



THE TAX ADVISER

**AN IN-HOUSE NEWSLETTER FOR MEMBERS OF THE MALTA
INSTITUTE OF TAXATION: ISSUE NO 5: DECEMBER 2015**

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FROM THE PRESIDENT'S DESK



With this issue of the TAX ADVISER we come to the end of another busy year for the Malta Institute of Taxation. The days, weeks and months roll by inexorably, and sometimes we have little time to pause and reflect on the progress which we hope for, and that which has been achieved. Please allow me to take this opportunity to do so, as the year 2015 has been an extremely busy one and our workload notable.

Perhaps first mention has to be given to this internal newspaper. Believe me it is far from easy to publish every two months (except in summer) a review of the calibre which a professional institute demands. We hope that our efforts in 2015 will become a normal part of our activities for future years, so that the TAX ADVISER will not become a one year wonder. Members can help a lot, and in due course our Publications Committee (soon due to be reconstituted following the election of the new Council) will no doubt be considering how members can be invited to co-operate in its production.

Another achievement is that our extremely popular Diploma Course in Taxation has now been graded officially at level 6MQF by the National Commission for Further and Higher Education. This is effectively a degree level. Due to NCFHE requirements, the course has been renamed Professional Certificate in Taxation, but very little else has changed. Grading could only be done after the Institute had been recognised as a Teaching Organisation. As a result of this grading (no doubt together with other factors), we have been swamped with requests for places, to the extent that one of the priorities for the coming years will be how to regulate better admission to the course. We are also working on arrangements to enable holders of a Diploma obtained in past years to convert it into a Professional Certificate with the new grading.

It is with pleasure that we can confirm that the University of Malta has formally approved the introduction of a new Masters in taxation amongst its other courses. Details are now being worked out and it is hoped that the course will be launched in October 2016. First indications are that the course will be of two years duration on a part-time basis. The Institute has been working on this project for several years, and we hope that students and practitioners will soon be able to reap the benefits.

We have also during 2015 given fresh life to our series of evening lectures, seminars and workshops. These go back to the time when the short lived C.E.T. legislation was being introduced, but we now intend to hold these events on a more regular basis than had been possible during the intervening years. To round up on our educational activities, I must mention that what we called Foundation Courses in recent years are now being reviewed and recast in the light of other developments in our educational activities I have already referred to. We will be advising on progress in this matter in due course.

Turning to Institute publications, we have this year brought out a Digest of 500 published income tax cases: a classified review of 500 cases decided by the Court of Appeal and the now defunct Board of Special Commissioners over some 60 years. Work on this publication was again assigned to our Life President, Mr Edwin A Vella, who had already been responsible for the preparation of the relative decisions for publication and printing by the Revenue Departments. It appears that the flow of decisions for publication has currently dried up, but efforts are being made to get the process moving again. It will be recalled that the publication of this wealth of information about legal aspects of taxation only became possible when the Institute entered into arrangements with the departments for this purpose. During the year we have stepped up our efforts to have our publications reworked in E-book form. Progress is rather slow, and this is a costly project, but perhaps we can link it up with the ongoing revision and updating of our earlier publications.

Several years ago, the Institute made suggestions regarding the better control of our profession through appropriate legislation: raising standards and consequential status. No progress had been achieved, but this year it was felt that the need for the enactment of suitable legislation for this purpose had become imperative. It has therefore agreed with the authorities that we would prepare new draft legislation updating our proposals in the context of today's requirements, and taking into account developments since our original proposals were made. This has been done, and fresh proposals have been submitted to Government.

Concurrently with the proposals for regulatory legislation, we have also had a look at our internal organisation as reflected in the Institute's Statute, including its By-Laws and Regulations. Work has begun on this project, but it is of course the General Meeting of the Institute which will have the final say on this matter.

The Council of the Institute for 2016 has now been elected. The election of officers and their powers are regulated by the provisions of the Statute, but the division of work to be undertaken is a matter of internal organisation, particularly the setting up and functioning of various committees. Past arrangements in this regards are being carefully reconsidered and we hope to have the new structure in place before very long: we should be able to give fuller details in the next issue of the TAX ADVISER.

In conclusion, I would like to thank all members of the Council and our Staff for the work they have put in during this year. To them, and to all our members I extend my best wishes for a happy Christmas and a prosperous New Year.

ELECTION OF MEMEBRS TO THE COUNCIL FOR 2015 – 2016

The following members have been elected to the Council for the coming year.

Mr. Christopher Borg, Mrs. Jeanette Calleja Borg, Mrs. Ritianne Camilleri Galea, Dr. Conrad Cassar Torregiani, Dr. John Ellul Sullivan, Mr. George Farrugia, Dr. Renald Micallef, Mrs. Geraldine Schembri, Dr. Robert Taylor East and Mr. Christian Vella.

Election took place during the Annual General Meeting held on the 30th November 2015. The full composition of the Council will be carried in the next issue of the TAX ADVISER.



TAXPAYERS CHARTER: THE NEW 'TEN COMMANDMENTS'

The Institute is proud to have set in motion, in Malta and in Europe through the Confederation Fiscale Europeenne, the demand for the introduction of a Taxpayers Charter. Eventually, the Ministry of Finance published a robust Charter for Malta: this was met with a marked degree of approval and was later only adversely affected by isolated lapses in practice. The Institute has however continued to request that there should be structures to enable aggrieved taxpayers to insist upon the application in practice of the principles set out in the Charter. At present, this seems to be only possible through court action -- not specifically on alleged infringements of the Charter itself, but on constitutional grounds, or issues concerning human rights or in respect of normal administrative law and practice. The office of the Ombudsman may not be appropriate for this purpose, though it would help if a specialised ombudsman is assigned to this task. The Institute has also continued to insist upon the setting up of proper "customer services" in the Revenue Departments. It is appreciated that valuable resources would have to be allocated for this purpose, but we consider it essential that, for the proper functioning of the systems now in place for what is essentially self assessment, the Revenue Departments should have a smooth process of public relations. This can only be achieved if such services are assigned to trained and competent officials who appreciate that members of the public cannot be expected to have the know-how and '*nous*' of tax professionals.

We would point out that the Taxpayers Charter had itself half promised that the above issues would be duly attended to, but progress appears to have been very limited. At the same time, it should be noted that some antiquated concepts such as that comprised in the *dictum* "there is no equity about a tax" have been quietly dropped.

The Confederation Fiscale Europeenne, on its part, took up the matter actively and one of its celebratory publications on the occasion of its 50th anniversary was largely devoted to an analysis of Taxpayers Charters throughout the world. Further work on this theme continued, and in mid-November last the C.F.E. was able to issue the Press Release set out below as Annexe "A".

The so-called Ten Commandments of the Charter now proposed are set out in Annexe "B", while the summarised rights and obligations of taxpayers in Malta's own Taxpayers Charter are set out in Annexe "C". The resemblance between Malta's Charter and the "Ten Commandments" is striking, though there are of course various differences, and it is obvious that slightly different standpoints are taken on some issues, but the general thrust of both documents coincides very satisfactorily. The Institute therefore feels that though it would be interesting, there is no need for a compare and contrast exercise.

PRESS RELEASE BY THE CONFEDERATION FISCALE EUROPEENNE

On the 13th November 2015, three international professional bodies of tax advisers representing more than 500,000 tax advisers worldwide presented their joint proposal for a Model Taxpayer Charter.

The work is a collaboration of:-

- AOTCA (Asia-Oceania Tax Consultants Association), representing 330,000 tax advisers from 20 professional bodies in 16 countries in the Asian-Pacific region;
- CFE (Confederation Fiscale Européenne), the European federation of tax advisers representing more than 200,000 tax advisers from 27 professional bodies in 21 European countries; and
- STEP, representing more than 20,000 trust and estate practitioners in 95 countries.

The overriding purpose of the Charter is to foster a relationship of mutual trust, respect and responsibility between taxpayers and the State in order to reduce the cost of compliance, increase the quality and efficacy of willing compliance, and to ensure that all taxpayers are treated equally, and without bias or preference.

Care has been taken to strike a fair balance between rights and responsibilities to make the Charter acceptable and beneficial to both governments and taxpayers.

The provisions of the Charter were derived from a survey of taxpayer rights and responsibilities in 41 countries worldwide, representing over 80 per cent of the world's GDP.

The Model Charter is part of a Final Report, which includes an overview of how taxpayer rights and responsibilities are recognised in 41 countries.

The authors of the Charter and the Report, Michael Cadesky (STEP), Ian Hayes (CFE) and David Russell (AOTCA), are distinguished tax practitioners, each representing one of the three organizations involved.

The publication follows a two-and-a-half-year consultation period in which the draft Charter was discussed in meetings with the European Commission and the OECD and presented to the UN Tax Committee. Comments were invited from tax administrations, international organisations, academia and other stakeholders. The Final Report takes into account feedback received from these organisations.

One of the additions to the final version is a list of **Fundamental Principles** (see *Annexe “B”*), informally called the “Ten Commandments”: the ten key rights and responsibilities of taxpayers and tax administrators.

ANNEXE “B”

**MODEL TAXPAYERS CHARTER
(Fundamental Principles)**

As a Taxpayer you have the right to:

1. Integrity and equality

The tax system shall be designed and administered fairly, honestly and with integrity, according to the law, without bias or preference.

2. Certainty

The Tax system will be designed and administered to provide as far as possible certainty, clarity and finality in one’s Tax affairs.

3. Efficiency and effectiveness

The Tax system will be designed and administered fairly and cost effectively taking into account the attainment of its purposes.

4. Appeal and the right to dispute Resolution

In cases of disputes as to tax liability an independent, objective, speedy and cost effective appeal process. Disputes as to actions of the Tax Authority will be followed up without fear of reprisal under independent oversight.

5. Appropriate assistance

Taxpayers who face difficulties in carrying out their responsibilities as Taxpayers will be given appropriate assistance by the Tax Administration.

6. Confidentiality and privacy

A Taxpayer’s affairs and records will be kept confidential and private except in

And the responsibility to:

1. Be truthful

Be truthful in all Tax matters including legally required disclosures.

2. Provide information

Provide information on a timely basis and when reasonably required.

3. Be cooperative

Be cooperative in dealings with the Tax Administration, filing Tax returns and information reporting, the conduct of an Audit and payment of Taxes.

4. Make payment

Pay tax on time without deduction or offset subject to the right to appeal.

5. Comply with the law

Comply with Tax responsibilities and seek assistance if necessary.

6. Maintain records

Maintain accurate financial records and supporting information for such period

the case of public hearings in litigation or criminal prosecutions.

as may be reasonably required.

7. Pay correct amount of tax

A Taxpayer is required to pay no more than the amount of Tax based on Tax law.

7. Take due care

Exercise an appropriate degree of care and diligence in taxation matters.

8. Representation

A Taxpayer may be represented by a person of the Taxpayer's choosing.

8. Retain responsibility for advisers

Be held accountable for the correctness and completeness of the information supplied to the Tax Administration whether or not another person has been engaged to prepare, assemble and/or submit the information on your behalf.

9. Proportionality

Enforcement action including audits, collections, reassessment, penalties and prosecutions will be proportionate to the circumstances.

9. Show courtesy

Treat Tax Officers with courtesy and respect, noting that abuse of Tax Officers in the performance of their duties is never acceptable.

10. Honesty

In the absence of any evidence to the contrary to be presumed honest.

10. Comply cross border

Ensure that all legitimate cross border compliance requirements are met.

ANNEXE "C"

TAXPAYERS CHARTER -- MALTA

You have the right:

1. to be treated with fairness and impartiality
2. to be treated as honest and tax compliant unless there is evidence to the contrary
3. for certainty
4. for assistance and information from the Tax Departments
5. to pay no more than the correct amount of tax
6. not to be subject to retrospective taxation
7. to minimize compliance costs
8. to be advised and represented by any person on taxation matters
9. to appeal
10. to privacy and confidentiality of information we hold about you
11. to know what information we hold on you
12. for the licit arrangement of your tax affairs that minimize the tax liability
13. to request a payment plan
14. to complain about our service, behavior and action

You are expected :

1. to be honest
2. to be compliant, and cooperate when you deal with the Tax Departments
3. to keep proper records in accordance with the law
4. to file proper and complete tax documents and effect payments by the statutory due dates
5. to inform the Tax Departments about changes in circumstances
6. to know your tax responsibilities and the consequences for non compliance.

WHAT WE LOOK FOR IN THE FUTURE OF TAXATION

The points below represent a summary of the Institute's beliefs and aspirations for the way forward in taxation in Malta, as communicated to the political parties at the appropriate time. This summary may indeed be considered to be the philosophy behind the Institute's activities. As always, we try to be forward looking though we appreciate that the future must rest solidly on the past, both on positive acquisitions and as regards difficulties and unsolved problems. Taxation as we know it today in our country is largely a product of the second half of the twentieth century. Inevitably, it has grown and developed hand in hand with society and the economy and can no longer be considered to be merely a fund collecting exercise for the state. Moreover, overshadowing everything today is the European factor: one simply cannot ignore the repercussions, direct or indirect, flowing from our obligations (and of course rights) in virtue of our membership of the European Union. The points set out below are updated to take account of developments in all the areas mentioned above.

- We look forward to further development in the concepts embodied in the Taxpayers' Charter. We are proud that the Institute has been to the forefront of efforts to introduce the Charter in Malta. As explained elsewhere in this issue, the Confederation Fiscale Européenne has now prepared, in conjunction with other organisations, a summary of current world-wide opinion on the subject: the new 'Ten Commandments'.
- There should be a means of redress in respect of lapses in the concepts covered by the Taxpayers' Charter: at present it seems that redress can only be obtained through court action. Surely this is too cumbersome.
- The tribunals over the years have often expressed doubts about the logic, and basic ethics of certain decisions taken and enforced by the fiscal departments. To a great extent, the tribunals' opinions have been improperly glossed over by the departments, and efforts should now be made to implement the guidance so given.
- There is a crying need for the establishment of efficient "customer services" in the fiscal departments. These must be seen to function properly.
- Formalities are given too much weight: this may be said both in respect of the departments and the taxpayers in general.

- It must be made a point that where formalities clash with justice, justice has to win the day. Formalities which go against this principle have to be discarded, irrespective of the actual text of the law.
- The old principle still embodied in our laws that the onus of proof before the tribunals rests on the taxpayer now needs to be revisited: the courts have done their best in this regards, but tax law and practice give too little elbow room for reversing this onus.
- The creation of a just and adequate system of pensions has to be given full backing by proper fiscal incentives.
- It is not acceptable that the Revenue be given wide sweeping powers in the approval or otherwise of pension schemes. Certain past practices in this regards should no longer be tolerated.
- Incentives for development are today a normal part of the tax scene in our country, and they have proved their worth. Certain old prejudices seem to have been allayed, but one must be alert against pseudo-economic and social arguments against incentives which still crop up from time to time. In fact, such tools as venture capital and leasing appear to merit more liberal arrangements than what tax law contemplates at present.
- The fiscal departments have always suffered from a chronic shortage of staff: particularly trained and qualified staff. Staff compliments must be updated and reasonable steps taken regarding incentives for training.
- The fiscal departments are too often given, or claim to be given, discretionary powers as to the determination of the amount of tax payable. Old case law may indicate that where discretion is so given and properly exercised, the results of its use cannot be queried further, but such restrictive practices belong to another age. The tribunals cannot be expected to take it upon themselves to overturn Revenue practices which, *prima facie*, may rest validly on law and practice. It should therefore be made clear in the legislation itself that any decision which affects the amount of tax payable is subject to appeal.
- In particular, the old established rule that no appeal lies to the court on points of fact needs to be revisited. In actual fact, this appears to have been already done in the case of the Duty on Documents and Transfers Act: why should income tax and value added tax lag behind?
- Tax legislation (including for this purpose the Legal Notices) is now atrociously long and complicated. Moreover, there is also, particularly in the Income Tax Acts, a lot of dead wood. From time to time an entirely new law should be prepared to help both practitioners and the public understand better what are their actual duties, obligations and rights.
- Almost every year, a new set of anti-avoidance measures are launched. It seems to have been forgotten that unacceptable tax planning has always been provided for in the law, and action under the relative provisions has been upheld by the tribunals. The detailed sniping at specific circumstances are usually bound up with isolated cases which are then very soon lost sight of, but which leave some

rather extraordinary provisions cluttering the legislation. Current practice in this regards needs to be rethought.

- A dangerous practice has crept into the process of legislation in recent years. The annual Budget Speech by the Minister for Finance explains what changes in taxation are being contemplated for the succeeding year, and the necessary draft legislation is published immediately. By the time that the Budget debate has been finalised and all votes taken, however, considerable changes will have been effected to the law and eventually sprung on an unsuspecting public. This is legislating by stealth; it is totally unacceptable in a democratic country and should be stopped immediately.
- Facts shows that the process of appeal to independent tribunals is not functioning properly. Paradoxically, this emerges from the sharp decrease in such appeals following the introduction of the Administrative Review Tribunal. One must ask whether the process of establishing the correct amount of tax payable has gained or lost through the new system. A thorough review of the situation is clearly called for. Perhaps the time has come to examine whether a system of mediation and/or arbitration could be introduced in the process before matters are referred to the Administrative Review Tribunal.
- Revenue investigations should be reserved solely for cases where there exist fears of serious fraud or evasion. The idea often mooted that there should be some system of 'lottery' whereby cases are selected for detailed investigation should be repudiated in no uncertain terms. Nor should action be taken solely on the basis of anonymous information, unless this is backed by *prima facie* evidence of a certain weight, and substantiated by more than mere rumours or evident personal vendettas. Reference need only be made to right no. 11 given to tax payers by the Taxpayers Charter.
- Investigations should be carried out reasonably, in a serious manner and without 'third degree' connotations. Any aggressive approach violates human rights, and is in fact counter-active.
- The move towards collection of tax by deduction at source is welcome and should be extended. Technically, this might result in some loss of revenue because the system glosses over what could be important information regarding a taxpayer's real income, but the clear advantages, administrative and otherwise, of withholding taxation have been seen in the flow of revenue it generates, and in the incentives which it provides for the release into the economy of hidden or hoarded funds.
- The Revenue easy way out of solving difficult cases by the raising of 'estimated' assessments must be carefully regulated. It is appreciated that there is always a measure of guesswork in such cases, but even an estimate has to be reasonable. In no case must this procedure be used to invert the onus of proof.
- The term 'arrears of revenue' should be restricted solely to cases of tax which is really due and collectible. It is of no use for the fiscal departments to state that they have millions of euros in uncollected tax, but then to state in the same breath

that only a tiny fraction is really due and collectible. Antiquated systems of fiscal reporting which lead to this situation should be over-ridden once and for all. Specialised, high powered tribunals may need to be set up to clear such dead wood, while a professional collecting agency has been found to be very useful in tackling the problem of unpaid tax.

- Unfortunately, there appears to be very little consultation with stakeholders. This is a fundamental stage in the process of legislation and public administration. Government would have nothing to lose by introducing such processes, and in fact it would have a lot to gain. There should be a structured policy of consultation on a regular basis.
- No legal instrument, including double taxation treaties, should be enacted without prior consultation with stakeholders, though obviously in some cases urgency and/or confidentiality, including public security, might otherwise dictate.

SNIPPETS

END OF AN ERA – THE LAST ‘ASSESSOR’ PASSES AWAY

The death of Mr. Gontran Borg last month means that the ‘assessors’ recruited on the introduction of income tax in Malta in the mid-twentieth century have now all passed away. This so-called departmental closed grade was constituted on the pattern which had already existed in the Succession/Death Duty Branch of the Inland Revenue Department for many years, but the practice created its own problems and was never repeated. In fact, not all in the group so recruited remained in Government service till retiring age. Apart from Mr Borg, the group also comprised Mr Richard Flores-Martin, Mr Edgar Cauchi, Mr Wilfred Castillo, Mr Lawrence Dalmas, Mr Salvu Mallia, Mr Salvino Tellus, Mr Joseph Attard, Mr Victor Camilleri, Mr Charles Cassano, Mr Wilfred Fenech and Mr Louis Cassar Demajo. R.I.P. old friends and colleagues!

GAP IN THE DUTY ON DOCUMENTS AND TRANSFERS ACT

In the published text of the law, articles 36, 37 and 38 of the D.D.T.A. are shown as having been cancelled and repealed. As a matter of curiosity, article 36 concerned the charge of duty on “any assignment of any debt or other right, referred to in Sub-Title VII of Title VI of Part II of Book Second of the Civil Code” and on contracts of antichresis. The reference to debts was probably the longest cross reference ever! In any case, the assignment of debts lies at the basis of factoring and other sophisticated financial operations so that the provision had to be removed as it would have constituted a serious impediment in the specialised operations of certain foreign banks registered in Malta. Contracts of antichresis, on the other hand, long ago virtually disappeared from the local scene. Later expansion of charges in other directions made good any possible loss of revenue. Article 37 levied duty on documents regarding the transfer of motor cars. This charge had given rise to problems of administration, and it was also eventually substituted by other fiscal arrangements. Article 38 had wound

up the arrangements concerning the other two articles by laying down that the relative assignments or transfers had to be made in writing on pains of nullity.

EXCESSIVE FORMALITIES DERIDED

In case no 1 before the Court of Appeal, dated 3 April 1951, the Court *inter alia* held that it was anti-juridical to limit taxpayer's rights of submission of all relevant reasons in support of an appeal. "Modern juridical practice, particularly in a quasi-juridical context, abhors formalisms and favours freedom in convincing the judicial authority, and it is therefore wrong to presume restrictive procedural practices which are incompatible with what the law has expressly laid down". This was very much in line with the advice tendered by a leading Scottish jurist when the Code of Organisation and Civil Procedure was being prepared in the mid-nineteenth century to the effect that: "... there is a medium between over strictness in regard to form and a dangerous laxity of procedure, and the safer side to err upon is to disregard errors and deviations which do not affect substantial rights.....". More than one and a half centuries have passed since then, and although further liberal advice by the distinguished gentleman was not immediately accepted and several years had to pass before legislative steps were taken in this regards, the courts themselves have never been reluctant to ignore arguments which though well constructed appeared to be excessively formalistic. With all due respect, Well Done!

ANOMALIES RE TAX APPEALS

The main fiscal laws (Income Tax, Value Added Tax and Duty on Documents and Transfers) all give aggrieved taxpayers the right of appeal against departmental decisions regarding the amount of tax payable. The appeal is to be made to the Administrative Review Tribunal set up under the Administrative Justice Act (Cap 490). Either party, that is the taxpayer or the relative department, can thereafter appeal to the Court of Appeal if dissatisfied with the Tribunal's decision. However, in the case of Income Tax (Cap 372, art 35(5)) and of Value Added Tax (Cap 406, art 47(1)), an appeal can only be made on points of law. In the case of the Duty on Documents and Transfers Act, Cap 384, there is no such restriction: a former restriction on the same lines appears to have been dropped when the law was amended to switch first stage appeals from the Board of Special Commissioners to the Administrative Review Tribunal. This actually appears to be in line with the provisions of the Administrative Justice Act which makes no such restrictions regarding appeals from decisions delivered by the Tribunal (see art 22(1) of Cap 490). While one would not wish to have the Court of Appeal bothered with minor issues of points of fact, the position appears to require attention, both as regards the principle of whether points of fact should continue to be excluded from the Court, as also regarding the above difference between the laws. Various solutions may be possible: perhaps the most satisfactory would be to continue admitting appeals on all points of law, but to admit also appeals on points of fact when the tax in dispute is in excess of

a given amount. This could seem to discriminate against the smaller taxpayer, but a similar provision already exists in the arrangements for appeals to the Court of Appeal under the three laws in question. Thus, where the tax in dispute is less than EUR 1,165,000, the appeal has to be made to the Court in its Lower Jurisdiction. There is no stipulation regarding appeals where the tax is higher, as it is only stated that the appeal has to be made to the Court of Appeal, but the relevant provision appears to emerge from the Second Schedule to the Administrative Justice Act – but the Value Added Tax Act does not appear in that Schedule: another Anomaly?

TRUSTS AND TRUSTEES IN THE LINE OF FIRE¹

LITIGATION ON TRUST RELATED MATTERS²

Life gets complicated

Trusts have been and are being created for a wide variety of reasons, often in an international context under foreign jurisdictions. Innumerable purposes may be sought to be achieved on the setting up of a trust, including asset protection. Some of these purposes may have a whiff of illegality (or at least under-handedness) about them, but there are a thousand and one other purposes which are perfectly legal and have been found to be of great help in the modern commercial and social life of most countries. This is shown by the continued development of the institute not only in Common Law countries in which it first appeared sometime in the middle ages, but also in other countries where the principles inherent in trusts are unknown, if not also contrary to the basic codified laws of the country concerned. As a creation under common law, trusts were born and developed almost totally free from Government intervention, though under the watchful eye and guidance of the courts, but the spreading of the institute to other jurisdictions has required direct action by the state to enable the assimilation of what would have otherwise been alien concepts. The process has been helped by the Hague Convention On The Law Applicable To Trusts and Their Recognition, with the individual countries then introducing Recognition of Trusts Acts in their legislation to enable them to integrate the Convention into their own laws³. Inevitably, following the spread of trusts to 'non-traditional' countries, new concepts have been introduced, some of which would not have been acceptable in the 'traditional' countries.

¹ Third in the series of articles on Trusts prepared for The TAX ADVISER by Edwin A. Vella.

² This article owes a great debt to a paper prepared by Prof. Peter G Willoughby, O.B.E., J.P., LL.B., LL.M., TEP. some years ago.

³ In Malta this was done through Act XX of 1994, The Recognition of Trusts Act (Cap 374) which was however repealed by Act XIII of 2004 and Legal Notice 497 of 2004 following amendments to the Trusts and Trustees Act (Cap 331) which consolidated trust provisions into one law.

Trusts under attack

Trust law has always been a fertile ground for litigation, but following the massive increase in the number of countries which provide trust legislation litigation has increased exponentially. Some of the main issues discussed may be set out as follows:

- Attacks alleging invalidity of trusts for failure to meet essential criteria.
- Attacks on the grounds that a trust is invalid under the laws of the settlor's home jurisdiction.
- Attacks on trusts on the ground that they are not valid as proper wills.
- Attacks from creditors seeking to set trusts aside as frauds on their claims, or for any of the reasons set out above.
- Allegations that the trust has not been properly administered and that the trustees have acted in breach of trust.
- Attempts by beneficiaries (and others) to obtain copies of trust documents.
- Disputes regarding compliance with letters of wishes.
- Problems with protectors and the exercise of their powers.

It does not appear that, to date, there has been much litigation in Malta regarding trusts, but it is in the nature of things that such attacks will appear sooner or later..

Alleged invalidity

The principal attack on trusts on the grounds of alleged invalidity has been on the issue that the trust is a sham as it was imply an *alter ego* of the settlor who maintained full control and direction of the trust affairs (as well as ultimate interest in the trust assets) through the provisions of the trust deed itself, or through tight provisions in letters of wishes, or through the institute of an external protector who would be ready (and authorised) to override the trustees at the behest of the settlor. This line of attack may not actually be very fruitful in Malta, seeing that the law now contemplates the settlor being the sole beneficiary of the trust, while the various provisions enabling the use of trusts for specified commercial purposes are very much on the same lines. Letters of Wishes may themselves be open to attack, irrespective of their being labeled 'confidential'. The office of 'protector' is now also part and parcel of the law, and not simply something thought up by practitioners to reassure settlors about their natural fear of vesting trustees (especially professional trustees whom they do not know and with whom they have likely never met) with their property. However, the limited powers of veto usually given to a protector, including also the power of appointing and dismissing trustees, has not been considered as seriously endangering the validity of a trust as long as his primary purpose is seen to have been that of defending and safeguarding the interests of the beneficiaries.

A much derided practice of appointing as first beneficiary of a trust a renowned body of persons who would actually never know about their appointment and could then be conveniently set aside by the trustees in the exercise of their discretion, no longer

seems to be favoured by practitioners. These were the so called 'Red Cross Societies' trusts which have been attacked on the grounds that there was never the intention of benefitting the society concerned so that it could be argued that the trust was null and void as there was no actual beneficiary named: one of the basic requirements for the establishment of a valid trust.

Another possible line of attack is that the trust's provisions may not be according to the laws of the settlor's home jurisdiction. Thus, our law contains provisions safeguarding mandatory rules concerning spouses' rights such as the community of acquests, and on rights of spouses, descendants and ascendants on inheritances. But these safeguards are restricted to rights granted under the law of Malta only to persons domiciled in Malta, and no provision of our law could be invoked back home by foreigners having a trust set up in Malta⁴. Thus, the heirs and other holders of mandatory rights under foreign civil law, or sharia law, as well as legislation in Japan and other countries, would have to try their luck under their home legislation, but not under Maltese law.

One has also to be wary of possible attack on the grounds that the substance of the trust was actually that of a will, and that the trust was not set up in line with the very clear (if complicated) provisions of Maltese laws regarding wills. This is another danger possibly arising from the settlor maintaining too much control over the trust, but some attention to the basic rules and concepts of trusts and their creation should see to this issue satisfactorily.

The rights of creditors against the trust and its assets

It may be possible for a creditor of the settlor to have a trust set aside or disregarded by the courts. This is most likely to occur under the normal principle enshrined in Malta's legislation enabling a creditor to chase a debtor's assets when these have been fraudulently transferred in order to deprive him of his rights. In fact, the Trusts and Trustees Act specifically retains the mandatory provisions of Maltese law relating to "the protection of creditors in matters of insolvency". Such provisions are to prevail over the terms of the trust. The court may also impose maintenance payments against a beneficiary's interest in a trust⁵. Moreover, our trust law does not impose any particularly restricted time limit within which recourse is to be available to creditors as is done in various jurisdictions.

It is all very well to enumerate asset protection amongst the functions of trusts, but as has been held in an outstanding decision given by the Cook Islands Court of Appeal:

"In the end we think that the Court should strive to give a common sense approach to a piece of legislation which is at once very sophisticated but also ineptly drafted in parts.

⁴ Articles 6A and 6B of Cap 331. In the Cayman Islands, for example, the same principles emerge from the Cayman Islands Trusts (Foreign Element) Law, 1987.

⁵ Article 6A of Cap 331.

We think that the better view is that Parliament, in attempting to balance the interest of settlors, trustees and creditors, has prescribed certain limitation periods; that the right to sue on either a cause of action or a judgement is abridged but not eliminated, and that a common sense interpretation should allow for intention to be given to those two concepts. It should not be lightly assumed that Parliament intended to defeat the claims of creditors by allowing international trusts to be used to perpetuate a fraud against a creditor”⁶

So, also, in a United Kingdom case, a man made a declaration of trust of his assets in favour of his wife and children and put the instrument away in his safe. He incurred various liabilities to the bank which, in due course, sought and obtained an order over the assets. The bank had no knowledge of the alleged trust which was only disclosed after the order was made. The court held that the debtor had no real intention of benefitting his wife and his children and that therefore the declaration of trust was mere pretence or sham which could not have priority over the charging order⁷.

Surely no court will uphold any provision blatantly designed to enable debtors to evade their creditors: where the real merits of a case clearly lie with the creditors, the court will strive to find against the debtor, trust or no trust. The court will declare that most arguments raised by the debtor are irrelevant: what will be considered to be relevant is that the debtor had set up the trust for the sole purpose of concealing his assets from his creditors. The court will lift the veil so put up and consider the trust assets subject to a charging order. It may be noted that this line of attack can place many so-called asset protection trusts in grave danger where settlors retain undue control over trust assets. On the other hand, asset protection trusts may be extremely useful where the creditor's claims are, to any degree, frivolous, vexatious or outrageously dangerous⁸.

Breach of trust: proper administration

Breach of trust is defined in our law⁹ in the following terms:-

“Any breach of duty imposed on a trustee by this Act or by the terms of the trust or the proper law of the trust, and any act or neglect on the part of the trustee which is not authorized or excused by this Act, or the proper law of the trust...”

The breach of trust discussed below is not that which would result through illegal or criminal activities by the trustees as these would fall under the normal provisions of law. The breach of trust discussed is that caused by shortcomings on the trustees' part regarding the onerous duties imposed by law, practice or theory, particularly the

⁶ South Orange Grove Owners Association v Orange Grove Partners and Others (1995).

⁷ Midland Bank Ltd v Wyatt (1994) EGCS 113.

⁸ Probably the most famous asset protection trust was that set up by Phillips in the Netherlands on the occasion of the occupation by Nazi Germany in the Second World War. The company set up a trust outside the country and settled all its foreign located assets for the benefit of its shareholders. In this way, the Nazis were prevented from getting hold of these extensive assets.

⁹ Articles 2 and 4 of Cap 331.

requirement that: "Trustees shall in the exercise of their powers and discretions act with the prudence, diligence and attention of a *bonus pater familias* and observe the utmost good faith"¹⁰. This requirement may be actually more onerous than in the original model found in the Jersey Trust Law.

The duties of trustees are many and onerous. They are especially onerous in relation to trust companies owned and operated by large institutions, such as banks or accountancy and lawyers' firms which usually advertise and claim special skills. Institutional trustees must still observe the fundamental duty of putting the interests of the beneficiaries before everything else. Trust records which show that the trustee has regularly taken instructions from the settler who is referred to as the 'client' or the 'customer' could constitute *prima facie* evidence of breach of the overriding duty of the trustee to act in the best interest of the beneficiaries. Trust records may also show that the trust's investments have been managed by a sister company owned by the bank (or other trustee), which is charging fees for its services. This could constitute evidence of failure to understand and observe the fiduciary duty of the trustee not to make secret profit out of the trust under his control. A trustee who can be shown to have put its commercial interests above those of the beneficiaries will be guilty of breach of trust, and cannot expect protection from the court. As has been stated: "a trustee owes undivided loyalty to the beneficiaries"¹¹. Another case makes the point even clearer:

*"It was the trustee's duty to conduct trust business with the care that a reasonably prudent businessman would extend to his own affairs, and, in the case of a private company in which he was a majority shareholder, a prudent businessman would not be content to receive only such information on that company's activities as was dispensed at annual general meetings. Moreover, a professional corporate trustee, such as a bank, owed higher duty of care and was liable for loss caused to a trust by neglect to exercise the special care and skill which it professed to have.....As a controlling shareholder under the settlement, (the bank) was under a duty as a trustee to ensure that it received an adequate flow of information in time to enable it to protect beneficiaries' interests by preventing the project from being commenced and later from becoming the financial disaster it did. The bank was therefore in breach of trust in neglecting to ensure that it received such information... it followed that the bank's breach of trust had caused the loss and that it was liable for that loss. The loss to the trust fund could have been avoided (as I find) without difficulty or disruption had the bank been prepared to lead, in a broad sense, rather than to follow"*¹².

It is often attempted to reduce the potential liability of trustees under the above so-called Bartlett principle by providing in trust deeds that trustees need not become involved in the management of trading or other companies whose shares are held by

¹⁰ Article 21(1), *ibid*.

¹¹ *Cowan v Scargill* [1985] Ch 270 at 292.

¹² *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 All ER 139.

the trust unless they have actual knowledge of an act of dishonesty or malpractice. A word of warning is here necessary, however, because it may be felt that when exemption is given to trustees as aforesaid, there comes a point when exculpation becomes inconsistent with the core concept of a trust and the trustees' responsibilities. While it may be possible to exclude liability even for gross negligence so long as the trustee has not acted dishonestly, there is a point beyond which the parties cannot agree to relieve a trustee for breach of a trust duty. Beyond such point, this sort of contract is invalid because it is repugnant to law¹³. One important development in Malta regarding trustees, is that they are no longer expected to enhance the value of the property in the trust. Amendments made in the year 2004¹⁴, removed this onus which had been carried forward into our law from that of Jersey, and was additional to the obligation that trustees had to safeguard the property in a trust and its value. In reality, seeking to enhance the value of trust assets does not seem to be an appropriate onus to lay on trustees.

Attempts by beneficiaries (and others) to obtain documents

Whenever a beneficiary is concerned about the proper administration of a trust, there will normally be an attempt to obtain copies of trust documents and records held by the trustees. The general feeling of the courts appear to have been up to fairly recently that the beneficiary is entitled to see all trust documents because they are trust documents, and because he is a beneficiary. In a sense they refer to his belongings and he is entitled to have access to them. He has a proprietary right which gives one access to documents which are his own. The courts would give exemption only in certain circumstances. This was clearly an excessive interpretation of the principle of proprietary rights within the context of trust matters, and the courts (both of the United Kingdom and elsewhere) will now refuse to enforce a blanket right to view documents¹⁵. Among the documents about which the court may have reservations would be a letter of wishes given by the settler to the trustees, particularly if this is clearly labeled 'confidential' (see below). Yet, there still continues to be authority for regarding a beneficiary's right to information as stemming from his status as beneficiary and the trustee's status as an accountable fiduciary. The right to information has also continued to be held to be a necessary incident of the trustee-beneficiary relationship at the core of a trust.

Trustees are required to make beneficiaries aware that they are beneficiaries "because knowledge of the trust is necessary to make the trustee accountable, this being the essential core incident of the relationship of trustee and beneficiary" which requires the trustee "to find and pay a beneficiary entitled to an income or capital payment, thereby making such beneficiary aware that he is a beneficiary"¹⁶. This duty assumes greater significance when the beneficiary is installed as such through the exercise of

¹³ *Browning v Fidelity Trust Company* 250 F 321 (3rd Cir 1918).

¹⁴ Act XIII of 2004.

¹⁵ Maltese law now gives ample powers to beneficiaries in this regards.

¹⁶ Prof David Hayton Q.C. – *Journal of International Trust and Corporate Planning*, Vol 5 no1.

discretionary powers. It necessarily follows that blanket attempts by settlors to exclude all trust information from beneficiaries will not be enforceable because they are repugnant to a trust relationship. It however remains dubious whether this principle can be applied to possible beneficiaries before they actually become beneficiaries.

Apart from beneficiaries there can be others who seek information such as foreign tax authorities, particularly when these are made in virtue of international agreements for the exchange of information. Such demands when made at official level should only be resisted on the strength of guidance sought from, and given by a competent court.

Access to letters of wishes

Problems often arise as to what extent beneficiaries should have access to letters of wishes. In 1992, the New South Wales court in Australia¹⁷ the case was commenced by a person within a class of eligible beneficiaries under the terms of the trust. The court held that a memorandum or letter of wishes provided by the settlor for use by trustees in exercising their discretionary powers is not a document which the trustees are bound to disclose to a beneficiary as it was provided on a confidential basis. On the other hand, it was also argued in the same case that a letter of wishes may be just a supplement to the trust deed, and it should be available to beneficiaries on the same basis as the trust deed itself – with the proviso, however, that it would not be readily available if the settlor had expressly made it a confidential document. It therefore appears that the crux of the question is really whether the settlor has specifically stated that his letter of wishes is being made on a confidential basis, whereupon it would form part of the confidential relations of a client with his adviser and not subject to release. This principle could also hold good in official requests for information from trustees.

In the same case, the court reiterated that trustees are not invariably bound to take a letter of wishes into account in exercising their discretionary powers. Trustees will no doubt take the wishes of settlors into account in exercising discretion, but they will still be bound to exercise discretion in a proper way after taking into account all proper considerations. If the settlor wants to make his wishes binding on the trustees, he should do so as an integral part of the trust deed, not in any supplement thereto.

Problems regarding protectors

The Trusts and Trustees Act makes provision for the office of protector of a trust¹⁸. The office of protector appears to be a fairly late development in the law of trust, and the main problem in its regard is whether a protector holds a fiduciary position. The situation is often complicated by the identity of a protector who may also be a beneficiary or occupy some other office within the purview of the trust such as that of a director of a company whose shares are owned by the trust. Our law makes only

¹⁷ Hartigan Nominees Pty Ltd v Rydge (1992) 29 NSWLR 405.

¹⁸ Article 24A.

brief provisions regarding a protector, the most important being that he is not to be deemed to be a trustee. This seems to indicate that a protector is not to be considered to be holding a fiduciary office: certainly the normal rules regarding trustees in this respect cannot be made automatically applicable¹⁹. Moreover, although the law lays down that a protector is to have power to appoint new or additional trustees, to remove a trustee and to require a trustee to obtain his consent before exercising a discretion, these powers are made subject to possible overriding by the terms of the trust itself. There is here no question of hard core provisions with mandatory status. In this sense, the position in Malta may be somewhat in conflict with court decisions in other countries which have tended to hold that protectors do have a fiduciary status, but it must be admitted that the precise status of a protector has still to be clarified in our country, and is at present rather fluid.

INCOME TAX AND OIL PRODUCTION

Early Provisions

When exploration for oil in Malta was taken up on an organized basis in the late 1950s, there was a debate as to whether there should be ad hoc tax legislation, or whether the necessary tax provisions could be introduced in the existing Income Tax Act. The latter route was finally selected, and the necessary measures were implemented by Act V of 1958. The relevant provisions set out what deductions were to be given on account of expenses against the revenue accruing to an oil company from the sale of oil produced in Malta.

Oil companies were given concessions over certain areas by way of lease which they were licensed to explore and from which, if successful, to extract oil. Any oil so produced belonged to the company. Government take would be three way: rentals according to the area leased, (payable annually irrespective of whether oil was produced or not), a royalty per barrel of oil produced, and income tax at the rate of 50% on the company's profits calculated as set out in the law. Rentals and royalties payable to the Government were not to be expensed against revenue, but it was provided that when royalties started being payable, the royalties due would be reduced by the rentals paid, and when income tax eventually became due, a credit would be allowed for the amount of the combined rentals/royalties payable as above. In this way, the minimum Government take would be the rentals payable, while the maximum would be tax on the company's profits at 50%: partly payable as tax and partly payable as rentals and royalties.

Some particular arrangements were made, such as balancing allowances and deductions for intangible exploration, drilling and development costs. These predated their introduction into the general tax law by several years. A provision was

¹⁹ As he is not a trustee the breach of trust rules of article 4 of Cap 331 are not operative against a protector.

however also inserted whereby no deduction was to be given for interest expenses. This issue has remained a bone of contention with companies seeking licences, and still appears in the latest arrangements discussed below. The fear has apparently always been that because of the vast amounts of capital involved in exploring for and producing oil, schemes could be prepared to siphon off by way of interest substantial profits that would otherwise yield large amounts of tax. No Malta tax would be payable on the interest so paid as the oil company would normally be a non-resident entity registered abroad, where it would also borrow capital and pay interest.

Another concept was introduced by Act VIII of 1959, whereby pre-trading expenses incurred for the purposes of the eventual trade were to be considered as having been incurred in the first year in which the trade was actually carried on, that is to say when the sale of oil commenced. This is crucial since, without this provision, exploration expenses would have been treated as capital outgoings, and either disallowed or possibly amortised over a long period. It is difficult to conceive how the industry would be viable without such provisions which still form part of the current arrangements. General provisions in this regards were also introduced much later in the Income Tax Act, though on a limited basis.

The 1977 Amendments

Further provisions were introduced by Act X of 1977. The scheme for integrating rentals, royalties and income tax was abandoned, and rentals and royalties became deductible as expenses incurred in the production of the income. Possible Government take was thereby increased considerably. Another innovation was the introduction of the concept of ring-fencing, which meant that every licence granted was to be deemed to have brought into existence a separate taxpayer. A company granted three licences to explore and produce oil from three different concessions was therefore to be deemed to constitute three different taxpayers, so that no expenditure or loss could move from one concession to another. Nor could any past losses from previous concessions be brought forward against current profits. It was also provided that dividends paid out of profits taxable at 50% were not to be taxable in the recipients' hands, but at the same time no credit for tax suffered by the company (commonly called tax at source) would be due. Again, this prevented any possible depletion of the 50% tax through the full imputation system used by Malta for the taxation of corporate income.

The Advent of the Production Sharing Contract (P.S.C.)

The method of taxation of oil production was changed radically by Act IX of 1981. The system of Production Sharing Contracts had by then been introduced whereby any oil discovered and produced in Malta remained the property of the Government, and the licensed oil company became only entitled to a share of the oil eventually produced, if any. The oil company effectively became the contractor of Government, doing all the work and putting up the necessary capital. Its gain, if at all, would be the share of

the oil due to it in terms of the relative contract. The rate of tax upon oil companies remained 50%, and the ring-fencing provisions remained in force, but the total chargeable income for tax purposes was now to be computed as agreed in each individual Production Sharing Contract. This mainly depends on the way in which it is agreed that the oil is to be shared between the Government and the oil company after the deduction of expenses allowable in the computation of the income as set out in the Section of the P.S.C. dealing with Recoverable Costs. Prominent among non-deductible items are again interest expenses, so that appropriate arrangements have to be made through negotiation in each individual P.S.C. There was no question now of royalties being payable, but rentals payable to Government regarding the area granted for exploration and production became deductible..

The Production Sharing Contract assumed over-riding importance. Under a P.S.C., the Contractor is entitled to recover his costs from the value of the petroleum lifted: provided that not more than 75% of the petroleum recovered in any given year can be utilised for this purpose. This means that Government will get a share of any petroleum produced from the very first. A complicated formula is then embodied in each P.S.C. defining how that element of the petroleum produced considered to constitute "Profit Petroleum" is to be shared.

Income tax is levied at 35% on the annual value of the petroleum produced and allocated to the oil company acting as Contractor, less expenses. The rate of tax was reduced from 50% to 35% in 1995. The P.S.C. provides that losses and expenses are to be carried forward indefinitely. In this respect, the P.S.C. follows general income tax provisions. Losses comprise also all unabsorbed expenditure on exploration and development of the oil field for production. It is made clear that only this tax is payable by the oil company on its operations, and there are specific exemptions from any sort of turn-over taxes, on distributions made to shareholders and on branch profits remitted to head office.

Provision is also made in the P.S.C. regarding the taxation of expatriate employees, and for the numerous sub-contractors who render particular services. As regards interest as a deduction to the oil company itself, to which reference has already been made, ad hoc arrangements have to be worked out in each P.S.C. It is clear that an outright prohibition of deductibility is not really viable and, if enforced, would require a major re-structuring of the economics of the P.S.C. reviewed below.

All Production Sharing Contracts have a law stability clause written into them so that, during the period in which the P.S.C. remains in force, its particular provisions cannot be superseded by amendments to Malta's legislation that would worsen the company's position. This provision applies to all legislation, including tax legislation. Another curious point is that while one normally speaks about oil production and the taxation of oil profits, the Income Tax Act still refers to "petroleum" rather than the more generic "oil". The P.S.C. follows suit. Another unusual provision is the denial

of double taxation relief to oil companies, though, as set out below, it is difficult to conceive how a company engaged in oil production in Malta could be entitled to double taxation relief in Malta.

The Economics of a Production Sharing Contract

The Petroleum (Production) Act (Cap 156 of the Laws of Malta) stipulates that “ownership of any Petroleum in its natural condition in strata wherever existing in Malta is hereby vested in the Government of Malta and the right of searching and boring for and getting such petroleum shall be subject to a licence granted under the provisions of this Act”. The same Act then defines Malta to include the land underlying Malta’s territorial waters. The full extent of the territorial waters is subject to various provisions in other laws of Malta, to the rules of international law and negotiations with other countries.

The Production Sharing Contract seeks to convert a successful strike into a financial gain for the Government in two principal ways: through the retention of a part of the oil lifted, and through tax on the profits made by the contractor granted a licence to search for and recover oil. The oil lifted remains the property of Government, but a substantial part thereof has to be assigned to the contractor to cover his costs and to enable him to risk money and effort in the hope of eventually making an attractive profit. The costs of the entire operation of exploring, drilling and recovering oil, including all capital expenditure, are borne by the contractor. The risk for the contractor is that it may spend several millions and be left with a dry well at the end of the operation. (Actually, this happens in the vast majority of cases).

The second contribution to Government finances comes by way of taxation of the contractor’s profits. The ratio between the intake from the sale of oil retained by Government and that from income tax will usually vary according to the stage reached in the exploitation of any find:

- a) At the start of production the contractor would usually be recouping its expenses, pre-trading and capital. No tax revenue can be expected at this stage, with Government take being restricted to its share from 25% of the oil lifted which is the minimum reserved for this purpose, and cannot be utilized to absorb expenses.
- b) During the normal life-time of an oil field, it may be expected that the total take from oil and by way of tax would be roughly equal.
- c) In the case of a large discovery, the take from Government’s share of oil may be expected to exceed substantially that from taxation of the contractor’s profits.

Variations in the market price of oil need not necessarily disturb the above ratios, though they will obviously have repercussions. On the other hand, any variation in the rate of tax would definitely have serious repercussions. These possibilities are not being gone into in this context.

Malta's Model Production Sharing Contracts have always been structured to achieve the above results, and all P.S.C.s signed with oil companies over the years were based on this pattern. The P.S.C. currently in use follows suit. The mix of revenue from oil retained by Government and from tax levied on the contractor is now standard practice under P.S.C. arrangements, not only in Malta but also elsewhere, and it also seems to be accepted by the oil companies. There seems to be no particular necessity to try to chase down the origin of the system, and it is taken as a given fact. (In fact, the first proposals in this regard appear to have been made by the World Bank in the 1970s, though the concept of Production Sharing appears to have originated some years before in Indonesia). Negotiations on the financial aspects of a P.S.C. seem set to remain mainly a question of finding the right formula for profit-sharing to achieve satisfactory takes for both Government and the contractor through the system, given that the rate of tax appears set to remain fixed at 35% for the foreseeable future.

It may be pointed out at this stage that the rents and various bonuses due under a P.S.C. are not being considered as part of the economic or financial structure of the P.S.C. Though taken individually, and at the moment in time when they are received by Government, these payments may be fairly substantial, they pale into insignificance when compared with the twin revenue streams that would materialise as above should there be a successful strike.

The 2011 amendments to the Income Tax Act

The rather poor legislative arrangements at the basis of the tax provisions in the context of a P.S.C. regime were finally removed by Act IV of 2011. This repealed the original arrangements in article 23 of the Act which had survived since 1958, as well as the minimal arrangements introduced by Act IX of 1981 on the advent of the P.S.C. regime in Malta. The new arrangements are again found in article 23 and follow very closely the arrangements in the Model P.S.C. currently in use. Thus, the division of production between Government and the oil company as agreed in each P.S.C. is catered for, the carry forward of unabsorbed expenses, the ring-fencing of production fields are also present. There has moreover been added a prohibition of inter-company group relief, and the taxation at a low rate of withholding tax (which is optional) in the case of nonresident sub-contractors (including individuals) who render services to the oil company concerned. Several of these arrangements have long existed in the P.S.C. Model itself, but may not have had a sound legal basis.

Possible non-oil production income is to be charged gross without any deduction for expenses (as these would presumably have been taken against production) at the rate which may be appropriate in its case.

An old prohibition which denied possible double taxation relief under a tax treaty was deleted, as such possibility was never real. On the other hand, a prohibition has been entered in respect of possible Commonwealth Double Taxation Relief. Though

unlikely, this is technically possible, and it was clearly thought advisable to remove this possibility. (The two other forms of double taxation relief available under the Income Tax Act, namely Unilateral Relief and Fixed Rate Foreign Tax Credit are not relevant).

At the same time that this up-dating was taking place, the occasion was taken to replace the old definition in the Income Tax Act as to what constitutes 'petroleum': it may be noted that the practice of referring to oil as 'petroleum' has been retained.

All the tax provisions relating to oil production have now been concentrated in the Income Tax Act itself, and Legal Notices which used to regulate certain issues have been repealed.

Rate of Income Tax Chargeable

It has to be noted that although the rate of tax chargeable on oil production is at 35%, which is the same rate chargeable on all companies, the tax on oil production is specifically levied as a separate charge under article 56(15)(a) of the Income Tax Act, so that changes in the general rate of company tax should not affect the rate chargeable on oil profits. A particular feature of the P.S.C. arrangements is that the revenue streams for Government depend on negotiations with the oil company concerned in so far as Government's share of the oil is concerned and for the determination of the chargeable income for tax purposes, but not on the statutory provisions of the Income Tax Act regarding the rate of tax chargeable. Everything else is negotiable, but not the rate of tax. In consequence, while arrangements can be made for a greater share of oil to be retained by Government as production increases, the rate of tax on profits, however large or small these may be, is fixed at the time of the signing of the P.S.C. The division of production between the two parties depends on commercial considerations and negotiations, but the rate of tax is immutable – except by law. As the oil company could have no redress against a change in the tax rate through Parliament acting under its sovereign powers, a stabilisation clause is entered in the P.S.C. to the effect that if the laws of Malta, including but not limited to tax laws, were, subsequent to the signing of the contract, to be changed as to materially diminish the Contractor's rights or expand the Contractor's obligations, the contract would be adjusted to restore the contractor's rights and obligations as on the date of the signing of the P.S.C. In other words, in so far as the rate of tax is concerned, and this is always specified in a P.S.C., if the applicable rate goes up from the current 35% to say 45%, should it not be possible for the provisions of the new law to be superseded by the rate stipulated in the P.S.C. itself, the contract would have to be adjusted to restore the status quo. This could be achieved (without ruling out other possibilities) by a revision of the two revenue streams indicated above through an amendment in the production sharing arrangements.

Taxation in the Model Production Sharing Contract

Section 14 of the Model P.S.C. makes provisions regarding “Taxes and Duties”. This Section is a multi-purpose provision which may be analysed as follows²⁰:-

- S.S (1) exempts the Contractor from customs duty (including VAT) on imports made for its own use in petroleum operations, but otherwise reaffirms liability to all charges and taxes;
- S.S (2) states that income tax payable by the Contractor shall be levied at 35%; it also contains the basic formula for ascertaining taxable income;
- S.S (3) binds the Contractor not to claim any double taxation relief to which it may be entitled;
- S.S (4) gives a guarantee against the imposition of certain taxes;
- S.S (5) contains provisions regarding the taxation of non-resident sub-contractors and of expatriate employees (presumably both of the Contractor and of sub-contractors); it also re-affirms certain exemptions available under mainstream tax law;
- S.S (6) makes provision for separate obligations and liabilities should the Contractor be composed of more than one entity.

The provisions of S.S (1) were drafted at the time that VAT was a possibility for the future: today VAT is a fact. The provision should now be re-drafted in accordance with the current situation. Legal backing is also necessary. The details in the Income Tax Act as to how chargeable income is to be computed in the context of the P.S.C. are sufficient and are also flexible enough for application in practice. S.S (4) gives a guarantee that no further income tax, under any name or form whatsoever, will be imposed in respect of the production profits taxable at the agreed rate. This does not appear to be backed by any law, and provision may need to be made accordingly. S.S (5) provides for the taxation of sub-contractors and expatriate employees, as well as for their exemption in certain cases. It has close links with Malta’s double taxation treaties and general tax law regarding employees. It now has legal backing in that the I.T.A. provides for a final withholding tax in respect of sub-contractors which is authorised under tax law. The last part of S.S (5) states that the provisions of the law stabilisation clause (Section 24) are not to apply to companies and individuals falling under the subsection (i.e. to sub-contractors and expatriate employees), except to the extent that it is there stated that the P.S.C. is subject to the Laws of Malta. The guarantee concerning tax given to the Contractor is not, therefore, extended to sub-contractors and to employees of both. This could be acceptable since the tax stability arrangements form part of the financial deal between Government and the Contractor, while sub-contractors and expatriate employees are peripheral and appear in the P.S.C. mostly to create administrative convenience in their regard.

²⁰ It is understood that somewhat more elaborate provisions have been proposed, but these have not yet been published.

Current Tax Provisions re Petroleum Production

The current provisions in the Income Tax Act concerning petroleum are as follows. There are no provisions in this respect in the Income Tax Management Act except for a minor matter referred to in the next following Section of this Report.

- Art 2(1), gives a definition of the term 'petroleum'.
- Art 7(10), contains a reference to 'oil prospecting companies'.
- Art 12(1)(p), exempts from tax dividends distributed out of oil production profits; it links up with art 59(1)(a) below..
- Art 23, replaces the original petroleum provision enacted in 1958.
- Art 56(13), establishes the rate of tax chargeable on persons engaged in the production of petroleum in Malta.
- Art 59(1)(a), links up with the provisions of art 12(1)(p) above to deny any imputation of tax suffered by the oil company to its shareholders on the distribution of dividends.
- Art 89(7), denies double taxation relief to oil companies under the arrangements for Commonwealth relief.

Possible Further Amendments to the Income Tax Act

Apart from the suggestions made above, possible further amendments to the Income Tax Act in connection with the taxation of oil profits are as follows:-

Article 7(10): This provision forms part of what was known as the 'Special Concession', a tax amnesty linked with the introduction of P.A.Y.E. and Provisional Tax in 1973 and the declaration of 1973 as a tax-free year. Art 7(10) sought to remove the exemption for 1973 in respect of profits made from oil production. The provision obviously never became operative and is today totally obsolete – together with all other provisions in the law concerning the Special Concession.

Article 12(1)(p): This provision exempts from tax dividends distributed out of oil profits. It reflects the system of imputation in the general provisions of Malta's tax law whereby the tax suffered by a company is normally imputed to its shareholders in satisfaction of their own liability, with any excess being refunded. The provision links up with that in article 59(1)(a) which is considered further down and which denies any imputation of the tax suffered by oil companies to its shareholders on the distribution of dividends. The tax suffered by an oil company (which was higher than that payable by any shareholding company at the time this provision was enacted) was thereby safeguarded. In actual fact, the provisions of article 59(1)(a) seem, in this regards only, to have been superseded by later amendments to the Income Tax Act, now found in article 60(a), which denies any set-off of tax on dividends in the case of exempt recipients, and by article 48(1)(a) of the Income Tax Management Act which denies a refund in the same circumstances. The provisions of article 59(1)(a) may not be necessary any longer, but those of article 12(1)(p) should be retained, particularly

in view of the major recasting of the taxation of corporate profits being carried out in an ongoing process. This has made the general structure regarding company distributions extremely complicated and possible repercussions on the taxation of oil profits cannot be defined with total certainty.

Article 59(1)(a): This provision has already been mentioned above. The wording “other than a dividend referred to in article 12(1)(p)” contained in this sub-article was later made superfluous by the general provisions contained in paragraph (a) of the final proviso to article 60, and article 48(1)(a) of the Income Tax Management Act. The said wording may therefore be deleted. The general provisions contained in article 60(a) of the I.T.A. and the analogous provisions of article 48(1)(a) of the I.T.M.A. whereby no refunds emerging from the imputation system of taxing corporate profits will be granted where the recipient of the dividend is himself exempt from tax thereon, cover the matter satisfactorily, and no specific provisions are required in respect of oil profits.

Article 89(7): Article 89 of the Income Tax Act makes provision for double taxation relief in the case of Commonwealth countries. The relief may be due both where the taxpayer is deemed to be resident in Malta and also when he is deemed to be resident in another Commonwealth country. It is, however, only due if the two countries operate a broadly similar system of taxation and of double taxation relief. Where there is a tax treaty between Malta and the relative country, the provisions of this article are not operative. This automatically rules out most Commonwealth countries from the ambit of this provision seeing that Malta has treaties with a large number of these countries, and it is most unlikely that an oil company would register in a non-treaty Commonwealth country to suffer tax in that country and claim relief in Malta. The provisions of article 89 are also clearly not intended for corporate bodies, though this issue does not appear to have ever been tested. It is in fact difficult to see how the workings set out in this article of the Income Tax Act could be operative in the case of oil profits. The general opinion on this point appears to be that this provision is in fact superfluous, but administrative caution may require its retention.