MALTA INSTITUTE OF TAXATION

Deductions and Exemptions

1

DISCLAIMER

This material is the intellectual property of Malta Institute of Taxation. It is for the sole use of the registered attendee of the MIT Course on Tax Compliance to whom it was made available, exclusively for their educational purposes. The publication, whether in whole or in part, reproduction, distribution and/or editing of the content is prohibited. Likewise, the recording of a lecture in audio or video, including by means of screenshots, is strictly prohibited.

Any views and opinions that may be expressed during the lecture are those of the speaker and may not necessarily reflect or represent the views and opinions of the Malta Institute of Taxation. Any reference to practices, whether past or present, should not be construed as an endorsement thereof.

As this material is intended for educational purposes only, it does not in any way constitute advice and should not be relied upon as such.

The content of this presentation is intended to reflect the Lecturer's understanding of the legislation and/or practices applicable as at the date of first delivery, that is, the date specified below.

MALTA INSTITUTE OF TAXATION

2

AGENDA

- Deductions - General Principles
- Disallowed expenses
- Allowable expenses
- Balancing Statement
- Allowable expenses – in a trade, business profession or vocation
- Pre-trading expenditure
- Group Relief Provisions
- Article 12
- Non-resident exemptions
- Individual dividend exemption
- Participation exemption
- Permanent establishment exemption

MALTA INSTITUTE OF TAXATION

3

Deductions
General Principles

4

Deductions
General Principles

- Not all the expenses incurred by a taxpayer in a given year are deductible for tax purposes. As a result there are instances where the profit before tax of a company does not necessarily equate to the chargeable income of the same company.

- The ITA sets out two tests for deductibility through the application of Articles 14 and 26. Article 14 sets out the general rule for deductibility and a list of allowable expenses (positive test) and Article 26 sets out a list of deductions that are not allowable for tax purposes (negative test).Both tests need to be satisfied in order for an expenses to be treated as deductible for tax purposes.

MALTA INSTITUTE OF TAXATION

5

Deductions
General Principles

- Article 14(1) sets out the general rule for deductibility as follows:
- *"For the purpose of ascertaining the total income of any person there shall be deducted all outgoings and expenses incurred by such person during the year preceding the year of assessment to the extent to which such outgoings and expenses were **wholly and exclusively incurred in the production of the income**…"*
- If an expenditure is incurred wholly and exclusively in the production of the income, the expense in question would be deductible even if it not specifically mentioned in the list in Article 14, insofar as it is not specifically excluded in Article 26.
- Article 14A to Article 14H represent domestic or private expenses which are allowed as deductions for tax purposes.

MALTA INSTITUTE OF TAXATION

6

Deductions
General Principles

Wholly and exclusively

- The expenditure must therefore be incurred with the sole intention of producing the income and expenses not incurred with this sole intention would not be deductible expenses for tax purposes.
- Such expenses not incurred with the sole intention of producing the income may include expenses for private use.

MALTA INSTITUTE OF TAXATION

7

Deductions
General Principles

In the production of the income

- This suggests a direct relationship between the expenses incurred and the income generated therefrom.
- Expenses therefore, as a general principle, need to be incurred during the production of the income.
- Expenses with the exception of losses incurred in a trade, business, profession or vocation are generally allowed only against the income to which it relates.

MALTA INSTITUTE OF TAXATION

8

Article 26
Disallowed expenses

9

Article 26
Disallowed expenses – Article 26(a)

As outlined earlier, Article 26 contains a list of expenses specifically disallowed for tax purposes:

- *"Domestic or private expenses other than those specifically allowed by this Act."*
- Any domestic or private expenses are disallowed by virtue of this article. Nevertheless one may argue that such expenses would not represent expenses incurred wholly and exclusive in the production of the income and would still not fall within the scope of the general rule in Article 14(1).

MALTA INSTITUTE OF TAXATION

10

Article 26
Disallowed expenses – Article 26(b)

- *"any outgoings and expenses to the extent to which they are not wholly and exclusively incurred in the production of the income and, in the case of gains or profits chargeable under article 4(1)(b), not being furthermore necessarily incurred in the performance of the duties of the relative employment or office"*
- This article further emphasises that expenses are only deductible to the extent that they are not wholly and exclusively incurred in the production of the income. However it is important to take into account that this Article also outlines that in respect of employment income or income from holding of an office, expenses need to **necessarily incurred in the performance of the duties relative to employment or office.**
- The word **"necessarily"** in this article would imply an added and more rigorous test for deductibility in respect of employment income or from income from the holding of an office.

MALTA INSTITUTE OF TAXATION

11

Article 26
Disallowed expenses

- *"any loss, diminution, exhaustion or withdrawal of capital, any sum employed or intended to be employed as capital or any expenditure for a capital purpose or of a capital nature save as provided in article 14 and 23"*
- This Article represents the foundation as a result of which expenses which are capital in nature are not deductible for tax purposes. An exception is made for capital expenses which are specifically allowed for in terms of Article 14 and 23 of the ITA.

- *"the cost of any improvements"*
- This provision is very similar to the previous paragraph.

MALTA INSTITUTE OF TAXATION

12

Article 26
Disallowed expenses

- *"any loss or expense which is recoverable under any insurance or contract of indemnity"*
- *"rent of any premises or part of premises not paid for the purpose of producing the income"*
- *"any payments of a voluntary nature"*
- Limited voluntary payments may be deductible through specific provisions in respect of donations which may be treated as deductible expenses for tax purposes.

MALTA INSTITUTE OF TAXATION

13

Article 26
Disallowed expenses

- Article 26(h) disallows deductions in respect of any interest, discount or premium paid or payable to a person not resident in Malta.
- This article has three cumulative tests which all need to be satisfied:
  - *"The person not resident in Malta derives or benefits from the said interest, discount or premium, directly or indirectly, from the granting of loans or from any form of credit to finance the acquisition, development, construction, refurbishment, renovation of immovable property situated in Malta…"; and*
  - *"the said interest discount or premium is exempt from tax under the provisions of article 12(1)(c)(i); and*
  - *"the payor of the interest, discount or premium is a person related to the person not resident in Malta"*
- A specific definition of related persons applies for the purposes of this article by virtue of which if one of the following is satisfied, the payor and the non-resident person would be deemed to be related persons:
  - "that person [the payor] and the person not resident in Malta are, directly or indirectly, controlled or beneficially owned to the extent of more than 10% by the same persons; or
  - "That person owns, directly or indirectly more than 10% of the ordinary share capital or voting rights of the person not resident in Malta"

MALTA INSTITUTE OF TAXATION

14

Article 14
Allowed expenses – Incurred in the production of the income

15

Article 14
Allowed expenses

- As discussed earlier in this lecture, Article 14 includes the general rule for deductibility.
- In addition, Article 14 also sets out a number of expenses which are specifically allowed for tax purposes.
- In the next slides we will be going through the allowable expenses in terms of Article 14.

MALTA INSTITUTE OF TAXATION

16

Article 14
Allowed expenses - Interest

- Article 14(1)(a) contemplates deductibility of interest expenses and reads as follows:
- *"borrowing costs incurred by such person where the Commissioner is satisfied that they were wholly and exclusively incurred for the purpose of that person's trade, business, profession or vocation, or on capital employed for the purpose of acquiring income: Provided that the deduction allowance under this paragraph shall be subject to such limitations, and may be carried forward, in such manner as may be prescribed and in accordance with guidelines issued under article 96(2);"*
- This has been changed recently in order to reflect the interest limitation rule contemplated in ATAD.

MALTA INSTITUTE OF TAXATION

17

Article 14
Allowed expenses - Interest

- An interest expense is only deductible if the interest is payable on capital employed to acquire the income. Therefore interest is only deductible against the income generated through that capital.
- If a company takes a loan to finance the acquisition of shares in another company, the interest expense incurred on that loan may only be utilised as a deductible expense against dividend income generated from those shares. In the event that the shares do not generate any dividend income, the interest expense would not represent a deductible expense in the hands of the first company.
- The deductibility of interest expense is also now required to be assessed in light of the interest limitation rule introduced as a result of ATAD.

MALTA INSTITUTE OF TAXATION

18

Article 14
Allowed expenses - Rent

- Article 14(1)(b) contemplates deductibility of rent expenses and reads as follows:
- *“rent paid by any tenant of land or buildings occupied by him for the purpose of acquiring the income”*
- It is important to note that any rent paid in respect of immovable property when such immovable property was not being utilised, is not to be treated as a deductible rental expense.

MALTA INSTITUTE OF TAXATION

19

Article 14
Allowed expenses - Repairs

- Article 14(1)(c) contemplates deductibility of expenses incurred for the repair of moveable or immovable property and reads as follows:
- *“any sum expended for **repairs of premises, plant or machinery** employed in acquiring the income, or for the **renewal, repair or alteration of any implement, utensil or article** so employed”*
- Repairs are allowed in respect of premises, plant or machinery and therefore the expense to restore the asset to a state where it will continue to generate income represents a deductible expense.
- On the other hand renewal, repair or alternation of any implement, utensil or article is allowed in terms of this article. Implements, utensils and articles may refer to small hand tools and such other assets. Capital allowances are not available in respect of such assets and therefore no deduction for the original cost is allowed, however the cost of replacing the items would be deductible.

MALTA INSTITUTE OF TAXATION

20

Article 14
Allowed expenses - Pensions

- Article 14(1)(e) contemplates deductibility of pensions incurred and reads as follows:
- *"any sum contributed by an employer to a pension, saving, provident or any other society or fund which may be approved by the Commissioner as may be prescribed"*
- Pensions payments represent deferred payment of wages for past employment and therefore such payments are deductible for tax purposes insofar as the society or fund is approved by the Commissioner.

MALTA INSTITUTE OF TAXATION

21

Article 14
Allowed expenses – Candidates for election

- Article 14(1)(k) contemplates deductibility of expenses incurred in respect of candidates for election and reads as follows:
- *"any sum or expenses proved to the satisfaction of the Commissioner to have been paid or incurred by or on behalf of a candidate for election as member of the House of Representatives on account of or in respect of the conduct or management of such election"*
- The proviso to Article 14(1)(k) also stipulates that the deduction is allowed only:
  - in respect of an elected candidate; and
  - is the lesser of the maximum amount of expenditure allowed under the General Elections Act and the actual expense.
- This article represents an allowable deduction which, in theory, would not fall within the scope of the general rule as it does not represent an expense in the production of the income.

MALTA INSTITUTE OF TAXATION

22

Article 14

Expenses incurred in a Trade, Business, Profession or Vocation – Intellectual Property Rights

- Article 14(1)(m) contemplates the deductibility of expenses on Intellectual Property Rights:
- *“any expenditure of a capital nature on intellectual property or any intellectual property rights incurred by a person and proved to the satisfaction of the Commissioner to have been incurred in the production of the income of such person:”*
- The expense has to be spread equally over a number of years not being less than three years.

MALTA INSTITUTE OF TAXATION

23

Article 14

Allowed expenses – Capital allowances

- As a rule of thumb, only expenses of a revenue nature (i.e. not capital) are allowable deductions against chargeable income.
- However deductions for wear and tear (capital allowances) in respect of capital assets are allowable and Article 14(1)(f) reads as follows:
- *“a deduction in respect of the wear and tear of any plant and machinery, and any premises being an industrial building or structure, arising out of the use or employment of such property in the production of the income…”*

Capital allowances are, in principle, the tax equivalent of the depreciation for accounting purposes.

MALTA INSTITUTE OF TAXATION

© Malta Institute of Taxation 2023

24

Article 14
Allowed expenses – Capital allowances

- Industrial Building or structure is defined in Article 2 of the ITA and “includes a building used as a hotel or a car park or offices, as may be prescribed…:
- *“(a) the word "hotel" includes any number of constructions suitably furnished and equipped, with accommodation in single or double bedrooms, provided that such constructions are grouped together and have in common ancillary hotel services and amenities within a single and defined parcel of land and are operated by a common management for the accommodation and for the use of guests against payment;*
- *(b) the word "car park" refers to a structure of a commercial nature available to the general public, which is the main income generating activity of any person claiming any deductions in its respect under article 14(1)(f) or (j), and which is first used for this purpose after the 1st January 2012”*

MALTA INSTITUTE OF TAXATION

25

Article 14
Allowed expenses – Capital allowances

- The definition of the term ‘Offices’ on the other hand can be found in Rule 2 of the Industrial Buildings and Structures (Capital Allowances) Rules, S.L. 123.173.
- "offices" means an office business centre that is first used and occupied on or after the **1st January 2016**. The word "office business centre" means any number of units suitably furnished and equipped, with a total office space area of more than **two thousand five hundred square meters**, to be used **exclusively for offices**, provided that such units are grouped together and have in common ancillary services and amenities within a single and defined parcel of land and are **operated by a common management for the use by the owner or tenants**, in the course of their trade or business against payment

MALTA INSTITUTE OF TAXATION

26

Article 14
Allowed expenses – Capital allowances

- The cost and date of acquisition of the property is made with reference to the original transfer in the event that the owner acquired the property through the provisions of Articles 5(9), 5A(4)(f) or 5A(4)(j) of the ITA.
- For the purpose of the deduction in terms of Article 14(1)(j) of the ITA, the capital expenditure should not include the cost of the land and the value attributable to any real right on the airspace, if any.
- In the event the cost of the land is not identified, the cost of the land would be deemed to be the market value of the land at the time of construction or acquisition of the property.

MALTA INSTITUTE OF TAXATION

27

Article 14
Allowed expenses – Capital allowances

- The Industrial Buildings and Structures (Capital Allowances) Rules also includes the following specific restrictions:
- If capital allowances are claimed in respect of offices, the Deduction of Expenses in respect of Immovable Property Rules, S.L. 123.26 would not be available in respect of that year or any subsequent year.
- If a deduction in terms of S.L. 123.26 is claimed, no capital allowances may be claimed in respect of the same property during that year or any subsequent year.
- If the 15% tax on rental income in terms of Article 31D in respect of offices in any year, no capital allowances may be claimed in respect of the same property during that year or any subsequent year of assessment.

MALTA INSTITUTE OF TAXATION

28

Article 14
Allowed expenses – Capital allowances

- Capital allowances can only be claimed as a deduction against the income generated from the use of the asset on which capital allowances are being claimed and cannot be set off against other sources of income.
- The allowable deduction for capital allowances is to be availed of by the person making use of the asset in the production of the income, regardless of whether he is the owner of the asset (therefore the person suffering the burden of wear and tear is allowed the deduction).
- Any amount which is not claimed as a deduction in a particular year may be carried forward to subsequent years.
- The total capital allowances claimed as a deduction in respect of a particular asset must not exceed the cost of the asset.

MALTA INSTITUTE OF TAXATION

29

Article 14
Allowed expenses – Capital allowances

- Capital allowances on industrial buildings and structures are claimed at 2% per year of assessment [Article 14(1)(f)]. In addition an initial allowance of 10% in terms of Article 14(1)(j) on assets which are new or first used in Malta.
- Capital allowances for plant and machinery are claimed with reference to the cost of the asset used in the production of the income over a minimum number of years prescribed in the "Deduction for Wear and Tear of Plant and Machinery Rules" Subsidiary Legislation 123.01 of the laws of Malta.
- In respect of Motor Vehicles not being commercial motor vehicles, if the cost of acquisition is in excess of €14,000. The capital allowances are to be computed with reference to a cost of €14,000.

MALTA INSTITUTE OF TAXATION

30

Article 14
Allowed expenses – Capital allowances

SCHEDULE

Amended by: L.N. 323 of 2001; L.N. 291 of 2010; L.N. 322 of 2018.

Minimum number of years over which items of plant and machinery are to be depreciated

Category		Years
1.	Computers and Electronic Equipment	4
2.	Computer software	4
3.	Motor Vehicles	5
4.	Furniture, Fixtures, Fittings and Soft Furnishings	10
5.	Equipment used for construction of buildings and excavation	6
6.	Catering Equipment	6
7.	Aircraft airframe, aircraft engines, Aircraft engine or airframe overhaul and Aircraft interiors and other parts	4
8.	Ships and vessels	10
9.	Electrical and Plumbing Installations and Sanitary Fittings	15
10.	Cable Infrastructure	20
11.	Pipeline Infrastructure	20
12.	Communication and Broadcasting Equipment	6
13.	Medical Equipment	6
14.	Lifts and Escalators	10
15.	Air-conditioners	6
16.	Equipment mainly designed or used for the production of water or electricity	6
17.	Other machinery	5
18.	Other plant	10

MALTA INSTITUTE OF TAXATION

31

Article 24
Balancing Statement

32

Article 24
Balancing Statement

- If a taxpayer has claimed deductions for capital allowance in respect of an asset was subsequently disposed of, destroyed or put out of use as being worn out, obsolete, useless or no longer required before the source of income has ceased, the taxpayer is obliged to submit (with the tax return) a balancing statement in order to arrive at the balancing adjustment.

MALTA INSTITUTE OF TAXATION

33

Article 24
Balancing Statement

- A balancing statement must contain the following information:
  - Cost of the asset
  - Capital allowances claimed; and
  - Proceeds upon disposal.
- The difference between proceeds and the Tax Written Down Value (TWDV) of the relevant asset yields a balancing charge (if proceeds exceed TWDV) or a balancing allowance (if proceeds are less than TWDV).
- Nevertheless a balancing charge may not exceed the amount of capital allowances and initial deductions claimed in respect of that asset.

MALTA INSTITUTE OF TAXATION

34

Article 24
Balancing Statement

Roll Over Relief – Balancing Charge is greater than cost of the new asset:

- If the asset disposed of is replaced by another asset, insofar as the balancing charge would have been greater that the cost of the new asset, the taxpayer may opt for the balancing charge to be reduced by the cost of the new asset.
- This effectively grants a full claim for the cost of the new asset immediately and therefore no capital allowances may be claimed in such instances on the new asset.

MALTA INSTITUTE OF TAXATION

35

Article 24
Balancing Statement

Roll Over Relief – Balancing Charge is less than cost of the new asset:

- If the asset disposed of is replaced by another asset, insofar as the balancing charge would have been less that the cost of the new asset, the taxpayer may opt for the balancing charge to be set-off against the cost of the new asset.
- This effectively does not bring to charge the balancing charge and therefore capital allowances on the new asset would be computed on the cost less the balancing charge set off.

MALTA INSTITUTE OF TAXATION

36

Article 14
Allowed expenses – Incurred in a trade, business profession or vocation

37

Article 14
Expenses incurred in a Trade, Business, Profession or Vocation

- In the next slides we will be covering specific items which are listed as deductible in terms of Article 14 of the ITA but are only deductible in respect of a trade, business, profession or vocation.

MALTA INSTITUTE OF TAXATION

38

Article 14

Expenses incurred in a Trade, Business, Profession or Vocation – Bad Debts

- Article 14(1)(d) contemplates deductibility of bad debts and reads as follows:
- *"bad debts incurred in any trade, business, profession or vocation, proved to the satisfaction of the Commissioner to have become bad during the year immediately preceding the year of assessment notwithstanding that such bad debts were due and payable prior to the commencement of the said year:*
- *Provided that all sums recovered during the said year on account of amounts previously written off or allowed in respect of bad debts shall for the purposes of this Act be treated as receipts of the trade, business, profession or vocation for that year;"*

MALTA INSTITUTE OF TAXATION

39

Article 14

Expenses incurred in a Trade, Business, Profession or Vocation – Bad Debts

- With respect to Bad Debts the IRD issued the Bad Debt Guidelines which set out a number of criteria, in substantial detail which indicate whether a debt may be considered as bad for the purpose of Article 14(1)(d). Section 5 of the BDG includes:
  - The debtor has died leaving no, or insufficient assets to cover the debt;
  - The debtor has become insolvent;
  - The debtor cannot be traced and the credit has been unable to ascertain the existence of, or whereabouts of, any assets against which action could be taken;
  - The debt has become statute-barred;
  - In case of a corporate debtor, the debtor has been or is in the process of being liquidated and does not have sufficient funds to pay the whole debt or part thereof;
  - The creditor has taken all legally available steps to recover the debt (these may include notices, judicial letters and law suits);
  - The debtor has absconded and his whereabouts are not known.
- A debt falling within the remit of any of the above would to be deemed to have become bad in the strict sense.

MALTA INSTITUTE OF TAXATION

40

Article 14

Expenses incurred in a Trade, Business, Profession or Vocation – Bad Debts

- In addition to the scenarios outlined in the previous sense, the BDG contemplate, in Section 6, a possible deduction for bad debts in instances where the debt has not become bad in the strict sense.
- A deduction for bad debts, not being debts bad in the strict sense, may be allowed where *"on an objective view of all the facts or on the probabilities existing at the time the debt, or a part of the debt, is alleged to have become bad, there is little or no likelihood of the debt, or part of the debt, being recovered"*
- The BDG continue to outline a number of a number of steps which would be expected to be undertaken (all or some of them) by the taxpayer:
  - Reminder notices issued and telephone/mail contact ids attempted;
  - A reasonable period of time has elapsed since the original due date for payment of the debt;
  - Formal demand notice is served;
  - Issue of, and service of, a summons;
  - A judgement has been entered into with the delinquent debtor;
  - Execution proceeding have been instituted to enforce judgement;
  - The calculation and charging of interest is ceased and the account is closed;
  - A valuation has been made of any security held against the debt;
  - Sale of any seized or repossessed assets

MALTA INSTITUTE OF TAXATION

41

Article 14

Expenses incurred in a Trade, Business, Profession or Vocation – Bad Debts

- Further to the conditions reviewed in the previous slides, in terms of Section 7 of the Bad Debt Guidelines, a debt may still be deemed to have become bad and therefore allowed as a deduction if:
  - *"the period of time which has elapsed since the original due date for payment of the debt exceeds twenty four months; and*
  - *the debt is equivalent to an amount not exceeding €1,200; and*
  - *the total bad debts figure being written off during any year of assessment does not exceed 2% of the turnover of the taxpayer in the year of assessment in which the debt is written off; and*
  - *prima facie proof is provided that taxpayer has taken adequate steps in an attempt to recover the debt or a portion of the debt"*

MALTA INSTITUTE OF TAXATION

© Malta Institute of Taxation 2023

42

Article 14
Expenses incurred in a Trade, Business, Profession or Vocation – Bad Debts

- Bad debts are allowable on the basis that the relevant item of income was previously brought to charge and the bad debt has been incurred in a trade, business profession or vocation and in the production of the income.
- No deduction is allowed for capital loans or advances.
- An exception to the two points above is in respect of a taxpayer which is a money lender and the loans provided form an integral part of its activity. In such instances the Capital sum granted as a loan may be claimed as a deduction even though it represents a capital element of the loan and was never brought to charge.
- Bad debts arising on income reported in the same year can only be deducted if they have become bad in the strict sense (Section 5 of the BDG).
- Any bad debts, which are subsequently recovered, are to be subject to tax.

MALTA INSTITUTE OF TAXATION

43

Article 14
Expenses incurred in a Trade, Business, Profession or Vocation – Trading Losses

- Article 14(1)(g) contemplates deductibility of trading losses and reads as follows:
- *“the amount of a loss incurred by any person, solely or in partnership, in any trade, business, profession or vocation during the year preceding the year of assessment…” which, if it had been a profit, would have been assessable under this Act…”*
- It is important to note that losses are only allowed if the loss, would have been chargeable to tax had it been a profit.
- Losses are to be calculated in the same manner a profit would be calculated, and therefore taking into account all allowable deductions with the exception of capital allowances and initial allowances.
- Initial allowances and capital allowances are the last items which should be taken into account when determining the chargeable income.

MALTA INSTITUTE OF TAXATION

© Malta Institute of Taxation 2023

44

Article 14
Expenses incurred in a Trade, Business, Profession or Vocation – Trading Losses

- A trading loss incurred by a person in a trade, business, profession or vocation may be set off against other streams of income.
- If other sources of income are insufficient to absorb the loss, the loss can be carried forward indefinitely until it is utilised.
- The trading losses carried forward are not dependent on the continued existence of the trade, business, profession or vocation which generated that loss.
- Losses cannot be utilised to set off income which stands to be allocated to the Final Tax Account.

MALTA INSTITUTE OF TAXATION

45

Article 14
Expenses incurred in a Trade, Business, Profession or Vocation – Trading Losses

- In addition, subject to the group loss provisions, “no person shall, notwithstanding anything contained in any other Act, be entitled to a deduction under this paragraph in respect of any loss incurred by another person”
- This is provided that:
  - Where a merger or division referred to in the Ruling (Income Tax and Duty Treatment of Mergers and Divisions) Rules is being effected for bona fide purposes to the satisfaction of the Commissioner;
  - As a result of the merger or division the trade or business previously carried on by a company (first company) shall be carried on by another company or companies or other person involved in the merger (second company); and
  - The first company is entitled to any loss, wear and tear or initial allowance;
  - The Commissioner shall be entitled to grant his permission for the trading losses, capital allowances or initial allowances or part therefore as he may deem fit

MALTA INSTITUTE OF TAXATION

46

Article 14

Expenses incurred in a Trade, Business, Profession or Vocation – Expenses incurred for the promotion of a trade or business

- Article 14(1)(l) contemplates the deductibility of expenses incurred for the promotion of a trade or business and reads as follows:
- *"any expenditure incurred by a person engaged in a trade, business, profession or vocation for the purpose of promoting that trade, business, profession, or vocation including any expenditure on market research and obtaining market information, advertising or other means of soliciting business, providing samples, and participating in fairs and exhibitions"*
- Deductions are not allowed for expenditure of a capital nature. Therefore, for example, construction of permanent signs are not allowable.

MALTA INSTITUTE OF TAXATION

47

Article 14

Expenses incurred in a Trade, Business, Profession or Vocation – Childcare Services

- Article 14(1)(n) contemplates the deductibility of expenses incurred for the promotion of a trade or business and reads as follows:
- *"any sum proven to the satisfaction of the Commissioner to have been paid by an employer to a licensed or registered childcare centre as fees in respect of childcare services for the children of his employees, up to a maximum of nine hundred and thirty five Euro (€935) per child"*

MALTA INSTITUTE OF TAXATION

48

Article 14

Expenses incurred in a Trade, Business, Profession or Vocation – Notional Interest Deduction

- Article 14(1)(o) contemplates the deductibility of expenses incurred for risk capital and reads as follows:
- *"such sums in respect of risk capital as are aimed at approximating neutrality between debt and equity financing, as the Minister may prescribe."*
- This is the enabling provision for the Notional Interest Deduction Rules (Subsidiary Legislation 123.176 of the laws of Malta).
- Guidelines have been issued by the Inland Revenue Department in order to aid in the application of the NID Rules.
- This allows for a deduction in respect of risk capital (equity and interest free loans) as a deduction with a corresponding income recognised by the shareholder.

MALTA INSTITUTE OF TAXATION

Article 14

Expenses incurred in a Trade, Business, Profession or Vocation – Notional Interest Deduction

- Important Concepts for the application of the NID Rules:
- Calculating Risk Capital – the following equation is to be used **Y = A x B** where:
  - Y is the interest which may be claimed;
  - A is the reference rate; and
  - B is the Risk Capital **less** any Risk Capital directly employed as securities, interest in a partnership, contributions and any other loans or debts that do not bear interest provided that such investments generated or would have generated exempt income.

MALTA INSTITUTE OF TAXATION

Article 14
Expenses incurred in a Trade, Business, Profession or Vocation – Notional Interest Deduction

- Reference Rate – defined in the rules as “the risk free rate set by reference to the yield to maturity on Malta Government Stocks with a remaining term of approximately 20 years plus a premium of 5%.” The Guidelines issued by the IRD make reference to a quarterly statistic issued by the Central Bank of Malta.
- Risk Capital – “…any share premium, positive retained earnings, loans or other debt borrowed by the undertaking which do not bear interest, and any other reserves resulting from a contribution to the undertaking,…” or the amount attributable to the Malta permanent establishment of a company or undertaking not resident in Malta.

MALTA INSTITUTE OF TAXATION

51

Article 14
Expenses incurred in a Trade, Business, Profession or Vocation – Notional Interest Deduction

- The deduction contemplated in the NID Rules is available only against income which stands to be allocated to the Foreign Income Account or the Maltese Taxed Account.
- The deduction is limited to 90% of this chargeable income with any excess to be carried forward to the following year.
- An amount equal to the NID claimed and an additional 10% (limited to the amount which would stand to be allocated to the respective Foreign Income Account or Maltese Taxed Account, prior to this reallocation) would stand to be allocated to Final Tax Account.

MALTA INSTITUTE OF TAXATION

© Malta Institute of Taxation 2023

52

Article 14
Expenses incurred in a Trade, Business, Profession or Vocation – Notional Interest Deduction

- The NID claimed by a company would represent Notional Interest Income in the hands of the shareholder.
- The shareholder may claim a deduction for NID itself, without the 90% limitation in respect of the Notional Interest Income.
- In view of the fact that NID would impact the shareholder, there must be unanimous approval by the shareholders for the Malta company to claim the NID.

MALTA INSTITUTE OF TAXATION

53

Article 14
Expenses incurred in a Trade, Business, Profession or Vocation – Notional Interest Deduction

- The NID Guidelines clarify the following:
- NID should first be used against Notional Interest Income, if any.
- NID should then be directly attributable to the income generated and any amount which is not directly attributable to any source of income, it would stand to be indirectly apportioned to the various sources of income on the basis of the chargeable income.
- Directly attributable NID carried forward is to be utilised against the same source of income in the subsequent year.
- In the event that no income is generated during a particular year, no NID may be calculated and carried forward.
- Should a company limit the NID being utilised, the amount which may be carried forward is the amount in excess of the 90% of the chargeable income.

MALTA INSTITUTE OF TAXATION

54

Article 14(3)
Pre-trading expenses

55

Article 14(3)
Pre-trading expenses

- Expenses incurred prior to the commencement of a trading activity are generally not allowed as deductions as they would not have been incurred in the production of the income.
- Nevertheless Article 14(3) contemplates expenses incurred before the commencement of a trade insofar as expense
  - Has been incurred not more than 18 months before the commencement of the trade; and
  - Even though was not deductible, would have been deductible in terms of the general rule in Article 14(1)
- Not all expenses are allowed as pre-trading expenses and the Pre-Trading Expenditure Regulations (Subsidiary Legislation 123.62 of the laws of Malta) contains an exhaustive list of expenses so allowable, namely:
  - staff training
  - salaries and, or wages
  - advertising.

MALTA INSTITUTE OF TAXATION

56

Other consideration

57

Other considerations

- Expenses need to be supported by the relevant VAT invoice, where applicable, in order for the expenses to be treated as tax deductible [Article 14(5)]
- Interest paid for late payment of VAT is deductible for tax purposes and is treated as expense incurred in the production of the income. [Article 74(b) of the Value Added Tax Act, Chapter 406 of the Laws of Malta];
- VAT Administrative penalties, however, are not deductible for tax purposes. [Article 74(c) of the VATA]

MALTA INSTITUTE OF TAXATION

58

Deductions
Group Relief Provisions

59

Deductions
Group Relief Provisions

- The "group relief provisions" contained in Article 16 to 22 of the Income Tax Act, allow for the transfer of allowable losses between companies forming part of the same group.
- Article 17(1) of the ITA stipulates that *"…allowable losses may, in the case set out in sub-article (2), be surrendered by a company, hereinafter referred to as "the surrendering company", and, on the making of a claim by another company, hereinafter referred to as "the claimant company", be allowed to the claimant company as a deduction called "group relief". A claim made by virtue of this subarticle is hereinafter referred to as a "group claim"*
- The application of the group relief provisions is subject to a number of conditions set out in the aforementioned articles.

MALTA INSTITUTE OF TAXATION

60

Deductions
Group Relief Provisions

- Allowable losses are defined in Article 22(a) of the ITA as *"…"allowable loss" or "allowable losses" shall be construed as a reference to the loss or losses referred to in article 14(1)(g), to the extent that they are incurred in the year preceding the year of assessment and are not unrelieved losses carried forward from previous years"*
- Therefore the losses which may be surrendered constitute:
  - Trading losses in terms of Article 14(1)(g) of the ITA and therefore calculated after taking into account all the relevant add backs and deductions but before claiming a deduction for capital allowances; and
  - The losses surrendered need to be surrendered in the same year of assessment in which they were incurred.

MALTA INSTITUTE OF TAXATION

61

Deductions
Group Relief Provisions

- Article 17(2) outlines that *"Group relief shall be available where the surrendering company and the claimant company are both members of the same group throughout the year preceding the year of assessment for which the relief is claimed."*
- Companies will be deemed to be members of the same group of companies if:
  - One company is a 51% subsidiary of another company and both companies are resident in Malta and not resident in any other country for tax purposes; or
  - Both companies, being resident in Malta but not resident in any other country for tax purposes, are 51% subsidiaries of a third company resident in Malta.
- Companies under common ownership of the same individual or group of individuals would not form part of a group for the purposes of the group relief provisions.

MALTA INSTITUTE OF TAXATION

© Malta Institute of Taxation 2023

62

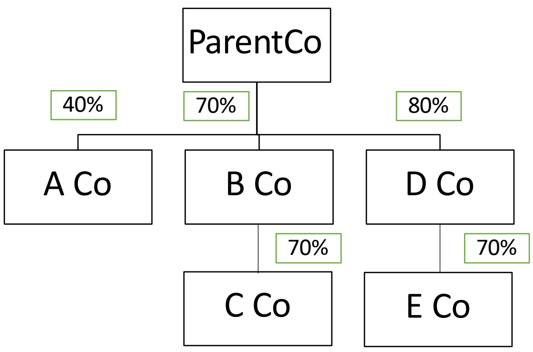
Deductions
Group Relief Provisions

- A company is a 51% subsidiary of another company, if the parent company holds or is beneficially entitled to, **directly or indirectly**, to more than 50% of:
  - The ordinary shares **and** voting rights in the subsidiary; **and**
  - Profits available for distributions of the subsidiary; **and**
  - assets available for distribution of the subsidiary on a winding up.

MALTA INSTITUTE OF TAXATION

63

Deductions
Group Relief Provisions

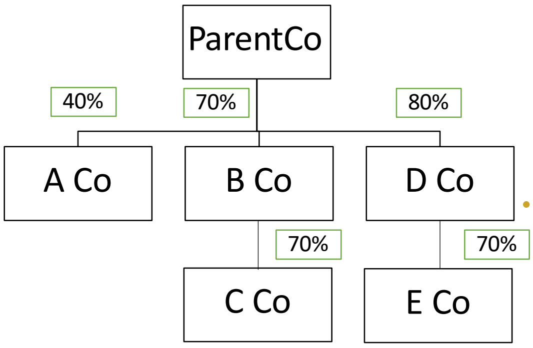


- ParentCo is the holding company of a small group of companies. All the companies are resident in Malta only.
- Assuming that the voting rights, rights to profits available for distribution and profits available on a winding up are equal to the percentage shareholding and on the basis of the structure to the left, which companies are members of the same group?

MALTA INSTITUTE OF TAXATION

64

Deductions
Group Relief Provisions

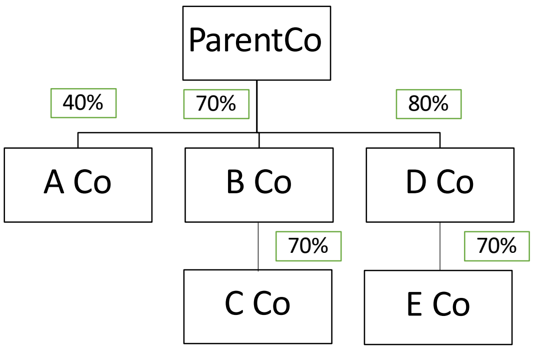


- ParentCo has direct or indirect shareholdings, as follows:
  - 40% directly in A Co;
  - 70% directly in B Co;
  - 49% indirectly in C Co;
  - 80% directly in D Co; and
  - 56% indirectly in E Co.
- Therefore only B Co, D Co and E Co are 51% subsidiaries of ParentCo, thus these companies are members of the same group.

MALTA INSTITUTE OF TAXATION

65

Deductions
Group Relief Provisions



- As outlined in the previous slide, C Co is not a 51% subsidiary of ParentCo, and therefore is not a member of a group with ParentCo or any of its other 51% subsidiaries.
- However, C Co is a 51% subsidiary of B Co, and therefore is a member of a group with B Co.

MALTA INSTITUTE OF TAXATION

66

Deductions
Group Relief Provisions

- In addition the surrendering company and the claimant company need to have accounting periods which start and end on the same dates.
- However the following exceptions apply:
  - Newly incorporated companies during the year, as long as the conditions for a group of companies were satisfied at all times after incorporation and the accounting year-end date for both companies is the same; and
  - Companies wound up during the year, as long as the conditions for a group of companies were satisfied at all times up to the winding up and the accounting start date for both companies is the same.

MALTA INSTITUTE OF TAXATION

67

Deductions
Group Relief Provisions

- When a surrendering company surrenders a loss to a claimant company, this surrender of the loss **may** be made for a consideration. However there is no obligation for compensation.
- If the loss surrendered is surrendered for a compensation:
  - The compensation is not taken into account when computing the profits or losses of either company;
  - Is not deemed to constitute a distribution; and
  - Such compensation may not exceed the amount of the losses surrendered.

MALTA INSTITUTE OF TAXATION

68

Deductions
Group Relief Provisions

- A company may surrender losses to multiple companies for each year of assessment;
- A surrendering company may surrender losses in excess of the claimant company's profits for the year. In such instances the claimant company may carry forward the losses as trading losses in terms of Article 14(1)(g).
- The losses surrendered by a surrendering company may represent a portion of the losses incurred in a particular year and as a surrendering company may not necessarily surrender the entirety of the losses incurred in a particular year.

MALTA INSTITUTE OF TAXATION

69

Deductions
Group Relief Provisions

- Losses, which had they been a profit would have been allocated to the Maltese Taxed Account or the Immovable Property Account, can only be utilised against profits which would stand to be allocated to the Maltese Taxed Account or the Immovable Property Account of the claimant company.
- Losses, which had they been a profit would have been allocated to the Foreign Income Account, can only be utilised against profits which would stand to be allocated to the Foreign Income Account of the claimant company.

MALTA INSTITUTE OF TAXATION

70

Deductions
Group Relief Provisions

- In practice it is sufficient for the surrender of the losses to be indicated in the tax returns of both the surrendering company and the claimant company.
- However, in the event that the tax return is not submitted within the time frames stipulated in the previous slide (slide 15), a certificate indicating the losses being surrendered endorsed by both the surrendering company and claimant company should be submitted to the IRD within the aforementioned timeframes.

MALTA INSTITUTE OF TAXATION

71

Article 12
Exemptions

72

Article 12
Exemptions

- Article 12 is the main article within the ITA which deals with exemptions and contains a number of exemptions which may be applicable to various taxpayers. In this section we will be covering the exemptions in Article 12.
- Other exemptions may be contained under local legislation, both in other articles of the ITA or in other chapters of the law. Some of these exemptions will be dealt with in the next section.

Article 12
Exemptions

- The exemptions contained in Article 12 of the ITA can be split into two types as follows:
  - Those which exempt from tax the income of certain persons; or
  - Those which exempt certain flows of income.

Article 12
Exempt persons

- The income of the following persons is exempt from Maltese Income Tax:
  - University of Malta [article (12(1)(a)];
  - Retirement funds or retirement schemes, other than income from immovable property in Malta [article 12(1)(d)];
  - Organisations of a public character engaged in philanthropic work (listed in SL 123.24 Exemption on Philanthropic Work Notice) [article 12(1)(e)];
  - Political parties, including clubs adhering to political parties [article 12(1)(f)];
  - Trade unions, except for income from a trade or business carried on by the trade union [article 12(1)(j)];
  - Non-resident shipowners [article 12(1)(k)]

MALTA INSTITUTE OF TAXATION

75

Article 12
Exempt persons

- The income of the following persons is exempt from Maltese Income Tax:
  - Institutions organised and operated exclusively for social welfare, civic improvement, pleasure or recreation, or for any other purpose except profit [article 12(1)(l)]
  - Philharmonic societies (band clubs) [article 12(1)(n)];
  - Sports clubs (provided that no part of the income is available for the personal benefit of any proprietor, member or shareholder, even on a winding up) [article 12(1)(o)];
  - Co-operative societies [article 12(1)(q)];
  - Collective investment Schemes, except for income from immovable property situated in Malta and investment income [article 12(1)(s)].

MALTA INSTITUTE OF TAXATION

76

Article 12
Exempt income

- The following streams of income may be exempt from Maltese Income Tax:
  - Allowances under the Social Security Act (specified by the Minister for Finance by notice published in the Gazette or announced in the annual budget speech) [article 12)(1)(b)];
  - Interest, discount, premium or royalties derived by non-residents [article 12(1)(c)(i) ITA] **(non-resident exemptions)**;
  - Gains or profits derived by non-residents on a transfer of shares in a company, units in a collective investment scheme or units and similar instruments in linked long term business of insurance [article 12(1)(c)(ii) ITA] **(non-resident exemptions)**;
  - Any dividend paid by a company registered in Malta to an individual, which dividend income represents income of the individual in excess of the relevant thresholds [article 12(1)(c)(iii)] **(Individuals dividend exemption)**;

MALTA INSTITUTE OF TAXATION

77

Article 12
Exempt income

- The following streams of income may be exempt from Maltese Income Tax:
  - Wound and disability pensions paid in respect of wounds and disabilities caused by war and any pensions granted to dependent relatives of members of the Commonwealth Armed forces killed on war service [article 12(1)(g)];
  - Capital sums received by way of commutation of pensions or retiring or death gratuities [article 12(1)(h)];
  - Scholarships [article 12(1)(i)];
  - Dividends paid by a company engaged in the production of petroleum in Malta [article 12(1)(p)];
  - Subsidies in respect of the Common Agricultural Policy [article 12(1)(r)];

MALTA INSTITUTE OF TAXATION

78

Article 12
Exempt income

- The following streams of income may be exempt from Maltese Income Tax:
  - Financial assistance for the maintenance of any child/ren by an individual from an estranged spouse (under authority of the courts or other authorities as the Commissioner may approve [article 12(1)(t)];
  - Dividend income and capital gains from a participating holding [article 12(1)(u)(1)] **(participation exemption)**;
  - Income of a company resident in Malta attributable to a Permanent Establishment outside of Malta [article 12(1)(u)(2)] **(permanent establishment exemption)**
  - Royalties, advances and similar income from patented inventions, copyright or trademarks [article 12(1)(v)]

MALTA INSTITUTE OF TAXATION

79

Article 12
Exempt income

- The following streams of income may be exempt from Maltese Income Tax:
  - Income from employment of a married person over the age of forty who has been absent from employment for a period of five years and whose name was not on the unemployment register as established by JobsPlus (income not exceeding €9,840 and applying married rates) [article 12(1)(w)];
  - Income from special individual saving accounts recognised as such by the Commissioner (deposits into such account and value of interest bearing securities must not exceed €1,000) [article 12(1)(x)]
  - Stipends paid to a student by the Government or Government institutions [Article 12(1)(y)]
  - Income or gains derived by the trustee of a disability trust or by a disability foundation from the transfer of immovable property forming part of the trust or foundation where the proceeds from the disposal are to be used exclusively to maintain the disable beneficiary [article 12(1)(z)]

MALTA INSTITUTE OF TAXATION

80

Non-resident exemption
Article 12(1)(c)(i)

81

Article 12
Exemptions

- Article 12(1)(c)(i) exempts *"any interest, discount, premium or royalties accruing to or derived by any person not resident in Malta".*
- The application of this exemption is subject to two conditions:
  - The taxpayer must not be engaged in a trade or business through a permanent establishment situated in Malta and the debt claim generating the income or the royalties are effectively connected to such permanent establishment.
  - The beneficial owner of the interest, royalty, gain or profit, is not a person resident in Malta and is not owned and controlled by, directly or indirectly, nor acts on behalf of an individual or individuals who are ordinarily resident and domiciled in Malta.

MALTA INSTITUTE OF TAXATION

82

Article 12
Exemptions

- Article 12(1)(c)(ii) exempts any gains or profits accruing to or derived by any person not resident in Malta on the transfer of:
  - any units in a collective investment scheme;
  - any units and such like instruments relating to linked long term business of insurance (including the surrender or transfer of linked long term policies of insurance);
  - of any interest in a partnership which is not a property partnership; and
  - of any shares or securities in a company which is not a property company.
- The exemption is subject to the condition that the beneficial owner of the interest, royalty, gain or profit, is not a person resident in Malta and is not owned and controlled by, directly or indirectly, nor acts on behalf of an individual or individuals who are ordinarily resident and domiciled in Malta.

MALTA INSTITUTE OF TAXATION

83

Article 12
Exemptions

- Article 12(1)(c)(ii) makes reference to the terms **"property partnership"** and **"property company"** which are defined in Article 2 of the ITA as follows:

"property partnership" *shall mean a partnership as defined in article 5(1)(b) which owns immovable property situated in Malta, or any real rights thereon, or a partnership which, directly or indirectly, holds shares or other proprietary interests in any entity or person, which owns immovable property situated in Malta, or any real rights thereon, where five percent or more of the total value of the said shares or other proprietary interests so held is attributable to such immovable property or rights:*

Provided that where a partnership, entity or person carrying on a trade or business owns immovable property situated in Malta, or any real rights thereon, consisting only of a factory, showroom, warehouse or office used solely for the purpose of carrying on such trade or business, such partnership, entity or person shall, for the purpose of this definition, be treated as not owning immovable property if not more then fifty percent of the value of its assets consist of immovable property situated in Malta, or any real rights over such property, and it does not carry on any activity the income from which is derived directly or indirectly from immovable property situated in Malta.

"property company" *shall mean a company which owns immovable property situated in Malta or any real rights thereon or a company which holds, directly or indirectly, shares or other interests in any entity or person, which owns immovable property situated in Malta or any real rights thereon where five percent or more of the total value of the said shares or other interests so held is attributable to such immovable property or rights:*

Provided that where a company, entity or person carrying on a trade or business owns immovable property situated in Malta or any real rights thereon, consisting only of a factory, showroom, warehouse or office used solely for the purpose of carrying on such trade or business, such company, entity or person shall, for the purpose of this definition, be treated as not owning immovable property if not more then fifty percent of the value of its assets consist of immovable property situated in Malta or any rights over such property and it does not carry on any activity the income from which is derived directly or indirectly from immovable property situated in Malta.

MALTA INSTITUTE OF TAXATION

84

Article 12
Exemptions

- In addition, the term “transfer” has the same meaning assigned to it in Article 5(1)(b) of the ITA, and therefore has a wide scope and includes:
- *“any assignment, sale, emphyteusis or sub-emphyteusis, partition, donation, settlement of property on trust, distribution and reversion of property settled on trust, sale by instalments, and any alienation under any title including any redemption, liquidation or cancellation of units or shares in a collective investment scheme as defined in article 2 of the Investment Services Act and maturity or surrender of linked long term policies of insurance, and any occurrence that is deemed to be a transfer in accordance with the provisions of subarticles (9A) and (13)(b), and for the avoidance of doubt includes any transfer of an asset by a company to its shareholders, or by a commercial partnership en nom collectif or commercial partnership en commandite the capital of which is not divided into shares to its members, in the course of winding up the company or partnership or in the course of a distribution of assets to its shareholders or partners pursuant to a scheme of distribution, but does not include a transfer causa mortis, or a transfer of property by the trustee of a disability trust or disability foundation to any one or more of the remaining beneficiaries of such trust or foundation or the heirs of the disabled beneficiary upon the death of the disabled beneficiary of such trust or foundation and where such remaining beneficiaries or heirs comprise only persons referred to in sub-article (2)(e)(i); for the purposes of this article, the expressions "disability trust" and "disability foundation" shall have the meaning assigned to them in article 12(1)(z)”.*

MALTA INSTITUTE OF TAXATION

85

Individuals dividend exemption
Article 12(1)(c)(iii)

86

Article 12
Exemptions

- Article 12(1)(c)(iii) exempts any dividend paid by a company registered in Malta to an individual dividends out of the taxed account (excluding the untaxed account and the final tax account) which dividend is in excess of the relevant threshold.
- However:
  - If an individual is entitled to a deduction against the dividend income, the income equal to the deduction which may be claimed, is not exempt;
  - If the chargeable income (disregarding the dividend income) of the individual is less than the relevant threshold, the exemption only applies to the dividend income in excess of the threshold.

MALTA INSTITUTE OF TAXATION

87

Article 12
Exemptions

- The relevant thresholds are as follows:

Applicable Tax Rates	Relevant Threshold
Single Rates	€19,500
Parent Rates	€21,200
Married Rates	€28,700

MALTA INSTITUTE OF TAXATION

88

Article 12
Exemptions

- Regardless of the above, as from year of assessment 2018, the provisions of Article 12(1)(c)(iii) do not apply in respect of dividend income received by an individual from companies the shares of which are listed on the Malta Stock Exchange, if such individual holds less than 0.5% of the paid-up share capital of the listed company, where such distributions are made out of profits derived in the year preceding the year of assessment 2018 or later.

MALTA INSTITUTE OF TAXATION

89

Participation exemption
Article 12(1)(u)

© Malta Institute of Taxation 2023

90

Participation exemption
Introduction

- Article 12(1)(u)(1) exempts from tax *"any income or gains derived by a company registered in Malta from a **participating holding** or from the transfer of such holding…"*
- Despite the fact that article 12(1)(u)(1) makes reference to *"any income"* the IRD have issued a clarification* that interest income would not fall within the remit of this exemption and as a result the participation exemption is generally understood to refer to dividend income and capital gains.

* https://cfr.gov.mt/en/inlandrevenue/legal-technical/Pages/Guidelines-on-the-Tax-Treatment-of-Interest-from-a-Loan.aspx

MALTA INSTITUTE OF TAXATION

91

Participation exemption
What is a participating holding

- A holding to qualifies as a Participating holding where the Malta company holds:
  - At least 5% of the equity shares granting at least 10% of two of the following three rights: (i) the right to vote, (ii) profits available for distribution, and (iii) assets available for distribution on a winding up.
  - At least one equity share and an option to acquire the remaining shares;
  - At least one equity share and the right of first refusal over the remaining shares;
  - At least one equity share and has the right to appoint a director;
  - Equity shares with a value, on the date of acquisition, of €1,164,000 and held for 183 consecutive days; and
  - Equity shares for the furtherance of its own business and not as a trading stock.

MALTA INSTITUTE OF TAXATION

92

Participation exemption
Equity shares

- The definition of participating holding makes constant reference to the term “equity shares”, this is also defined in Article 2 of the ITA as follows:
- In order for shares to be equity shares they need to grant to the holder of such shares two of the following three equity holding rights:
  - (i) right to vote;
  - (ii) right to profits available for distribution; and
  - (iii) a right to assets on a winding up.
- Furthermore the shares must be held in a company which is not a property company (refer to slide 29).

MALTA INSTITUTE OF TAXATION

93

Participation exemption
Anti-avoidance conditions

- With respect to dividends from a participating holding, the exemption will only apply if the participating holding satisfies one of the following three anti-avoidance conditions:
  - It is resident or incorporate in an EU country or territory;
  - It is subject to any foreign tax of at least 15%; or
  - It does not have more than 50% of its income derived from passive interest or royalties.

MALTA INSTITUTE OF TAXATION

94

Participation exemption
Anti-avoidance conditions

- If none of the conditions in the previous slide are met, a further two cumulative conditions may be applicable. The conditions, which must be satisfied are the following:
  - *"the equity holding by the company registered in Malta in the body of persons not resident in Malta is not a portfolio investment and for this purpose the holding of shares by a company registered in Malta in a body of persons not resident in Malta which derives more than fifty per cent of its income from portfolio investments shall be deemed to be a portfolio investment; and*
  - *the body of persons not resident in Malta or its passive interest or royalties have been subject to any foreign tax at a rate which is not less than five per cent (5%)."*

MALTA INSTITUTE OF TAXATION

95

Participation exemption
Passive interest and royalties

- Passive interest and royalties are also specifically defined in Article 2 of the ITA and are defined as follows:
- *"…interest or royalty income which is not derived, directly or indirectly, from a trade or business, where such interest or royalties have not suffered or suffered any foreign tax, directly, by way of withholding, or otherwise, at a rate of tax which is less than five per cent (5%)."*

MALTA INSTITUTE OF TAXATION

96

Participation exemption
Portfolio investment

- A portfolio investment is defined in the ITA as:
- *"an investment in securities such as shares, bonds, and such like instruments and which is held as one of many such investments for the purpose of investment by risk spreading where such an investment is not a strategic investment and is made with no interest in and without the intention of influencing the management of the company invested in and in addition is made only to follow the share price and dividend policy of the company invested in to maximise investment returns and to sell the investment as soon as it appears that the shares may lose value"*

MALTA INSTITUTE OF TAXATION

97

Participation exemption
Anti-avoidance conditions – Further condition

- As from 1st January 2016 a further anti-avoidance condition is applicable which reads as follows:
- *"Provided further that as from 1st January, 2016, in the case of distributed profits received from a participating holding by a parent company that is resident in Malta or the permanent establishment of a parent company that is resident in another EU Member State, which permanent establishment is situated in Malta and which benefit from the exemption from withholding tax set out in article 5 of EU Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States as amended, the exemption under the provisions of subparagraph (u)(1) shall only apply to the extent that such profits are not deductible by the relevant subsidiary in that other EU Member State."*

MALTA INSTITUTE OF TAXATION

98

Participation exemption
Anti-avoidance conditions – Further condition

- The EU directive in question is commonly known as the Parent-Subsidiary Directive.
- If by virtue of the directive a dividend is exempt from any withholding tax and the dividend received by the Malta company is deemed to be a tax deductible expense in the country of the participating holding, the participation exemption would not be applicable and the dividend income would be taxed in Malta.

MALTA INSTITUTE OF TAXATION

99

Participation exemption
Maltese Participating holdings

- The Participation exemption is also available on investment in Malta registered participating holdings, provided that all the other conditions are met.
- The application of the participation exemption is, however, limited to gains or profits earned on the transfer of such a participating holdings.

MALTA INSTITUTE OF TAXATION

100

Permanent Establishment exemption

Article 12(1)(u)

101

Permanent establishment exemption

Article 12(1)(u)(2)

- Through Article 12(1)(u)(2) the income of a company attributable to a permanent establishment outside of Malta or form the transfer of the permanent establishment, may be exempt from Malta tax.
- For the purposes of this exemption to profits or gains of the permanent establishment are to be calculated on the basis that the permanent establishment is an independent enterprise conducting its business activities at arm's length.

MALTA INSTITUTE OF TAXATION

102

MALTA
INSTITUTE
OF TAXATION

103