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# *Chapter 14*

Partnerships and other entities

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For the purpose of this Chapter, the term ‘partnership’ refers to those entities which do not fall within the meaning of ‘company’ as defined in the Income Tax Act (see Chapter 123 of the Laws of Malta). Such entities include inter alia:

- A partnership en nom collectif - This is a legal entity that has its obligations guaranteed by the unlimited and joint and several liability of all the partners. Such commercial partnership is formed under and governed by the Maltese Companies Act;
- A partnership en commandite (or limited partnership) the capital of which is not divided into shares – This is another kind of commercial partnership that is specifically regulated by the Companies Act. This entity has its obligations guaranteed by the unlimited and joint and several liability of one or more partners (the general partners) and by the liability, limited to the amount of their contribution, of one or more partners (the limited partners). Partnerships en commandite with capital divided into shares are, for Maltese income tax purposes, treated in the same manner as companies;
- A civil partnership – Civil Partnerships are regulated by the Maltese Civil Code and need not be registered with the Maltese Registrar of Companies. This grants the partners added flexibility and reduces the compliance obligations. However, subject to the rules laid down in the Civil Code, the civil partners are liable with all their assets, present and future, to the creditors with whom they have contracted;
- Bodies of persons constituted or registered outside Malta and which are of a nature similar to the above listed entities.

### Income Tax Treatment

The Income Tax Act (‘ITA’) defines ‘partnership’, for the purposes of taxation of capital gains, as follows:

*“... a commercial partnership en nom collectif, or commercial partnership en commandite the capital of which is not divided into shares and, ... shall include any other partnership having a legal personality distinct from that of its members other than a commercial partnership en commandite the capital of which is divided into shares;”.*

Profits derived by the above-listed partnerships or legal entities from a trade or business activity are not brought to charge to tax in the hands of the partnership itself but rather in the hands of the partners in proportion to their respective interest therein. Thus, partnerships and legal entities which are not treated as a ‘company’ for Maltese income tax purposes are not recognised as a separate taxpayer even though they might have a distinct legal personality for company law purposes.

As a general rule, the partnership will still need to be registered for income tax purposes and the partners are required to keep partnership accounts and file a partnership tax return. The partnership income (or loss) is computed in accordance with the normal rules but it is then deemed to be the income of the partners. The tax is not levied on the partnership as such but directly on the partners at the rates applicable to them respectively and may therefore depend on their residence and other circumstances.

A loss incurred by the partnership is similarly treated as a loss incurred by the partners and may therefore be set off against their other income and carried forward by them, subject to the rules applicable to such losses.

The ITA also brings to charge gains or profits arising from the transfer of the ownership or usufruct of or from the assignment or cessation of any rights over any interest in a partnership.

In this respect, the ITA contains rules to ascertain the acquisition cost for the purpose of determining the gains or profits arising from any transfer of a partnership interest. The determination of such cost depends on a number of factors including the circumstances under which the partnership interest was first acquired.

The transfer value of a partnership should presumably be the higher of market value and the consideration, however, this is not stated specifically in the law.

### **Exemptions from Tax**

Gains on the transfer of a partnership interest are exempt from tax in a number of circumstances, including:

- Assignment of partnership interest between spouses consequent to a judicial or consensual separation, or upon dissolution of the community;
- Donations to spouse, descendants and ascendants in the direct line and their relative spouses, or in the absence of descendants to his brothers and sisters and their descendants, or to approved philanthropic institutions;
- Intra-group transfers and settlement of partnership interest on trust.

Any gains or profits accruing to or derived by any person not resident in Malta on a transfer of any interest in a partnership, which is not a “property partnership”, are also exempt from income tax. The ITA provides a detailed definition of the terms “property partnership”.

## Stamp Duty

The Duty on Documents and Transfers Act (DDTA) imposes a stamp duty at the rate of 2% on transfers of a partnership interest. This provision does not apply for transfers in certain foreign partnerships.

A transfer of partnership interest is not deemed to arise for the purposes of DDTA in respect of a partnership share in a civil partnership or in a foreign partnership.

The duty chargeable increases to 5% in cases where 75% or more of the assets, excluding all other current assets other than immovable property, of the partnership in which the interest is being transferred or is deemed to be transferred, consists of immovable property or any right over an immovable; or a partnership, in which an interest is being transferred or is deemed to be transferred holds, directly or indirectly, shares in a company having 75% or more of its assets consisting of immovable property or any rights over an immovable. The provisions applicable to a company in respect of the increase in rate apply in the same manner to a partnership.

Other relevant provisions of the DDTA include that:

- Every transfer inter vivos of an interest in a partnership executed in Malta shall, under pain of nullity, be made in writing;
- Where such transfer is executed outside Malta upon an order given directly in Malta by any person, such person shall give a notice in writing to the Commissioner of such transfer in such manner and in such term as may be prescribed;
- A person to whom an interest in a partnership registered in Malta are transmitted causa mortis shall not later than such term after the happening of the transfer causa mortis as may be prescribed, give notice to the Registrar of Companies.

Article 41B, DDTA states that, “

### Conversion of a Commercial Partnership

Where a commercial partnership en nom collectif or a commercial partnership en commandite, the capital of which is not divided into shares is converted into a company, it is deemed that no transfer or acquisition of assets has taken place. Subsequently, for the purpose of determining the chargeable income or gains on a transfer of the said assets by the company, the cost and date of acquisition taken into account are the cost and date of acquisition by the commercial partnership that had been converted.

In a similar manner, the transfer of assets upon a conversion as indicated above does not attract stamp duty.

In the case where a company is converted into a commercial partnership en nom collectif or a commercial partnership en commandite the capital of which is not divided into shares:

- any balance of distributable profits allocated to any of the tax accounts, existing on the day the company ceases to be a company, are deemed to have been distributed by way of dividend on the said day and all relevant provisions apply accordingly to such profits;
- it is deemed that no transfer or acquisition of assets has taken place and subsequently, for the purposes of determining the chargeable income or gains on a transfer of the said assets by the partnership, the cost and date of acquisition taken into account shall be the cost and date as applicable to the company that has been converted;
- the conversion may give rise to a clawback of a previous intra group exemption of transfer of assets
- capital losses available to the company prior to conversion shall be carried forward and set off only against capital gains derived by the partnership;
- trading losses available to the company prior to conversion shall be carried forward and set off against the total income derived by the partnership.

### **Winding up of Partnership**

Both in terms of the ITA and of the DDTA, the distribution of the partnership's assets to its members upon the winding up of a partnership pursuant to a scheme of distribution, is considered to be a "transfer".

However, the ITA definition refers only to distributions by a partnership en nom collectif or a partnership en commandite the capital of which is not divided into shares. On the other hand, the DDTA definition refers to distributions by a partnership to its members i.e. by any partnership.

### **Joint Ventures and irregular partnerships**

The rules outlined above apply also to joint ventures and irregular partnerships, except that in such cases there is usually no obligation to register the body of persons with the Inland Revenue Department and to file a partnership return.

## Trusts

A trust exists where a person (called a trustee) holds as owner, or has vested in him, property under an obligation to deal with that property for the benefit of persons (called the beneficiaries) whether or not yet ascertained or in existence, which is not for the benefit only of the trustee, or for a charitable purpose, or for both such benefit and purpose.

The Trusts and Trustees Act (Act XIII of 2004) introduced substantial changes to the Maltese trust legislation in a bid to strengthen Malta's international obligations in respect of non-discrimination, transparency and prevention of money laundering. Trusts formed prior to the coming into force of the Trusts and Trustees Act were granted a transitional period of ten years from the date of their registration within which to become compliant with the new legislation. Until the lapse of the said ten years, such trusts should continue to be taxed at a fixed annual rate of €466.

The Maltese fiscal implications relative to trusts vary depending on a number of circumstances including (i) the particulars of the parties involved (e.g. the residence of the trustees or beneficiaries), (ii) the act or event under review (e.g. the settlement of property, transfer of beneficial interest, distributions of trust assets, etc.) and (iii) the nature of the trust assets.

Furthermore, the Maltese Income Tax Act also contemplates a number of look-through provisions whereby income that is attributable to a trust is deemed to be derived directly by the beneficiaries. The application of such tax transparency provisions is mainly intended so as to allow the application of tax exemptions that would have been available to the beneficiaries if there was no trust relationship.

## Anti-avoidance rules

The Commissioner of Inland Revenue has the right to disregard a partnership if he is of the opinion that it was formed for the purpose of fragmenting income and that the partners do not in fact carry on jointly a trade, business, profession or vocation. In such cases, the Commissioner can decide the manner in which the tax liability on the profits is to be borne.

Similarly, the Commissioner may disregard transactions involving a trust where, in his opinion, such transactions are carried out with the sole or main purpose of reducing the amount of the tax payable.

A number of general anti-avoidance provisions applicable to companies are also relevant to partnerships.

## Estates

Under Maltese law, the assets of a deceased person devolve immediately and automatically to the heirs. An estate is not a taxpayer but if an estate is administered by an executor and the heirs or their shares are not readily identifiable, the executor is responsible for reporting the income of the estate and paying the tax on behalf of the heirs.

If the heirs subsequently report the income or are otherwise taxed on their share, the tax paid by the executor is available to them as a credit.

## Other Legal Entities

The Civil Code provides for the rules governing the registration in Malta of certain types of organisations that are vested with legal personality and which may, in certain limited circumstances, be used for investment purposes. These organisations include, inter alia, foundations and associations.

An organisation is defined as “universality of persons who associate, or universality of things which are appropriated to achieve a lawful purpose having a form recognized by law, and which is capable of being a legal person in terms of law”. Associations relate to universality of persons while foundations to universality of things.

Associations are not bound to register as legal persons but are entitled to do so. Legal personality however depends on registration and an association must, on pain of nullity, be constituted by means of a written agreement. The Second Schedule of the Civil Code lists the contents that the statute must contain. No special rules have yet been issued relating to the tax treatment of associations

Foundations are also constituted in writing (public deed or will) and they may be private or public. The deed of foundation must be registered by the notary with the Registrar of Legal Persons and such registration endows the foundation with legal personality.

A foundation created under foreign law may be recognised as a ‘foundation’ created under Maltese law. The foreign foundation should register with the Registrar for Legal Persons if it carries on an activity in Malta for more than 3 months. Foreign organisations having legal personality under foreign law would be recognised as legal persons for all intents and purposes of Maltese law.

Tax rules seek to extend the scope for using foundations. Foundations are treated in the same manner as companies ordinarily resident and domiciled in Malta, hence the rules pertaining to the taxation of companies apply mutatis mutandis, i.e the applicable tax rate is 35% and tax due is payable in the same manner as applicable to companies; etc.

A foundation thus may elect to be treated as a company or as trust (e.g. for stamp duty purposes).

However, a foundation may elect not to be treated as a company if it is either: enrolled in terms of the Voluntary Organisations Act or established for the achievement of a social purpose AND is non-profit making. In such cases, foundations are, subject to satisfying the relevant conditions, either taxed at marginal rates (15% - 35) or exempt from tax.

Where at least one of the administrators of the foundation is resident in Malta for tax purposes, then tax is payable in Malta on all income or gains earned by the foundation which is chargeable to tax under Maltese law. However, on the basis that the foundation satisfies the applicable conditions, the foundation may be treated as a look-through entity and the income is deemed not to be income attributable to the foundation but income which is derived directly by the beneficiaries and taxable in the hands of such beneficiaries.