stemming from a regulation of the tax advisory service in Malta, to ensure the necessary provision of expert professional advice to clients, and similar in nature as to how other professionals in different spheres are regulated. Such regulation would ultimately also serve to further promote Malta as a sound financial jurisdiction.

It was agreed that the Institute would forward to the Minister's advisers an updated draft of a Tax Advisory Services Bill as a first step in this process.

The President of the Malta Institute of Taxation, Dr Renald Micallef, accompanied by Dr Conrad Cassar Torregiani, Vice President, Ms Geraldine Schembri, Chairperson, Direct Tax Sub-Committee, and Mr George Portanier, CEO, paid a courtesy visit to the Inland Revenue Department, on the 14th May 2015, where they were warmly welcomed by Mr Marvin Gaerty, Commissioner for Revenue.

Also present during this meeting were Mr. Aldo Farrugia, Director General, Legal and International, Mr. Mario Borg, Director General, Inland Revenue and Mr. Tarcisio Scicluna, Director, Tax Compliance Unit.

This courtesy visit served to touch base once again with the Department and Dr Micallef welcomed this opportunity to meet with the highest Revenue's echelons. He expressed the need for a constant dialogue between the Institute and the Revenue Department. Mr. Gaerty thanked the MIT contingent for their visit and stated that the door was always open for discussions with the Institute. The Department appreciated the educational role played by the Institute in furthering the education of service providers in the field of taxation and finance.

Dr. Micallef mentioned various technical items which could be further discussed with the Department in future meetings. These ranged from Malta's position on the Common Consolidated Common Tax Base which is being proposed by the European Commission, to VAT Bad debts guidelines and schemes being used overseas, such as the Patent Box principle adopted in the UK to govern intellectual property revenue, and similar schemes used in Belgium, Luxembourg, the Netherlands, including the regulation of tax professionals and tax compliance issues.

During this cordial meeting, it was agreed that further discussions will be held where such issues could be discussed further.

EXEMPTIONS: CHARITY AND PHILANTHROPY

It is recorded in the Encyclopaedia Britannica that non-Government, non-profit making philanthropic and charitable foundations have existed since ancient times¹. Thus Plato's Academy was established in the 4th century BC with an endowment which helped sustain its existence for some 900 years. The medieval Church set up and administered what we today would call 'trusts' or 'foundations' for benevolent purposes, while Islam launched the 'waqf' as early as the 7th century. In Western Europe, merchants in the 16th and 17th century set up similar organisations for worthy causes. These early efforts have continued to grow so that it is reported² that in the United States alone an incredible \$400 billion dollars is donated each year for such purposes: 70% of which by individuals. Such names as the Smithsonian Institution, Carnegie Foundation, Rockefeller Foundation, Wellcome Trust, Nuffield Foundation, Gulbenkian Foundation, Toyota Foundation and the Bill and Melinda Gates Foundation are familiar to everybody and need no introduction. Seeing the vast amount of funds involved, it will be appreciated that today it is almost impossible to give a detailed account of this outflow of generosity: sufficient to note that in the United Kingdom alone there are some quarter of a million registered charities. Unfortunately, this volume of activity has sometimes caused problems through administrators of trusts and foundations turning the generosity of the donors to their own advantage. It is said that the retrograde movement in the 1970s in Malta which is commented on below was caused by such an event: overseas, not in Malta itself.

Seeing this massive outflow of generosity from the private sector, it is no wonder that states have felt compelled to reciprocate by topping up these funds through granting tax exemptions to the institutions

¹ Article on Philanthropic Foundations and Charitable Organisations by Joseph C Kiger.

² Acton Institute for the Study of Religion and Liberty.

set up for this purpose. It must of course be noted that the largest chunk of public expenditure in most countries is today devoted to social purposes: in fact what could be grouped under philanthropy or charity as defined below. The activities of the private sector in this regards are mostly directed at areas which are not, or cannot be adequately covered by government intervention, be it for political or other reasons.

This article is mostly intended to review how in Malta we deal, and have dealt with tax exemptions for this sector. Before so doing, however, some space must be dedicated to trying to find a difference, if it exists, between charitable and philanthropic purposes and institutions. This clarification is necessary as, at least technically, we moved from 'charity' to 'philanthropy' in the mid-1970s for income tax purposes. Charity is ingrained in the Maltese social and cultural fabric: we cannot make any claim for exclusivity in this regard, as the facts quoted above are enough evidence that this is, and has been for millennia, part of western civilisation. We give to charity because we feel we have a moral or religious calling to do so, or just a kindly or sympathetic disposition to aid the needy as a result of deep feeling or understanding of their misery or suffering. Charity is how we show compassion for people suffering from so many situations ranging from natural disasters to support for victims of crime or violence, and the unbelievable poverty (whether natural or man-made) in some third world countries. Yet charity viewed from this angle is sometimes criticised as being short-sighted: it seeks to alleviate the immediate need, but does little to create a chance for the future.

Helping to created institutions which will avoid the continued use of charity in the future is often labelled as philanthropy, which has been defined as goodwill towards one's fellow men, especially as expressed through efforts to promote human welfare³. 'Charity tends to be a short-term emotional, immediate response, focused primarily on rescue and relief, whereas philanthropy is much more long term, more strategic, focused on re-building'⁴. Charity is slaking people's thirst in a remote village, philanthropy is building a well for the villagers. Charity is aunt Rebecca helping with disabled children and sending an anonymous donation of EUR 200 every year to the relative institution; both activities can be vital for someone in need, but philanthropy is what creates research into the problem and sets up institutions to cater in the future for the sufferers.

All the above may be very true, but is there any real difference between the two, or is this just hair splitting? Going back to the origin of the meaning assigned to 'charity' in legal terms, it looks very much that the two terms have always been considered to be interchangeable, and that charity comprises also what one would call philanthropy in terms of the above distinction. The precise meaning of the term 'charity' has never been worked out, and recommendations made to modernise and simplify the categories of activities which were first worked out in the United Kingdom in the Charitable Uses Act of 1601 (usually referred to as the Statute of Elizabeth) seem to have largely fallen on deaf ears⁵. The Charitable Uses Act was slowly eroded in the U.K. as specific provisions were introduced by other legislation, until only the Preamble to the Act remained in existence. This was very intricate, but it makes interesting reading:

³ Acton Institute, *ibid*.

⁴ Steve Gunderson, former president of the Council on Foundations in the U.S.A.

⁵ Both the Nathan Committee (1952) and the Goodman Committee (1976) failed to come up with anything tangible.

WHEREAS Lands, Tenements, Rents, Annuities, Profits, Hereditaments, Goods, Chattels, Money and Stocks of Money, have been heretofore given, limited, appointed and assigned, as well by the Queen's most excellent Majesty, and her most noble Progenitors, or by sundry other well disposed Persons; some for Relief of aged, impotent and poor People, some for the Maintenance of sick and and maimed Soldiers and Mariners, Schools of Learning, Free Schools, and Scholars in Universities, some for repair of Bridges, Ports, Havens, Causeways, Churches, Sea-Banks and Highways, some for Education and Preferment of Orphans, some for or towards Relief, Stock or maintenance for Houses of Correction, some for marriages of poor Maids, some for Supportation, Aid and Help of young Tradesmen, Handicraftsmen and Persons decayed, and others for Relief or Redemption of Prisoners or Captives, and for Aid or Ease of the poor Inhabitants concerning Payments of Fifteens (a tax on immoveable property), setting out of Soldiers

The legislation was actually not so much intended to give a definition of charity or of charitable purposes, as to the correction of abuses which had grown up in the administration of trusts of a charitable nature, but the Court of Chancery used the preamble of the Statute in order to simplify its task of determining which purposes were charitable and which were not. Actually the Court never seems to have considered itself bound by the objects enumerated as above, but only used the preamble as tangible examples of what could be considered to fall under the term. The preamble was itself finally repealed by the Charities Act of 1960, but by then a long list of cases had shed light on what fell under charity, and a vital summary of the scope of charity had been given in a tax case '*Commissioners for Special Purposes of Income Tax v Pemsel*⁶, where Lord Macnaghten stated that 'Charity in its legal sense comprises four principal divisions: trusts for the relief of poverty, trusts for the advancement of education, trusts for the advancement of religion, and trusts for other purposes beneficial to the community not falling under any of the preceding heads'. The case concerned a trust, and it is clear that that is why the judgement mentions only trusts, but the same line has been followed in all cases concerning any issue in respect of charity. However, another leading judge in 1968⁷ pointed out that '.....three things may be said about it (*i.e. the Macnaghten definition*), which its author would surely not have denied: first that, since it is a classification of convenience there may well be purposes which do not fit neatly into one or other of the headings; secondly, that the words used must not be given the force of a statute to be construed, and thirdly, that the law of charity is a moving subject which may well have evolved even since 1891'. It may be worth emphasising that most disputes concern cases falling under Lord Macnaghten's final classification of 'other purposes beneficial to the community'.

In the light of the above considerations, it becomes somewhat difficult to draw a line or distinguish between charitable and philanthropic purposes. The only known case where this was attempted was the Scottish case of *Duncan v Duncan*, which has been unfortunately lost sight of over the years, leaving no useful guidance. Surely, however, one can say that for all legal purposes the term 'charity' comprises also 'philanthropy'. But what has been happening in Malta in this regards? As so often is the case, the story begins with the Model Income Tax Ordinance which in section 8(d) granted exemption to:

⁶ [1891] AC 531.

⁷ Lord Wilberforce: [1968] AC 1238, [1967] 3 All ER 215.

'the income of any ecclesiastical, charitable or educational institution of a public character in so far as such income is not derived from a trade or business carried on by such institution'.

This exemption was transmuted into the Income Tax Act⁸ as follows:

'the income of any educational institution of a public character, in so far as such income is not derived from a trade or business carried on by such institution, and the income of ecclesiastical or charitable institutions, trusts, bequests or foundations of a public character'.

The only real difference between the two versions was that, in Malta, the prohibition for qualifying institutions from carrying on trade was restricted to educational institutions. This condition may give rise to problems in the sense that many viable institutions have to make some charge for services offered. For example, a charitable institution working in the medical field will have to hire professionals to render specialist services, and spend a lot of money on making available costly medical stores – not to mention maintenance of their premises, cleaning, sterilisation etc. The original endowment setting up the institution would soon be exhausted if all these expenses were to be borne by it since few endowments could produce a steady income stream for this purpose, or obtain regularly a replenishment of funds from further endowments. The prohibition against trade appeared to follow the decision in *Coman v Governors of the Rotunda Hospital Dublin*⁹. In the United Kingdom, however, the unfortunate effects of that decision were reversed by section 30(1) (c) of the Finance Act 1920, which still forms part of U.K. law. In terms of the arrangements so made if a charity is considered to be carrying on a trade, it will still be exempt from tax on the profits if: (a) profits are applied solely for the purposes of the charity, and (b) either (i) the trade is exercised in the course of the actual carrying out of a primary purpose of the charity, or (ii) the work in connection with the trade is mainly carried on by the beneficiaries of the charity.

These arrangements have been carefully dissected and enlarged upon by the courts, with the main points made being as follows. Requirement at (b) (i) has been held to mean, for example, that if a charity caters for the diffusion of legal studies, and one of its objects is the provision of lectures and general legal education, profits from holding conferences for legal practitioners are exempt. Likewise, if a school or college carries on the trade of education and charges fees, or an old people's home charges for its services, the trade is exercised in the actual carrying out of a primary purpose of the charity. Requirement (b)(ii) contemplates the sort of situation where inmates of an institution for the blind carry on basket making activities, with the inmates being themselves the beneficiaries of any profits made. The principle has however been extended to a charitable association which organised a competitive music festival, the competitors being treated as the beneficiaries. So also, the profits of a school run by nuns have been held to be exempt, with both nuns and pupils being considered beneficiaries. However, commercially oriented trading such as the sale of Christmas cards or the organisation of the sale of gifts is deemed to give rise to taxable profits, such sales not being integral parts of the charity's purposes. (By concession, the profits from bazaars or jumble sales by voluntary organisations are not generally charged to tax)¹⁰.

⁸ Act LIV of 1948.

⁹ At 7 T.C., 517 H.L.

¹⁰ Butterworth's U.K. Tax Guide, quoting Simon's Taxes.

Reverting to the local scene, the only solution to institutions' financial constraints is often the charging of a relatively small fee for these services, but problems may arise with the tax authorities as to whether they would be thereby carrying on a trade or business rather than a philanthropic undertaking. In practice, however, this problem rarely arises and making such charges appears in general to constitute no hindrance and does not run the risk of disqualification. On the other hand, in case no 166 before the Board of Special Commissioners¹¹, appellant was a voluntary welfare organisation which was called a 'club' but actually had no members as such. It also had no income except for charges made to persons making use of its facilities. The Board therefore felt that although the institution was clearly doing laudable work in the sphere of welfare, it did not qualify for exemption as in essence it was running a business and could not be classified as a 'charitable trust'. Though, unlike the United Kingdom, we have no enabling legal provisions, in general it appears that a non-trading concept is linked with the requirement that an institution is not a profit making organisation. It is public knowledge that some of the approved institutions do make some charges in the course of their operation. As shown by the above case, however, trading or trade-like activities can be dangerous for a claim of exemption. The decision in Board case no 166 should, in actual fact, no longer be relevant as the text of the law as revised in 1975¹², and set out below, does not specifically prohibit a philanthropic organisation from carrying on trade. The said Board decision was also delivered a few months before the amendment was published and it concerned the years of assessment 1957 to 1967. It would however be useful if the provisions of the Voluntary Organisations Act in this respect¹³ were introduced into the Income Tax Act, or at least the two provisions were linked up. The V.O.A., as a matter of principle, prohibits a voluntary organisation from carrying on trade or the promotion of a commercial enterprise, but it then gives a detailed list of activities which are none the less allowed. Such a device would regularise the position satisfactorily and remove all doubts.

The only relevant case on the interpretation of the provisions of the Income Tax Act on charity/philanthropy as originally enacted, was case no 27 decided by the Court of Appeal¹⁴. The case concerned a bequest made by a person for the purpose of helping the progress to sainthood of his brother. It was agreed that the bequest was in no way ecclesiastical, having been made by a private person in respect of his brother, while the funds were under the control of private individuals. The Board considered whether the fundamental requirement regarding the 'public character' of the bequest was satisfied, and it felt that, in the circumstances of the case it was not since everything in the bequest was tied up with members of the same family. The Court of Appeal disagreed since whether the dead person was declared to be a saint or not benefitted him in no way: if he was a saintly person he would have already gained eternal glory for himself. The real benefit from his canonisation would be obtained by the people of God in general, and in particular the people of Malta who would have a new saint whose exemplary life could be followed and who's proclaimed sainthood would be an inspiration and help in their own quest for eternal glory.

For several years no fresh initiatives or developments appear to have taken place in this field, except that the Commission entrusted with the preparation of new death duty legislation stated very clearly

¹¹ Decision dated 17 March 1975.

¹² At XLII of 1975, section 3(c).

¹³ Cap 492 of the Revised Laws of Malta, article 38.

¹⁴ Judgement dated 12 April 1959.

that its recommendations followed closely the four-fold division of charity in the Pemsell case. The proposal was accepted by Government and the exemption granted was set out as follows:

'..... no duty shall be chargeable on.....any bequest or gift by way if inter vivos disposition for charitable, educational or philanthropic purposes made to an institution or organisation of a public character set up for the achievement of one or more of the said purposes¹⁵'.

Religion was catered for in the new law in the same way that had been done in the precursor of the Death & Donation Duty Act, that is to say the Succession and Donation Duties Act of 1918, by the exemption of:

'any bequest for the repose of souls, or providing for any use of public worship: provided that the amount so exempt shall not exceed one hundred pounds in respect of any chargeable transmission'¹⁶.

The income tax position was however changed radically in the mid-1970s, though no changes appear to have been made in this regard to the new D.D.D.A. First of all, specific legislation was enacted concerning ecclesiastical matters. This did not mean that institutions connected with the Church could not also benefit from general provisions relating to charity and/or philanthropy, but any doubts whether the church in Malta actually enjoyed exemption in principle from income tax was removed. More germane to the subject matter of this article, however, is that the traditional exemption for charity was thrown overboard and substituted by exemption for philanthropy. Moreover, such exemption was not automatic or subject to court review in case of dispute, but made dependent upon ministerial approval which could be exercised in one of two ways: namely, via rules made under the normal provisions of the Income Tax Act, or through direct approval by the Minister. The actual text of the law has never been changed since then and is now found in article 12(1)(e) of the Income Tax At, which grants exemption in the following terms:

'the income of any institution, trust, bequest or foundation, of a public character, and of any other similar organisation or body of persons, also of a public character, which is engaged in philanthropic work and either qualifies for exemption under this paragraph in accordance with rules made for this purpose by the Minister responsible for finance under article 96 or is named by the said Minister as engaged in philanthropic work for the purposes of this paragraph and there is not in respect of it a declaration by the said Minister that it has ceased to be so named'.

This change in concept has never been accepted as proper by the Institute which fully endorses pre-budget submissions made some years ago by an informal federation of institutes to the effect that:-

'Clearly the time is now ripe for the reversal of what was done when the notion of 'charitable institutions', or more properly 'charity' in its wider legal sense, was removed from tax law to be substituted by the narrower concept of 'philanthropic institutions'. This downgrading has never been satisfactorily

¹⁵ Death and Donation Duty Act, section 9(1)(b). This legislation is no longer on the statute book.

¹⁶ Article 9(1)(e) *ibid*. Perhaps a niggardly provision even for those times.

explained, nor has the grant of discretionary powers to the Minister to give recognition to such institutions. This constituted an unjustified restriction of state generosity towards worthwhile causes. It has also put Malta's legislation out of step with that of the rest of Europe, and has led to the loss of international organisations which were ready to set up their Head Quarters in Malta, but were reluctant to do so on learning that their exempt status could not be guaranteed in terms of a law adhering to recognised principles concerning the legal meaning of 'charity'.

An extremely curious aspect of the whole affair is the reason which is supposed to have been given for the substitution of 'charity' by 'philanthropy'. This was to the effect that there had been a major international scandal about one of the best known charitable institutions through the usual problem of a few administrators caring more for their private interests than for the interests of the institution they were supposed to be looking after, and the beneficiaries therefrom. What this had to do with Malta was never explained, still less one can understand how such unhappy events would be avoided by merely changing 'charity' to 'philanthropy'.

This unfortunate (and totally unnecessary) change in concept may today perhaps have been somewhat tempered by legislative and consequential developments as set out below, but there has been no development which could give the slightest veneer of justification to the assignment of powers to the Minister to rule specifically which institutions would qualify as being 'philanthropic'. The hypothetical possibility of issuing Rules (that is subsidiary legislation) to set out binding norms on the matter was, and remains, just a possibility as the centuries' long experience in the United Kingdom of the courts, commissions and Parliament wrestling unsuccessfully with this problem proves unequivocally. Why, one must ask, was this power vested in a political authority and not with the normal courts of the land, or at least with a quasi judicial tribunal? Should a minister be above the law in this respect? Why has nothing been done on this matter during the intervening years? Does not this arrangement conflict with constitutional and fundamental human rights?

This situation contrasts badly with arrangements under the Voluntary Organisations Act¹⁷, which one would have thought catered more or less for the same area of activity. In contrast with the tax legislation, the V.O.A. devotes Part V of the law to appeals which can be made to the Administrative Review Tribunal on perceived grievances caused by a refusal of the Commissioner for NGOs to enroll applicants, or to suspend or cancel enrolment. The Commissioner can also request dissolution of organisations, whether enrolled or not, and power to review such issues is also vested in the A.R.T. Why cannot something on the same lines be provided for under the Income Tax Act, thus removing once and for all this incongruity from Malta's legal system?

Reverting to the charity/philanthropy discussion, it has been noted above that developments have reduced the impact of the exclusion of 'charity' from the picture through its substitution by 'philanthropy'. One of the main (and perhaps totally unexpected) developments has been the large number of institutions which in fact have been approved as being 'philanthropic' under the 1970s arrangement. Without prejudice to the question that the system of approval is not acceptable, it must be admitted that in fact several of the 157 approved bodies could more properly be classified as 'charitable' rather than 'philanthropic' under the distinction discussed above. Mentioning individual

¹⁷ Cap 492 of the Revised Laws of Malta.

cases may perhaps not be quite ethical, but one of the oldest existing bodies that has gained approval is a fund which predated the changeover and whose laudable purpose is to provide money for the purchase of meat by orphanages etc which might otherwise have difficulty in so doing because of financial constraints. This is pure charity, not philanthropy. The same may be said for various creches which have been granted exemption. In any case, this list must surely prove that, in actual practice, it is extremely difficult to draw the line between the two terms and that, at the minimum, many institutions must be considered to be hybrid in nature.

Various exemptions have also been given by the Income Tax Act itself which are over and above the general provisions of article 12(1)(e). Presumably, the further exemptions have had to be given because they are deemed not to fall under the term 'philanthropy'; while another reason might have been that it was thought advisable to relieve the Minister from having to take decisions about such cases. Be it as it may, these specific exemptions have expanded substantially the system introduced in the 1970s, and have ridden roughshod over the charity/philanthropy divide. These may be listed as follows:

*The income of political parties and of clubs adhering to such parties*¹⁸.

*The income of a club or similar institution which the Commissioner of Inland Revenue is satisfied is organised and operated exclusively for social welfare, civic improvement, pleasure or recreation, or for any other purpose except profit*¹⁹.

*The income of a philharmonic society which the Commissioner of Inland Revenue is satisfied constitutes a bona fide band club (and subject to other conditions)*²⁰.

*The income of a club or similar institution which the Commissioner of Inland Revenue is satisfied constitutes a bona fide sports club (and subject to other conditions)*²¹.

*The income of a youth club or youth centre which is organised and operated solely for pastoral purposes (and subject to other conditions including specific approval by the Minister of Finance)*²².

It may also be considered that various other exemptions granted under the same article 12 of the Income Tax Act which grants the above exemptions likewise fall under the categories of charitable or philanthropic grants, particularly as most of them have to be made to some constituted body or other.

Finally, two important laws enacted much after the 1970s changeover from charity to philanthropy for tax purposes, further indicate how unwise it was to effect such a change. The first was the Trusts and Trustees Act²³ which makes detailed provisions by defining 'charitable purposes' to mean 'any charitable, social, or philanthropic purpose and, without prejudice to the generality of the aforesaid, includes in particular:

- (a) *The advancement of education, including physical education and sports;*
- (b) *The advancement of religion;*
- (c) *The advancement of health;*

¹⁸ Article 12(1)(f) of Cap 123.

¹⁹ Article 12(1)(l), *ibid*.

²⁰ Article 12(1)(n), *ibid*.

²¹ Article 12(1)(o), *ibid*.

²² Subsidiary Legislation 123.56.

²³ First introduced into Maltese legislation as Act XXXV of 1988, the Offshore Trusts Act, now Cap 331 of the Revised Laws of Malta.

- (d) *Social and community advancement;*
- (e) *The advancement of culture, arts and national heritage;*
- (f) *The advancement of environmental protection and improvement, including the protection of animals;*
- (g) *The promotion of human rights, conflict resolution, democracy and reconciliation;*
- (h) *The promotion or protection of the interests of other social purpose organisations, including federations of such organisations; or*
- (i) *Any other purpose as may be prescribed by the Minister by means of regulations made by virtue of this Act.*

Unlike what happens under the Income Tax Act, this extremely wide definition is then followed by a blanket exclusion of political purposes. All in all, this exemption must be recognised as going a long way towards a legislative definition of 'charity': something which had long eluded the legislators both in Malta and abroad.

The Voluntary Organisations Act²⁴ gives the following definitions:

'philanthropic' means the relief of poverty, pain and suffering, and other humanitarian needs;

'charitable purpose' means a social purpose;

'charitable trust' means a trust as defined by the Trusts and Trustees Act which is established for a social purpose;

'charitable purpose' means a social purpose;

'social purposes' means (and then follows a word for word repetition of the text of the items listed under the definition of 'charitable purpose' under the Trusts and Trustees Act as set out above., saving that there is no prohibition of political purposes).

In conclusion, can one perhaps hope that the remarks made in this article, and the considerations therein set out, will lead at some time or other to a revamping of the entire legislative set up in Malta in this regards along more rational and generally accepted lines?

²⁴ Cap 492: enacted as Act XXII of 2007.

Diploma Course in Taxation 2014-2015: Examination Paper

Date: Thursday, 14th May 2015 Time: 09:00 – 12:00hrs

Premises: IMLI Hall

Instructions:

1. The examination is held in accordance with the Course Regulations. No materials or reference books are to be brought into the exam hall save as allowed by the Regulations.
 2. Black ball-point pens should be used.
 3. Use only one side of each page of the note books provided. Insert full name in block letters and add your identity card number. Sign each page used. Jottings and drafts are to be clearly cancelled.
 4. Candidates are to answer FOUR QUESTIONS IN ALL. These should be from three of the sections set out below, so that both questions need to be answered from one of the Sections, while no question will be answered from another Section.
 5. Each question carries twenty-five marks.
-

Section 1.

Question 1.

The Sharkey v Wernher principle regarding transfers of business assets to one's private account does not appear to be much in favour currently. What is this principle and how did it emerge in the case in question? Is it applicable in the case of all income chargeable under article 4(1)(a) of the Income Tax Act? Is it a logical measure or just one of those quirks which the theory and practice of income tax seem to throw up from time to time?

Question 2.

Wasting assets, amortisation, repairs and renewals, plant and machinery, implements and utensils, depreciation. What are the arrangements made regarding these matters for income tax purposes? Do you consider these arrangements to be practical and fair?

Section 2.

Question 3.

The Duty on Documents and Transfers Act is the responsibility of the Inland Revenue Department, but it is actually charged and collected by other persons who are not public officials. Explain how this happens, and what measures are prescribed by the law to make certain that, in fact, the duty is charged, collected and passed to the public purse when and as due.

Question 4.

The concept of residence for tax purposes has a central part to play in jurisdictional considerations in income tax: both in the Income Tax Act itself and in the Double Taxation Agreements to which Malta is a party. Outline the arrangements made in the said documents and indicate whether there are any material differences between the two.

Section 3.

Question 5.

Many countries where income tax legislation is, like that of Malta, based on the Model Income Tax Ordinance originally drafted in London in 1922, have incorporated in their law provisions for granting relief in respect of foreign employment income (earned income relief) to persons taxable on a world-side basis. You are required to set out what is the current situation in this respect in Malta. Has this evolved satisfactorily over the years?

Question 6.

“Member States’ existing anti-abuse rules often do not properly take into consideration the freedoms of the Treaty and are therefore increasingly challenged” (extracted from an EC Press Release)

A number of Member States apply anti-abuse rules, such as thin capitalisation and Controlled Foreign Company (CFC) regulations, to protect their national tax bases. However, such Member States existing anti-abuse rules often do not take into consideration the freedoms of the European Treaty and are therefore increasingly challenged by the European Court of Justice (ECJ).

Elaborate on the significance of the above statement and supplement your commentary with details of ECJ case law on the subject.

Section 4.

Question 7.

Attire Group is in the business of manufacturing clothing. The goods are manufactured in the UK by Attire UK Ltd (AUL). Its Maltese company Attire Malta Ltd (AML) is the group company which distributes the clothing to the retailers in Malta, France, UK and Germany. AUL sells the clothing to AML which in turn sells the goods to the retailers. All retailers have a valid EU VAT number in their Member State of establishment. Analyse the Malta VAT implications of the following transactions undertaken by AML:-

- (a) The purchase of clothing from AUL and the resale to retailers in Malta. The clothing is dispatched from AUL in the UK to AML in Malta. AML delivers the clothing to the local retailers.
- (b) The purchase of clothing from AUL and the resale to the retailers in France. The clothing is dispatched from the UK directly to France.
- (c) The purchase of goods from AUL and the resale to retailers in the UK. The clothing is dispatched directly from AUL’s factory to the retailers.

Question 8.

Mr. Joseph Borg is a local taxi driver. Three years ago, he inherited some fields in Rabat and, with the help of his wife, he started to sell agricultural produce therefrom. Due to EU funding opportunities, he is hoping to purchase a new sowing machine from Italy, costing around €30,000. The Italian company has asked him for details about his VAT registration in Malta to determine whether they should charge Italian VAT or otherwise. He considers himself to be a small sole trader but lately, his agricultural turnover has been increasing at a steady rate. He is confused over compliance with VAT laws as he intends to keep both his driving and agricultural activities.

Mr. Borg approaches you for advice on his VAT position in Malta to make sure that he is in line with the law. From the VAT certificate which he has shown you, it can be seen that he is registered in terms of Article 11 of the VAT Act of Malta. You are required to prepare a short synopsis for your client to clear his difficulties about his VAT position.

SNAKES ALIVE.....TRUSTS IN MALTA!!!!!!!

TRUST LEGISLATION ARRIVES IN MALTA²⁵

Right..... but what is a trust?

The hardly satisfying answer to the brief question so put may be sought, but perhaps not really found, in the opening pages of a leading textbook on trusts²⁶ where one finds the following opinions:

"Where judges and text-writers fear to tread professors of law have to rush in. I should define a trust in some such way as the following: When a person has rights which he is bound to exercise on behalf of another or for the accomplishment of some particular purpose he is said to have those rights in trust for that other or for that purpose and he is called a trustee. It is a wide vague definition, but the best I can make"²⁷.

"Many attempts have been made to define a trust but none of them has been wholly successful. It is not thought that a dissection and criticism of earlier definitions are very rewarding; rather it is better to define a trust and then to distinguish it from related but distinguishable concepts"²⁸.

"A trust is an equitable obligation, binding on a person (called a trustee) to deal with property over which he has control (which is called the trust property), for the benefit of persons (who are called the beneficiaries or cestuis que trust), of whom he may himself be one, and anyone of whom may enforce the obligation. Any act or neglect on the part of the trustee which is not authorized or excused by the terms of the trust instrument, or by law, is called a breach of trust"²⁹.

"(A trust) is a fiduciary relationship with respect to property, subjecting the person by whom the title to property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it. In this definition or description the following characteristics are to be noticed: (a) a trust is a relationship; (b) it is a relationship of a fiduciary character; (c) it is a relationship with respect to property, not one involving merely personal duties; (d) it involves the existence of equitable duties imposed upon the holder of the title to the property to deal with it for the benefit of another; and (e) it arises as a result of a

²⁵ This is the first of series of articles on Trusts in Malta prepared by Mr Edwin A. Vella.

²⁶ Trusts & Trustees: Cases & Materials. Butterworth.

²⁷ Maitland: Lectures on Equity (2nd edition) page 44.

²⁸ Hanbury & Martin: Modern Equity (14th Edition, page 46.

²⁹ Underhill and Hayton: Law relating to Trusts and Trustees (15th Edition) page 3

manifestation of an intention to create the relationship. The combination of these things characterises the notion of the trust as that notion has been developed at law”³⁰.

“If we were asked what is the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence I think that we should have no better answer to give than this, namely the development from century to century of the trust idea”³¹.

All the above extracts are concerned with trusts in Great Britain, but trusts tended to follow the flag across the world, and are found as an integral part of a country’s legal structure wherever British influence has been historically of major importance. This includes the United States of America, but not Malta where codified Civil Law was already well established prior to the advent of the British in Malta. Malta’s Civil Law made a massive leap forward along the lines of continental codified legislation in the middle of the 19th century, under the surveillance of, but with only minor infusions from their Common Law system of legislation by Malta’s new anglo-saxon overlords from the north. (Since then, it seems that British commercial and administrative legislation in all its modern complexities has been the main fount of Malta’s legislation).

Problems for Malta

The above extracts bring out two problems faced by the legislators in Malta when it was finally decided late in the 20th century that trusts could no longer be left out of our legislation, and that it was about time that something was done about the matter, particularly as Malta was then preparing to go into the off-shore market. Moreover, the overall situation in Malta was developing along lines which had been noted in the United Kingdom as follows:

“Trust law is indeed of considerable antiquity, but it has shown a remarkable ability to adapt itself to modern commercial requirements. Indeed, the full range and power of the modern trust are to be found not in the family trust..... but with the trust used in commerce and finance. The trust is not only a means of segregating assets for the protection of the beneficiaries, thus insulating them from the consequences of the settlor’s bankruptcy; its equally important function is to provide a mechanism for the collective representation and protection of the members of a group of people linked by a common interest. Good examples of such a mechanism are the unit trust and the bond or debenture trust deed. Under these, the individual interests of substantial numbers of holders of units, bonds, and debenture stock are channelled into the trust and held and protected by the trustees for the benefit of all the holders, so providing the collective mechanism without which efficient administration would be impossible. The mechanism is valuable even where there is no trust property in the normal sense, merely an aggregation of personal rights. For example, where unsecured bonds are issued, so that there are no assets securing repayment, there will still be a trust deed providing for the appointment of trustees for the bondholders and conferring powers on the trustees to take action for the protection of all bondholders if, for example, the issuer of the bonds

³⁰ Scott: Trusts (4th Edition).

³¹ Maitland Selected Essays, page 129.

defaults in payment"³².

The two basic difficulties faced by the legislators when the political decision had been taken to introduce the institute of trust in Malta were:

1. As is evident from the above extracts, there existed no adequate model that could be used setting out clearly and with finality what constituted a trust.
2. Many of the Common Law principles and usages referred to in the same extracts were alien to the codified law of Malta.

What others do

A look at our neighbours whose legislation was also based on codified civil law provided little help. Thus, Italy has never contemplated the institute of trust in its legislation, despite having probably the largest incidence of contact in non-Common Law Europe with actual trusts due to the huge number of emigrants of Italian extraction in the U.S.A.³³. A step further northwards, one finds Monaco which is a leading financial centre and has a large resident population of foreigners. The difficulty with Monaco is that its legislation is very rigidly based on traditional French Civil Code norms. *Inter alia*, this would subject foreign residents to Monaco forced heirship laws, and many such residents have resort to foreign trusts to have the same flexibility to dispose of immovable property on death as exists in their national jurisdictions. Monaco therefore allows foreigners resident in the principality to set up trusts governed by their own national law, and it permits trusts constituted in a foreign jurisdiction to be administered and applied in Monaco, but subject to the following rules:

1. The trust documents must be in the French language.
2. An approved lawyer must certify the validity of a trust formed under foreign law.
3. The trust deed must be registered so that information regarding its affairs becomes public.
4. Each trust must have at least one trustee from a Government approved list of trustees.
5. In the absence of a Monaco law on trust, all trust powers must either be stated in the deed, or implied in the foreign law governing the trust.

(No provision appears to be made for foreigners whose country of origin does not have its own trust legislation).

If disputes arise concerning foreign trusts, the courts of Monaco can exercise jurisdiction. If the law of Monaco contemplates the legal issue concerned (such as ownership of immovable property in Monaco), this will be applied, but otherwise the principles of the foreign law governing the trust will be applied. As will be appreciated, the Monaco model was not all useful as for use in Malta.

Going further afield to Canada, perhaps the most important province in the country is French speaking Quebec with legislation based on codified Civil Law. Yet Quebec forms part of a nation where most

³² Goode Report on Pension Law Reform, 1993 (Cmnd 2342). To note that a 'trust deed' in this context need not necessarily be a formal constitution of a trust.

³³ Italy has however now signed the Hague Convention of the 1st July 1965 on the Law Applicable to Trusts and on their Recognition. This in no way means that Italy and other signatories have necessarily adopted trusts in their law. Countries adhering to the Convention merely provide mechanisms enabling foreign trust to operate in the country (e.g. by owning property) and to enable their rights and obligations to be enforced therein, establishing uniform conflict of laws rules to be applied by all signatories.

provinces are English speaking, and with a Common Law basis to their legislation, while next door on the continent there is the dominant and massive U.S.A. most of whose states are common law users and where trusts flourish. Clearly, Quebec could not simply ignore trusts and continue in splendid isolation. Since 1994, therefore, the Civil Code of Quebec has allowed a person to transfer property from his own patrimony to a trustee who will hold the trust patrimony for the beneficiaries. This development actually took place after Malta had introduced its own trust legislation, but the Quebec case is interesting as it must surely be one of the very few cases where trust law becomes just another chapter in the country's Civil Code to be read and applied in the overall context of the Code, even though the basic dual ownership of property under trust is given due recognition. There are however various differences from normal Common Law practice (as well as from normal Civil Laws provisions) including the forced registration of all trusts, restrictions of trustees' powers of appointment, prohibition of certain pluralities of status as settlor, trustee and beneficiary, the 100 year rule admits modification through various 'ranks' of beneficiaries, protectors do not form part of the system, while unilateral declarations of trust are not acceptable. A notable departure from Civil Law rules is that a trustee need not apply to the Court as he would have been required to do under civil law for certain purposes where the beneficiary is a minor.

And so back to Malta

It is no secret that operators in Malta were aware of and familiar with trusts long before the enactment of the first trust law in 1988. The only problem was that the trusts had to be formed overseas and could not be enforced in Malta. Some of the trusts so formed before 1988 were of a slightly shady character tax-wise, but it may not be well known that a leading educational establishment in Malta was originally constituted as two trusts under English law, but through notarial deeds executed in Malta. Saving such questions as Exchange Control (then non-existent) this was perfectly legal, and the two trusts then came under the purview of the Charity Commissioners in the U.K. (Charity in its wider legal sense comprises also the advancement of education). This is of course not the place to go more deeply into the legal or practical consequences of that set up, but it shows that even before 1988 trusts were nothing mysterious or exotic to local practitioners and their clients.

Adopting the Jersey model

When trusts were introduced in 1988 under the Offshore Trusts Act³⁴, the model used was the trust law of Jersey which had been enacted a short time before (actually in 1984): a much acclaimed attempt to codify the English law of trusts as developed over the centuries, principally in the Courts of Chancery. Actually, the Jersey law was taken over lock, stock and barrel without so much as 'by your leave'³⁵. Only minimal changes were made, the main being the introduction of a full blown definition of what constitutes a trust which was taken from the Hague Convention, *supra*. The Jersey law in this regard had adopted the U.K. principle of not trying to define what constitutes a trust, which clearly emerges from the opinions at the top of this article. Incidentally, this device of not defining the subject matter

³⁴ Act XXXV of 1988.

³⁵ The draftsman of the Jersey law visited Malta some time after his law was transcribed into the legislation of Malta. He expressed satisfaction at how this had been done, and only suggested a minor, but important amendment which was incorporated in the law at the first opportunity. He also confirmed that Malta had done well to drop a suggestion that had been floated for some time to vest trusts with separate legal personality, as this would have changed completely the singular nature of the institute as it had grown over the centuries and reduced it to just another legal person.

on which one is legislating is also adopted in our Codes of Law. Thus, the Commercial Code devotes 140 articles to Bills of Exchange, but does not provide a definition of what is a bill of exchange, or what purposes it serves. So also, the Civil Code devotes several hundred articles to “persons”, distinguishing between “natural persons” and “legal persons”, but in no way does it define what constitutes a “natural person”: in other words, the Civil Code contains no definition of what is or who is a human person, male or female. Clearly, what is self-evident needs no defining, but our new trust law could not assume that what constitutes a trust was self-evident in Malta once there did not exist the benefit of several hundred years’ experience in the theory and practice of trusts.

Other adjustments to the law of Jersey which may be mentioned are:-

1. Trusts could only be made by persons who were not resident and/or domiciled in Malta, as the regime introduced was for offshore trusts (trusts were brought onshore a few years later, together with other arrangements for Malta’s Financial Centre).
2. Trusts were required to be registered: this was necessary because of condition at 1. above, but it was also necessary in the first few years to ensure that proper documentation was being generated by practitioners. This was to be done with the Malta International Business Authority (now re-branded as the Malta Financial Services Authority), via Nominee Companies. Both the Authority and Nominee Companies were constituted under the Malta International Business Activities Act³⁶.
3. Oral trusts eventually, but not immediately became acceptable, though special provisions were made for linkage with the provisions of the Civil Code on mandate and deposit.
4. In addition to trustees being required to act in utmost good faith, and avoiding any conflict of interest, they were required in the execution of their duties and the exercise of their powers and discretions to act with the prudence, diligence and attention of a ‘*bonus pater familias*’, which term is well known in Civil Law countries, but is perhaps not so familiar in Common Law countries.
5. Certain mandatory rules contained in the Civil Code relating to such matters as the indefeasible rights of spouses and ascendants/descendants were safeguarded.
6. The provisions of the Civil Code prohibiting entails and other related matters were rendered not applicable in the case of trusts.

Further developments³⁷

So, trust law finally came to Malta via Act XXXV of 1988. The text and the thrust of the law has been amended several times since then: Acts XIV of 1989, XX of 1994, XIII of 2004, XI of 2006, XIII of 2007, III and XV of 2009, X and XVI of 2011, and XI of 2014.

Legal Notices 424 of 2007, and 14 and 15 of 2015 are also relevant as are the transitory provisions contained at the end of Chapter 331 of the Laws of Malta, which is now the Trusts and Trustees Act, consolidating all the legislation on this institute.

A Recognition of Trusts Act was enacted in 1994 to enable Malta to ratify the Hague Convention on the Law Applicable to Trusts and on their Recognition. This continued to appear as a separate law

³⁶ Act XXXIV of 1988.

³⁷ Developments in the law and practice of trusts in Malta will be dealt with in the next article.

(Chapter 374 of the Laws of Malta) until its repeal as from 1st January 2005 by Act XIII of 2004, where upon all trust provisions were consolidated under Chapter 331.

**REMEMBER THAT THE NEXT ISSUE OF THE 'TAX ADVISER' IS BEING TARGETTED FOR
OCTOBER 2015**