Chapter 13

Taxation of Companies and Shareholders

Company tax system

Companies are subject to income tax and tax on capital gains in terms of the Income Tax Act and there is no separate law charging corporation tax. The general rules discussed in Chapters 11 and 12 apply to companies as well as to other persons. This chapter highlights the income tax provisions that are specifically relevant to companies.

Meaning of company

For income tax purposes, a company means a body of persons that falls under any of the following categories:

- A limited liability company constituted in Malta (provided that in the case of cell companies carrying on insurance business, every cell and that part of the company in which non-cellular assets are held are deemed to be a separate company)
- A partnership en commandite constituted in Malta whose capital is divided into shares
- A body of persons incorporated outside Malta of a nature similar to the limited liability company or to the partnership en commandite whose capital is divided into shares
- A cooperative society registered under the Co-operative Societies Act

Bodies of persons not covered by the definition of "company" include corporations constituted by an Act of Parliament, partnerships en nom collectif, partnerships en commandite whose capital is not divided into shares, civil partnerships and similar foreign entities.

When a foreign company sets up a place of business in Malta it is required to be registered under the Companies Act as an oversea company. The registration applies to the company and not to the branch and the branch itself is not recognised as a separate entity for company law or income tax purposes.

Rate of tax

The chargeable income of a company, which includes its taxable income and capital gains, is taxed at 35%. A number of entities which are exempt from tax include, inter alia, Cooperative Societies, Collective Investment Schemes consisting of non-prescribed funds, retirement funds or retirement schemes, and organisations of a public character.

Basis of taxation of companies

A company incorporated in Malta is treated as domiciled and resident in Malta and is subject to tax on its worldwide income and capital gains.

A company that is not incorporated in Malta is resident in Malta if its management and control are exercised in Malta. The test of management and control is usually applied by reference to the place where the shareholders' and directors' meetings are held and where the company's important decisions are taken.

Like other taxpayers, a company that is resident but not domiciled in Malta is subject to tax on chargeable income and capital gains arising in Malta and on chargeable income arising outside Malta, but not capital gains arising outside Malta, received in Malta. The fact that a foreign company has a branch in Malta does not, of itself, constitute residence. A company that is not resident in Malta is taxable on chargeable income and capital gains arising in Malta (unless such income/gains are subject to a specific exemption).

Accounting period

Companies are subject to tax for every year of assessment on the income derived in the financial year ending during the preceding calendar year. However, companies whose accounting date is not the 31 December require the approval of the Commissioner of Inland Revenue in order to adopt their financial year as the basis for taxation. In granting the approval the Commissioner may impose conditions.

Taxable income

The audited financial statements of the company will normally form the basis of the tax computation, but adjustments will be necessary in order to arrive at the company's income chargeable to tax. The general rule is that tax deductions are allowed only with respect to expenses incurred wholly and exclusively in the production of the income but the law contains special rules on various items. Adjustments would typically include the write-back of depreciation and a deduction for statutory capital allowances, the write-back of provisions and of expenses that do not satisfy the tax deduction rules, and the application of other special income tax rules such as those relative to the determination of income from the letting of immovable property and of capital gains. Rules on tax deductions are discussed in Chapter 11.

Transactions between a foreign company and a Maltese controlled company should be made at arm's length. There are no other specific transfer pricing rules but inter-company pricing may be scrutinised under the general anti-tax avoidance powers of the Revenue. There are no thin capitalisation rules nor any anti-controlled foreign company legislation.

Group Relief

Trading losses incurred by a company may be surrendered to another company or companies within the same group. Two companies are within the same group for tax purposes if:

- they are both resident in Malta and in no other jurisdiction and
- one is the subsidiary of the other or both are subsidiaries of a third company resident in Malta.

A company is treated as a subsidiary of another if it is owned and controlled, directly or indirectly, as to more than 50% by the other. Ownership and control are tested by reference to the ordinary share capital, voting rights, dividend rights and rights to distributions on liquidation. The surrendering and the claiming company must have financial years that begin and end on the same dates and must have been members of the same group for the full financial year in which the losses were incurred.

Losses may be surrendered within 12 months from the end of the financial year in which they were incurred. Group relief for a particular year may only be claimed with respect to losses incurred in that year but once the losses have been surrendered they are treated as trading losses of the claimant company and can be set off against the income and capital gains of that company or carried forward by it indefinitely. Surrendered losses cannot be surrendered again to another company. Capital losses do not qualify for group relief.

Capital gains exemption on transfers between related companies

No tax is charged on capital gains arising from transfers between two companies that are:

- Either within the same group as defined for group relief purposes (as above),
- Or controlled and beneficially owned directly or indirectly as to more than 50% by the same shareholders.

The exemption is clawed back if the asset is subsequently transferred outside the group. A claw back also occurs in the case of intra-group transfers of immovable property situated in Malta or intra-group transfers of shares in a property company (i.e. a company holding directly or indirectly, immovable property situated in Malta), where the companies involved in the intra-group transfer do not remain within the same group over a period of time set out in the law (currently six years).

Other capital gains exemptions

Replacement of business asset

When a company transfers a business asset that it had owned for at least 3 years and replaces it by another asset within 1 year (used solely for a similar purpose in the business), the transfer is not subject to tax on capital gains. The exemption is clawed back if the new asset, or any other replacing it, is sold without replacement.

Exchange of shares on reorganisation

The exchange of shares on restructuring of holdings upon mergers, demergers, divisions, amalgamations and reorganisation qualifies for exemption from tax on capital gains but the exemption is clawed back upon a subsequent transfer of the shares.

The exemption will apply insofar that the exchange of shares does not produce any change in the individual direct or indirect beneficial owners of the companies involved or in the proportion in the value of each of the companies involved represented by the shares owned beneficially, directly or indirectly, by each such individual.

Corporations and shareholders

Meaning of dividend

"Dividend" includes any distribution made by a company to its shareholders and any amount credited to them in their capacity as shareholders. It also includes bonus shares representing a capitalisation of profits. Distributions to shareholders in the course of winding up are deemed to be dividends paid, to the extent that the distribution is made out of income of the company.

Tax accounts

The taxation of dividends depends, in the first place, on the account out of which the distribution is made. Companies resident in Malta are required for tax purposes to allocate their distributable profits to the "final tax account", "immovable property account", "foreign income account", the "Maltese taxed account" or the "untaxed account".

The final tax account would include income which has been subject to a final tax. The distribution of such income is not subject to further tax and no tax credit is available upon its distribution.

The immovable property account includes gains or profits derived directly or indirectly from immovable property situated in Malta.

The final tax account and the immovable property account are accorded priority over the other taxed accounts with respect to both allocations and distributions of profits.

To the extent that they result from taxable income, the profits that are to be allocated to the foreign income account are:

- Dividends, interest, royalties and capital gains arising outside Malta, including income derived from a participating holding or from a disposal of such holding
- Rents and any other income derived from investments situated outside Malta
- Trading profits attributable to a permanent establishment situated outside Malta
- Dividends paid out of the foreign income account of another company resident in Malta

Further rules apply in the case of banks and insurance companies.

Distributable profits that are subject to tax but are not allocated to the final tax account, immovable property account and the foreign income account, are to be allocated to the Maltese taxed account.

Profits that are not allocated to the other taxed accounts, including negative balances, are to be allocated to the untaxed account. In most cases, the untaxed account is a balancing figure representing the difference between a company's accounting profits and its profits which would have been subject to tax in Malta. The profits of a cooperative society are allocated to its untaxed account.

The tax treatment of dividends

Distributions out of the final tax account, immovable property account, foreign income account and out of the Maltese taxed account do not attract any further tax. An exception applies in the case of distributions of old profits that had been taxed at the rate of 32.5%, which had applied before 1991. In such a case the company is required to withhold tax at 2.5% but no tax is withheld on distributions to non-resident shareholders. Distributions out of the untaxed account are subject to a withholding tax of 15% but non-resident shareholders are exempt from this withholding tax (subject to the satisfaction of certain rather straightforward conditions).

Distributions out of the untaxed account to a shareholder that is a company resident in Malta are not subject to withholding tax but such distributions are to be allocated to the untaxed account of the shareholder.

A shareholder who is an individual may opt to report or not to report dividends received from Maltese companies in his tax return. The same option is available to companies resident outside Malta. If the dividend is reported it will be taxed (unless it qualifies for an exemption) together with the taxpayer's other income at his applicable rates. The taxable amount is the net dividend grossed up by the withholding tax, if any, and the company tax. The withholding tax and the company tax (unless the distribution of profits is made out of the final tax account) can then be set off against the shareholder's tax liability and any excess credit is refunded.

When the shareholder is a company resident in Malta it will report the dividend in its accounts and tax return. Dividends received from the untaxed account of the paying company are not taxed in the receiving company's hands.

Dividends received from the final tax account, immovable property account, foreign income account and from the Maltese taxed account should not attract any further tax. Such dividends, except for dividends from the final tax account, are grossed up and taxed at the shareholder-company's rate. Any withholding tax, as well as the tax paid on the distributed profits (unless the distribution of profits is made out of the final tax account) by the paying company, is then credited against the shareholder's tax liability and any excess is refunded.

If the company paying the dividend had, as a result of double taxation relief, paid tax at an effective rate of less than the standard company rate, the shareholder will still qualify for a credit at the standard rate but any refund for excess credit will be restricted to the tax actually paid in Malta by the company paying the dividend.

When a company pays a dividend it is required to give a dividend certificate to the shareholders, showing the account out of which the dividend is being paid, the tax paid by the company on the distributed profits, double taxation relief claimed by the company on the distributed profits, tax withheld at source, if any and an analysis of the profits out of which the dividend is paid indicating the year of assessment in which the profits were chargeable to tax.

Shareholders who are exempt from tax do not qualify for a credit for company tax paid on dividends. This limitation does not apply to shareholders who are subject to tax but who do not have chargeable income.

Distributions by International Trading Companies

A company that had International Trading Company (ITC) status was a normal company and subject to the rules applicable to other companies but its activities were restricted to trading activities with non-resident persons outside Malta. The tax rate on dividends paid by an ITC to shareholders that are not resident in Malta, whether corporate or not, is 27.5%. This means that the credit of 35% available to them upon distributions will produce a refund of 7.5%. Furthermore, the non-resident shareholders qualify for a refund equivalent to two-thirds of the tax paid by the ITC in Malta on the distributed profits, thus reducing the overall tax burden of the ITC and its shareholders typically in the region of 4.17%. The same results are obtained when an ITC distributes profits to a company resident in Malta that is wholly owned by non-residents.
As of 1 January 2007 it is no longer possible to set up companies that could have the ITC status. Furthermore, ITCs that existed up to 31 December 2010 no longer qualify as such with effect from 1 January 2011. There was the possibility for ITCs, existing up to 31 December 2010, to opt to convert to the new tax refund system (described in the section below) before 1 January 2011.

Refund mechanism upon profit distributions

Distributions out of the foreign income account and out of the Maltese taxed account to shareholders may trigger refunds to the shareholders of Malta tax suffered on the distributed profits.

The extent of tax refunded depends, inter alia, on the nature and source of income derived by the Maltese company. Depending on the circumstances, the refunds may result in a net post-refund tax leakage in Malta ranging between 0% and 10% as set out below.

Dividends derived from a participating holding

Dividends and capital gains derived from holdings that qualify as participating holdings ("PH"), trigger a refund to the recipients of the dividend of 100% of the Malta tax suffered on the distributed profits. Alternatively, the Maltese company may opt to apply a participation exemption in respect of such income, thereby resulting in an outright exemption from tax on the dividend or capital gain derived from a PH or the disposal of a PH.

A PH includes a holding of 10% or more of the equity shares in a foreign entity or an investment of the equivalent of €1,164,000 or more in a foreign entity that is held for an uninterrupted period of not less than 183 days or that satisfies certain other criteria.

For a holding acquired on or after 1 January 2007 to qualify for the 100% tax refund or the participation exemption, such holding must also satisfy certain anti-abuse provisions (applicable in respect only of dividend income from a PH). Among others the holding in the non-resident entity would satisfy such conditions in the event that the non-resident entity is resident or incorporated in a country or territory, which forms part of the EU or where such non-resident entity is subject to a foreign tax of at least 15%.

Dividends derived from holdings not qualifying as a PH

Other refunds are available to shareholders of Maltese companies (registered in Malta on or after 1 January 2007) following the distribution of profits to the shareholders. The 'standard' refund amounts to six-sevenths of the tax paid in Malta (gross of any double taxation relief claimed in Malta in respect of tax paid outside Malta on taxed profits) – resulting in a net post-refund tax leakage in Malta typically amounting to about 5%. However the law provides for different refunds in the following circumstances:

- In the event that the dividend is paid out of profits that qualify as passive interest or royalties (as defined) or out of profits which were received from a PH which does not satisfy the anti-abuse provisions mentioned above, the above refund is reduced to five-sevenths of the tax paid in Malta (gross of any double taxation relief claimed in Malta in respect of tax paid outside Malta on taxed profits), resulting in a net post-refund tax leakage in Malta typically amounting to about 10%.
- If the dividend is paid out of profits allocated to the foreign income account and in respect of which the company had claimed double taxation relief, the applicable refund should amount to two-thirds of the Malta tax (gross of any credit for actual foreign tax suffered) in respect of those distributable profits.

Profits distributed by a Maltese company out of the immovable property account or the final tax account do not entitle shareholders of such company to tax refunds.

The flat rate foreign tax credit

Companies are entitled to a tax credit for any tax that has been paid outside Malta, including relief for underlying tax (see Chapter 11).

With respect to income allocated to the foreign income account, companies may claim relief under the Flat Rate Foreign Tax Credit method (FRFTC). Under the FRFTC, foreign income is deemed to have suffered foreign tax equivalent to 25% of the income received in Malta and does not require evidence of the foreign tax actually paid. Income allocated to the foreign income account is for this purpose grossed up by 25% and taxed at 35%. The deemed tax (20% of the grossed up amount) is then given as a credit against the company's tax liability. The grossing up is made before any deductions from the foreign income to which the company may be entitled. The credit is limited to 85% of the total tax payable by the company on the income allocated to its foreign income account, before the FRFTC itself but after any other double taxation relief that the company may have claimed.

Branch versus subsidiary

A branch of a foreign company is not taxed as a separate entity. The income of a branch is taxed in the hands of the foreign company at the standard company rate and subject to the normal rules. As a non-resident, the foreign company will be taxed only on income arising in Malta, that is, on the income of the branch. In terms of the rules contained in double taxation treaties, the income of the branch is determined as if it were a separate entity dealing at arm's length with the company.

A subsidiary incorporated in Malta is taxed on its worldwide income but if the subsidiary's activities are limited to the Malta business, its worldwide income will be equivalent to the income that the parent would have derived through a branch. The taxable amount and the tax burden of a subsidiary are therefore normally equal to that of a branch.

The refundable tax system outlined above extends to shareholders of foreign companies which have branches in Malta. Tax paid in Malta by branches on profits attributable to activities performed in Malta should be refunded upon a distribution of profits by the particular foreign company.

A branch could provide certain advantages as its losses may possibly be set off against the company's foreign taxable profits for foreign tax purposes whereas the losses of a subsidiary might not be available for set-off. On the other hand, the rules for the carrying forward of trading losses from year to year under Maltese tax law are clearer for a subsidiary than they are for a branch. The procedures for setting up a branch are simpler and the costs are lower but the differences are marginal. Dividends and interest paid by a subsidiary to its foreign parent company are not subject to any further tax (subject to certain rather straightforward statutory conditions), and the foreign company will be similarly exempt from tax on any capital gains derived from the disposal of the subsidiary (unless the subsidiary owns immovable property in Malta). When the company's structure requires Maltese tax residence on account, for example, of treaty considerations, this is best obtained through the formation of a subsidiary.

Special industries

Insurance companies

The Income Tax Act contains detailed rules on the determination of the chargeable income of insurance companies. When a non-resident company carries on insurance business in Malta, the tax liability is limited to the profits attributable in accordance with these rules to the Malta business.

In general, the taxable income derived from long term business is the investment income, including interest, capital gains, the surplus resulting in the long term fund and other income not related to that fund, less expenses. The company must withhold tax at 15% from payments to insured Maltese-resident persons on the maturity of their policy.

Gains from the transfer, surrender or maturity of certain linked long-term policies satisfying certain statutory conditions are exempt from tax. Other linked long-term policies satisfying certain statutory conditions are subject to a final withholding tax liability of 15%.

The income from general insurance business includes premiums and all other income and gains. The technical provisions and the equalisation reserve at the beginning of the year are included as income, while the provisions and reserves at the end of the year are allowed as deductions, together with claims paid, losses and other expenses.

Shipping and air transport

Companies incorporated in Malta and owning EU/EEA ships qualify for incentives under the Merchant Shipping Act (see Chapter 3). Subject to the condition of reciprocity non-resident ship-owners are exempt from Maltese tax. Profits of non¬-residents from the casual calls of ships in Malta are also exempt. The same rules apply to profits derived by non-residents from the business of air transport. Shipping and air transport profits of non-resident companies are usually exempt from Maltese tax also on account of the provisions of the relative double taxation treaties. In the exceptional cases where a non-resident is subject to Maltese tax, the taxable income is restricted to profits attributable to goods and passengers shipped in Malta.

Industrial activities

Companies carrying on industrial activities may qualify for incentives under the Malta Enterprise Act (see Chapter 3).