



MALTA
INSTITUTE
OF TAXATION

Award in Taxation
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Module A – Lecture 6

Double Tax Relief
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AGENDA

- What is double taxation?
- Bilateral & Multilateral situations
- What is double taxation relief?
- Double taxation relief mechanisms
- Interaction of relief
- Double taxation relief under the ITA
- Commonwealth relief
- Treaty relief
- Unilateral relief
- Flat rate foreign tax credit
- Double taxation treaty network

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Double Taxation Relief

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DOUBLE TAXATION RELIEF

WHAT IS DOUBLE TAXATION?

- Results from the overlap of countries tax systems – **juridical double taxation**
- Results from the taxation of the income that is economically derived from the same source, but taxed at two or more different points – **economic double taxation**
- Examples....
 - **Cross-border situations** – interest from a foreign bank account (juridical double taxation)
 - **Local situations** – profits of a company, distribution of a dividend (economic double taxation)



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DOUBLE TAXATION RELIEF

BILATERAL & MULTILATERAL SITUATIONS

BILATERAL SITUATIONS

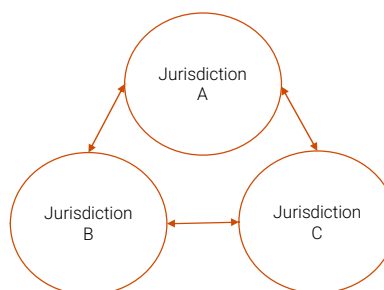
Involve **two** jurisdictions



Example: A Maltese resident earns income from Germany

MULTILATERAL SITUATIONS

Involve **three or more** jurisdictions



Example: A Maltese company with subsidiaries in Sweden & Austria



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DOUBLE TAXATION RELIEF

WHAT IS DOUBLE TAXATION RELIEF?

- The aim of double taxation relief is to **remove** or **reduce** the tax burden resulting for the double taxation of income or gains
- Importance of relief from double taxation to remove tax obstacle to cross border flows and prevents income / capital gains being taxed twice, thus promoting international trade.
- Various forms of double taxation relief are possible but principally may be split into **exemption** and **credit** methods, less common and less favourable being the **deduction method**.



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DOUBLE TAXATION RELIEF

MECHANISMS

- Not all taxes qualify for relief but only those which are of an **income** nature - importance to check type of tax involved.
- **Credit method** - the country of **residence** of the taxpayer grants relief for foreign tax paid, i.e. the country of residence of the taxpayer recognises the right of the country of source to tax the income/gains fully or partially (as the case may be) and grants relief for such source country tax.
- **Exemption method** normally relieves tax by granting **exemption** on the particular **foreign source** income in country of residence of taxpayer as long as country of source has right to tax such income. Sometimes exemption is with progression (applicable in foreign jurisdictions).
- Some double taxation relief measures may also be granted by the source state of source, i.e. the state in which the income arises, e.g. Art 12(1)(c)(i), ITA.



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DOUBLE TAXATION RELIEF

INTERACTION OF RELIEF

Hierarchical Ranking - Art. 75, ITA:

In respect of any claim for relief of double taxation:

- a. the provisions concerning **unilateral** relief shall be applied in calculating a person's tax liability in those cases where [treaty] relief ... are not available to the person making the claim; and
- b. the provisions concerning the flat-rate foreign tax credit shall be applied in calculating a person's tax liability only in those cases where [treaty] relief ...and **unilateral** relief, as governed by articles 79 to 88, are not available to the person making the claim.



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DOUBLE TAXATION RELIEF

DOUBLE TAXATION RELIEF UNDER THE ITA

Hierarchical Ranking - Art. 75, ITA:

- Treaty Relief (Art. 77 – 78) / Commonwealth Relief (Art. 89)
- Unilateral Relief (Art. 79 – 88)
- Flat Rate Foreign Tax Credit (Art. 92 – 95)



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DOUBLE TAXATION RELIEF

DOUBLE TAXATION RELIEF UNDER THE ITA

Legal Basis to implement Double Tax Treaties (Art. 76 (1), ITA)

- Enables Minister of Finance to enter into Treaties with foreign governments aimed at providing relief from double taxation – ensure that **income is not taxed twice** in Malta & another jurisdiction.
- **Income Tax and any tax of a similar character**; solves problem of differences in taxes in different states.
- Extend to **exchange of information, assistance in tax collection and preventing fiscal evasion**.



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DOUBLE TAXATION RELIEF

DOUBLE TAXATION RELIEF UNDER THE ITA

Legal Basis to implement Double Tax Treaties (Art. 76 (1), ITA)

- "Notwithstanding anything in ...any enactment": wide powers to Minister intended to **supersede legal difficulties** in the way of such treaties on entry into force of a double tax treaty with any territory forming part of the commonwealth.
- Minister of Finance may remove a double tax treaty by a subsequent order and he may also make rules for carrying out the provisions of any treaty (Art,76(3)&(4)).



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DOUBLE TAXATION RELIEF

COMMONWEALTH RELIEF

Commonwealth Relief (Art. 89, ITA)

- Applies on a **reciprocal** basis to relieve taxes paid in Commonwealth countries other than the United Kingdom.
- Limited or no application in practice.



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DOUBLE TAXATION RELIEF

TREATY RELIEF

Treaty Relief - Art.77(1), ITA:

The provisions of this article shall have effect where, under arrangements having effect under article 76, tax payable in respect of any income in the territory with the Government of which the arrangements are made is to be allowed as a **credit** against tax payable in respect of that income in Malta; ...

- Foreign tax paid on income (under the **treaty**) is to be **credited against Maltese tax** on the **same income**
- Evidence is required of the foreign tax suffered



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DOUBLE TAXATION RELIEF

TREATY RELIEF

- Amount of **income tax** to be reduced by amount of **credit** (Art. 77(2) DTR (same for unilateral relief, vide Art. 81))
- No credit to be allowed in a year of assessment, unless **person** is **resident** in Malta in particular basis year (Art. 77(2))
- Credit not to exceed amount produced by **computing amount of income under ITA**, charging it to income tax at a rate ascertained by **dividing income tax chargeable (before credit) on total income by amount of total income** (Art. 77(3))

$$\text{Maximum credit allowed} = \text{Foreign income} \times \frac{\text{Total Maltese Tax Due}}{\text{Worldwide Income}}$$

- Total credit for foreign tax under all DTAs not to exceed total income tax payable for that YoA (less certain specified tax) (Art. 77(4) DTR)



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DOUBLE TAXATION RELIEF

TREATY RELIEF

- In computing amount of income:
 - **No deduction** to be allowed in respect of foreign tax (whether in respect of the same or any other income) (Art. 77(5)(a), DTR; Art. 85 - UR)
 - Where income tax chargeable depends on amount of income received in Malta, the said amount is to **be increased by the appropriate amount of foreign tax** in respect of that income (Art. 77(5)(b), DTR – Art. 85 - UR)
 - Where income includes a dividend and under DTA, foreign tax not chargeable directly or by deduction in respect thereof is to be taken into account in considering whether any, and if so what, credit is to be given against income tax in respect of the dividend, amount of income must be increased by amount of foreign tax not so chargeable which is to be taken into account in computing credit (Art. 77(5)(c))



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DOUBLE TAXATION RELIEF

TREATY RELIEF

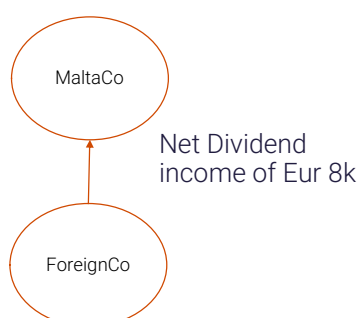
- **Elective nature of the credit:** Credit for double taxation is not allowed for any Y.O.A in which taxpayer elects that credit is not to be given in respect of his income for the particular year (Art. 77(8) DTR - Art. 87 UR)
- Claims for relief must be made **not later than 2 years after the end of the year of assessment** to which the claim refers (Art. 77(9)-DTR, Art.87-UR)
- If any dispute arises on the amount allowable claim is subject to objection and appeal in like manner as an assessment (Art. 77(9)-DTR, Art.87-UR)
- Limitation of full imputation credit on dividends where distributed profits have benefitted from double taxation relief (Art. 78 -DTR, A. 87 - UR)



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DOUBLE TAXATION RELIEF

TREATY RELIEF EXAMPLE



Consider:

- MaltaCo receives net dividend income from ForeignCo of Eur 8k,
- Underlying foreign tax is Eur 2k

Step 1: Gross up – increase amount by foreign tax
 $\text{Eur } 8\text{k} + \text{Eur } 2\text{k} = \text{Eur } 10\text{k}$

Step 2: Compute Maltese income tax due
 $\text{Eur } 10\text{k} @ 35\% = \text{Eur } 3.5\text{k}$

Step 3: Credit method (not as an expense) – **Malta tax payable**
 $\text{Eur } 3.5\text{k} - \text{Eur } 2\text{k} = \text{Eur } 1.5\text{k}$



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DOUBLE TAXATION RELIEF

TREATY RELIEF EXAMPLE



Maltese Tax
resident &
domiciled



Foreign
source
income

Foreign source
Employment
income of Eur 7.5k

Limitation as per Art 77(3), ITA

- Foreign gross income: Eur 10k
- **Foreign tax suffered: Eur 3.5k**
- Worldwide Income: Eur 70k
- Total Malta tax due: Eur 15.1k

Maximum credit allowed =

$\frac{\text{Foreign income} \times \text{Total Maltese Tax Due}}{\text{Worldwide Income}}$

$$\text{Eur}10\text{k} \times \frac{\text{Eur}15.1\text{k}}{\text{Eur}70\text{k}} = \text{Eur}2.15\text{k}$$

Total tax credit cannot exceed Eur 2.15k

Excess Foreign tax = Eur 1.35k



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DOUBLE TAXATION RELIEF

UNILATERAL RELIEF (Art. 80, ITA)

- Unilateral relief may be available in respect of a claim for relief of double taxation where tax under this Act is computed by reference to income which:
 - **arises outside Malta;** and
 - is subject to any tax of a **similar character** to that imposed under the Income Tax Acts under the laws of a territory outside Malta, including, in the case of a claim for relief to which article 82(a) and (b) applies, tax imposed under the Income Tax Acts.
- For the purposes of paragraph (b), a tax shall not be prevented from being of a similar character by reason only that it is payable under the law of a province, state or other part of a country, or is levied by or on behalf of a municipality or other local body.
- Persons must prove to the Commissioner satisfaction **that particular income has borne foreign tax of a similar character and must prove amount** of tax (Art.88).



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DOUBLE TAXATION RELIEF

UNILATERAL RELIEF (Art. 80, ITA)

- Amount of Income Tax chargeable is **reduced by** amount of credit (Art. 81)
- No credit to be allowed in a Y.O.A. unless person is **resident** in Malta or is a **company registered in Malta** in particular basis year (Arty. 81)
- Credit **not to exceed** amount produced by computing income under ITA, charging it to income tax at a rate ascertained by dividing income tax chargeable (before credit) on total income by the total income (Art. 83)
- Total credit for foreign tax under unilateral relief **not** to exceed total income tax payable for the Y.O.A. (less certain specified tax) (Art. 84)
- Credit pursuant to unilateral relief is not allowed for any Y.O.A. in which taxpayer elects that credit is not to be given in respect of his income for the particular year (Art. 87)



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DOUBLE TAXATION RELIEF

UNILATERAL RELIEF (Art. 80, ITA)

The provision concerning unilateral relief shall, where the income under article 80 includes a dividend distributed by a company not resident in Malta, .. have effect so that **tax not chargeable directly or by deduction in respect of the dividend** shall be deemed to fall under the provision of article 80(b) and shall be taken into account in computing the credit to be given against income tax in respect of the dividend.

(a) "**tax not chargeable directly or by deduction in respect of the dividend**" shall include tax payable in respect of a dividend distributed by a company which is related to the overseas company as specified in paragraph (b), hereinafter referred to in this article as "related company", where such dividend forms part of **a chain of successive dividends** distributed from one related company to another ending in the dividend received by the person making the claim, or on the profits out of which such dividend was distributed;

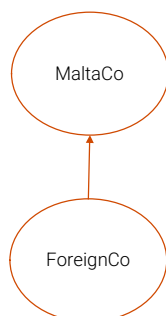
(b) a company is **related** to the overseas company if the overseas company controls, directly or indirectly, **not less than 10%** of the voting power of the related company.



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DOUBLE TAXATION RELIEF

UNILATERAL RELIEF(Art. 80, ITA)



Net Dividend
income of
Eur 450

Foreign Subsidiary

Taxable income	1,000
Underlying tax paid @ 50%	<u>(500)</u>
Net profits	500
Dividend distributed	500
WHT @ 10%	<u>(50)</u>
Net dividend	<u>450</u>

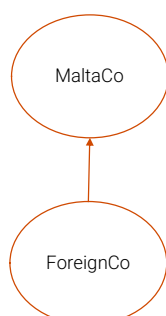


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DOUBLE TAXATION RELIEF

UNILATERAL RELIEF(Art. 80, ITA)



Net Dividend
income of
Eur 450

MaltaCo

Net Dividend	450
Gross up by Foreign tax	<u>550</u>
Chargeable income	1,000
Malta tax @ 35%	350
Total foreign tax paid	550
Limitation: Cannot exceed Malta tax	
Foreign tax credit	<u>(350)</u>
Malta tax payable	0
Total tax paid	550



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DOUBLE TAXATION RELIEF

FLAT RATE FOREIGN TAX CREDIT (Art. 92, ITA)

- Credit on income or gains received by **a company registered in Malta** (does not apply to individuals or other bodies of persons)
- which the company is specifically **empowered** to receive which fall to be allocated to **FIA**
- but **excluding** profits from dividends paid out of **FIA of another Maltese resident company**
- in respect of which **documentary evidence** is available to satisfy CIR that such income or gains fall to be allocated to FIA; auditor's cert. is satisfactory documentary evidence in this respect.
- Definition of **"a company registered in Malta"** in article 2(1), ITA
- **Anti-avoidance provision**



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DOUBLE TAXATION RELIEF

FLAT RATE FOREIGN TAX CREDIT (Art. 92, ITA)

- FRFTC is a credit for a **deemed** amount of foreign tax
- Grossing up by 25% (deemed amount of foreign tax is 20%)
- Income grossed up is net amount receivable **after deducting any foreign tax** but before any other deductions or payments are made
- Net amount receivable plus FRFTC less attributable deductions and payments is subject to Maltese tax
- Credit limited to **lower of FRFTC and 85% of tax payable** on profits allocated to FIA after deducting any foreign tax set-off under any of other reliefs (so credit system operates as in other reliefs)



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DOUBLE TAXATION RELIEF

FLAT RATE FOREIGN TAX CREDIT (Art. 92, ITA)

- Certain rules applying to TR and UR apply also FRFTC e.g.
 - Company may not take FRFTC if it so elects;
 - FRFTC claim to be made **within 2 years from the end of the year of assessment** to which the claim refers and amount allowable is subject to objection and appeal like an assessment;
 - Limitation on dividends and foreign tax credits applies also for FRFTC



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DOUBLE TAXATION RELIEF

FLAT RATE FOREIGN TAX CREDIT – EXAMPLE 1

	€		
Foreign income (net of any foreign tax)	800		
FRFTC gross-up (25%)	<u>200</u>		
Chargeable income	<u>1,000</u>		
Tax @ 35%	350		
FRFTC	<u>(200)</u>		
Malta tax payable	<u>150</u>		
			18.75%
			Limitation
			$350 * 85\% = 297.5$
			$297.5 > 200$
			Full FRFTC may be claimed



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DOUBLE TAXATION RELIEF

FLAT RATE FOREIGN TAX CREDIT - EXAMPLE 2

	€	
Foreign income (net of any foreign tax)	800	
FRFTC gross-up (25%)	<u>200</u>	
Grossed up income	<u>1,000</u>	
Less Expenses	(500)	
Chargeable income	500	
Tax @ 35%	175	
FRFTC (limited to 85% of Malta tax)	<u>(149)</u>	
Malta tax payable	<u>26</u>	

8.7%

Limitation

$175 * 85\% = 148.75$

$148.75 < 200$

Limited FRFTC may be claimed

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DOUBLE TAXATION RELIEF

FLAT RATE FOREIGN TAX CREDIT

Optimal FRFTC

$$\frac{0.2975}{0.7025} \times (\text{Chargeable income} - \text{allowable deductions})$$

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DOUBLE TAXATION RELIEF

FLAT RATE FOREIGN TAX CREDIT - OPTIMAL

Foreign income (net of any foreign tax)	€ 800		Optimal FRFTC
FRFTC gross-up (25% on part of income - 508)	<u>127</u>		Income less expenses = 800 – 500 = 300
Grossed up income	<u>927</u>		0.2975×300
Less Expenses	(500)		0.7025
Chargeable income	427		Optimal FRFTC = 127
Tax @ 35%	149		Income claimed on FRFTC = 508
FRFTC (limited to 85% of Malta tax)	<u>(127)</u>		7.47%
Malta tax payable	<u>22</u>		Limitation
			$149 \times 85\% = 127$
			$127 = 127$



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DOUBLE TAXATION RELIEF

FLAT RATE FOREIGN TAX CREDIT - OPTIMAL

Foreign rental income (net of any foreign tax)	100,000		Optimal FRFTC
FRFTC gross-up (25% on part of income)	<u>15,457</u>		Income less expenses = 100k – 20k – 43.5k = 36.5
Grossed up income	115,457		0.2975×300
Less 20% deduction on rental income	(20,000)		0.7025
Less NID	<u>(43,500)</u>		Optimal FRFTC = 15,457
Chargeable income	51,957		Income claimed on FRFTC = 61.828k
Tax @ 35%	18,185		7.47%
FRFTC (limited to 85% of Malta tax)	<u>(15,457)</u>		Limitation
Malta tax payable	<u>2,728</u>		$18,185 \times 85\% = 15,457$
			$15,457 = 15,457$



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DOUBLE TAXATION RELIEF

MALTA DOUBLE TAXATION TREATY NETWORK

- Albania
- Andorra
- Armenia
- Australia
- Austria
- Azerbaijan
- Bahrain
- Barbados
- Belgium
- Botswana
- Bulgaria
- Canada
- China
- Croatia
- Curacao (NYF)
- Cyprus
- Czech Republic
- Denmark
- Egypt
- Estonia
- Ethiopia (NYF)
- Finland
- France
- Georgia
- Germany
- Ghana (NYF)
- Greece
- Guernsey
- Hong Kong
- Hungary
- Iceland
- India
- Ireland
- Isle of Man
- Israel
- Italy
- Jersey
- Jordan
- Korea (Republic of)
- Kosovo
- Kuwait
- Latvia
- Lebanon
- Libya
- Liechtenstein
- Lithuania
- Luxembourg
- Malaysia
- Mauritius
- Mexico
- Moldova
- Monaco
- Montenegro
- Morocco
- Netherlands
- Norway
- Pakistan
- Poland
- Portugal
- Qatar
- Romania
- Russia
- San Marino
- Saudi Arabia
- Serbia
- Singapore
- Slovakia
- Slovenia
- South Africa
- Spain
- Sweden
- Switzerland
- Syria
- Tunisia
- Turkey
- Ukraine
- United Arab Emirates
- United Kingdom
- United States of America*
- Uruguay
- Viet Nam



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* Besides a comprehensive tax treaty, a separate agreement limited to profits derived from the operation of ships or aircraft in international traffic is in force with the USA.