

Tax system for companies resident in Malta.

1. Extended tax refund system under income tax legislation in Malta

In 2006 Malta reached agreement with the European Commission that effectively preserves intact its competitive imputation tax system for business in Malta. The proposal, which was developed by the Maltese Government, extends the refundable tax credit system to all Maltese companies and shareholders. Under the agreement the proposals came into effect on 1 January 2007, while the outgoing system will be retained up to 2010 for beneficiaries existing as at 31 December 2006. This important agreement ensures Malta's future ability to continue to be an attractive and competitive environment for international business and investment.

Essentially the logic of the imputation tax system has remained unaltered: Under the new system companies are taxed at 35% and upon a distribution the shareholder is entitled to the tax refunds. The differences of substance are that the tax refunds are now available to all shareholders in respect of the distribution of all profits other than those derived from immovable property. Upon distributions of profits a company will pay an advance company income tax "ACIT" which satisfies the company's tax liability and is also available for refund to the shareholder. This change will not essentially affect the tax refund as it is operates today.

As a result of these changes companies need not restrict their activities to international activities in order to be eligible for the tax refunds, as was the case under the old system.

2. Mechanics of the extended tax refund system

General income tax system

All companies resident in Malta are subject to income tax at a rate of 35%. There is no separate system of corporation tax, and a company is subject to tax in much the same way as an individual. A full imputation system is applicable which means that dividends paid by a company resident in Malta carry a tax credit equivalent to the tax paid by the company on its profits out of which the dividends are distributed. This system applies to both resident and non-resident shareholders. Resident shareholders are taxed on the gross dividend at the applicable tax rates, but are entitled to deduct the tax credit attached to the dividend against their total income tax liability. Individual shareholders of companies will be entitled to tax refunds when their marginal tax on the dividend is less than the tax paid by the distributing company.

Within this general system an Advance Company Income Tax (ACIT) combined with a system of refunds has been introduced as described below.

Extended tax refund system – general conditions and tax consequences

Under this system, ACIT is payable upon distributions, by all companies, of profits which are not derived from immovable property situated in Malta. The ACIT paid is

then set-off by the distributing company against its company income tax. Once ACIT has been paid by the distributing company, shareholders, whether resident in Malta or not, may claim tax refunds as described below.

The ACIT is levied at the level of the distributing company at the rate of 35% and upon distribution the shareholder is entitled to a refund of a part or whole of that ACIT. This refund is reduced where the distributing company would have claimed double taxation relief. The amount of the tax refund is set at 6/7ths of the tax paid by the company (5/7ths in the case of passive interest and royalties). In the case of participating holdings the shareholder is entitled to a full refund. The resident shareholder is taxable for the total amount of net dividend and refund received. The non-resident shareholder is not taxed in Malta.

With regard to acquisitions of participating holdings made on or after 1 January 2007, where the non-resident company, having mainly passive income, is not resident or incorporated in an EU Member State or is subject to tax at a rate which is less than 15%, the following additional conditions must be satisfied:

- the shares in the non-resident company must not be held as a portfolio investment; and
- the non-resident company or its passive income must have been subject to tax at a rate which is not less than 5%.

When dividends received from a participating holding are distributed by a Maltese company to its shareholders such shareholders are entitled to claim a refund of 100% of the ACIT paid on the distributed profits. Resident individual shareholders will be subject to Malta tax on the dividend and tax refund while non-resident shareholders and resident corporate shareholders in receipt of the dividend and tax refund will not be subject to tax thereon.

As from 1 January, 2007 a participation exemption will be introduced which will exempt dividends derived from participating holdings and gains derived from the disposal of such holdings. The participation exemption is also subject to the anti-abuse provisions described above for participating holdings. Where the participation exemption applies obviously the refund system in respect of participating holdings will not apply.

If the conditions to qualify as a participating holding or for the participation exemption to apply are not met the normal general tax system including the normal tax refunds will be applicable.

3. Transitional arrangements

- 1 The new system described above came into effect on 1 January 2007 and is applicable to all new companies registered on or after that date;
- 2 International trading companies (ITCs) and companies having certain foreign income benefiting from the rules existing on 31 December 2006, will continue to benefit from the respective regimes until 31 December 2010.

