The Offshore Tax Planning Review

MALTA: AN EMERGING OFFSHORE CENTRE

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The Maltese Islands are located in the middle of the Mediterranean sea, just 93km south of Italy. The climate is warm, and just as warm is the character and temperament of its population of 360,000.

Six years ago the Malta Government embarked on the process of making Malta a financial centre of repute by enacting the Malta International Business Activities Act 1988 (MIBAA). This law provides for the establishment of trading companies, non-trading companies, banking companies, insurance companies and nominee companies. The legislation provides for clear and extensive monitoring structures, both at the registration stage and thereafter and consolidates all regulations dealing with off-shore activities.

Trading companies are liable to income tax at 5% while non-trading companies are exempt. The incentives are guaranteed for ten years.

Investment in Malta may be made in onshore companies or offshore companies registered under MIBAA.

Onshore

Onshore companies are subject to tax at 35% on the profit resulting from the adoption of accepted accounting principles adjusted for tax purposes. Expenses not wholly and exclusively incurred in the production of income, or not of a revenue nature, are not allowed for tax purposes. Provisions are also not allowed.

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The income tax charged on companies and the income tax imposed on the shareholders is fully integrated and hence a company is entitled to deduct and retain tax from a dividend at the rate at which the company itself pays tax on the profits being distributed. The tax is credited to the shareholder against his total tax liability. If a dividend is paid out of untaxed profits, the amount received is brought into charge to tax.

Trading losses are carried forward indefinitely.

Companies are allowed deductions for wear and tear as follows:

Initial allowance on new assets only:

-	industrial buildings and structures	10% of cost
-	plant and machinery	20% of cost

Wear and tear allowances:

-	plant and machinery	10% of reducing balance
-	vehicles	20% of reducing balance
-	industrial buildings and structures	1% of cost

Fiscal and other incentives are also available under the provisions of the Industrial Development Act 1988 (IDA) among which are a ten year tax holiday, accelerated rates of depreciation, investment allowances, reduced rates of tax and subsidised loans, etc.

The tax year is the calendar year; however, a company is allowed to have its accounts made up at a date other than 31st December.

Companies which are resident in Malta are subject to income tax on their worldwide income, otherwise companies are subject to Malta tax on income arising in Malta. Residence in Malta depends upon whether management and control of a company is exercised in Malta.

Offshore

Companies registered under MIBAA may be either non-trading or trading companies.

The non-trading company is exempt from tax while the trading company pays tax at 5% on its profits as adjusted for tax purposes. Only non-resident investors may hold shares in such companies.

These companies are guaranteed incentives for ten years from the date of registration, such as full confidentiality screening beneficial ownership, low tax or exemption from tax, and customs and stamp duty exemptions.

Offshore companies may hold shares in Malta onshore companies which are engaged in the manufacture or processing of goods.

From an international tax planning point of view, offshore companies may be used as tax shelters for dividend income, ownership of property abroad, patents, royalties, ship management and ownership, international trading operations and onselling operations.

On the other hand, onshore companies may be able to benefit from the excellent network of 16 double tax treaties, which includes 11 European countries, the United States of America, Canada, Australia, Libya and Pakistan.

Recent Legislative Changes

The beginning of 1994 saw the introduction of a wide range of legislation which completely overhauls the regulation and taxation of financial services in Malta. The legislation also seeks to eliminate the distinction between offshore and onshore companies.

The legislation deals with banking, insider dealing, prevention of money laundering, recognition of trusts, company law, duty on transfers and documents, professional secrecy, investment services, income tax, a taxes management Act and liberalisation of exchange controls.

MIBAA

Companies already registered under MIBAA may retain their status for ten years from the date of registration, but not later than the year 2004. During this period they may elect to transfer to the new regime.

New registrations under MIBAA will be permitted up to the 31st December 1996.

The new tax regime makes all companies registered in Malta (excluding new registrations under MIBAA) liable to tax at 35% and residence in Malta depends upon the place of incorporation.

Although this may appear less advantageous in respect of the previous MIBAA regime, the following incentives make Malta an interesting option:

Double Taxation Relief

Until now, income arising in a tax treaty country would be subject to tax in Malta and a credit given for the foreign tax paid. Otherwise, the foreign tax is in practice allowed as an expense. There is also a limited form of unilateral relief in respect of tax paid in Commonwealth Countries.

The new regime introduces two additional forms of relief, namely unilateral relief generally and flat rate foreign tax credits.

The flat rate foreign tax credit (FRFTC) equals 25% of the foreign income. This applies even if no foreign tax has been suffered. Documentary proof has to be provided by an auditor that the income is from a foreign source.

The following illustrates the mechanics of the deemed credit:

Foreign source received	LM 800
Deemed credit 25%	200
	1,000
Malta tax at 35%	350
Less FRFTC	200
Malta tax payable by company receiving foreign dividend/income	LM 150

The FRTC is limited to a maximum of 85% of the Malta tax payable before the deemed credit is deducted from it.

Participation Exemption

When Maltese holding companies satisfy the conditions for the participation exemption, shareholders are entitled to a full refund of tax paid by the company on the foreign source income received in Malta.

A "qualifying participation" is one where the Maltese company owns 10% or more of the shares in an overseas company, or which exceeds LM500,000 in value, or meets any one of the following criteria in the case that its shareholding is less than 10%:

- the shareholder is entitled at its option to purchase the balance of the equity shares of the overseas company; or

- has the first right of refusal upon a disposal of the balance of the equity shares of the overseas company; or

- is entitled to be represented on the board of the overseas company; or

- holds the shares in the overseas company in relation to its own trade.

International Trading Companies

Advance tax rulings, binding for five years and renewable for a further five years, are available to determine the status of international trading companies (ITC) whose activities are restricted to international business.

Non-resident shareholders of the ITC (and Maltese companies wholly-owned by non-residents) are taxed at the rate of 27.5% on dividends paid out by the ITC and furthermore, a two-thirds refund of the tax paid by the company may be claimed.

Upon a subsequent distribution of the dividend by the Malta company to a foreign shareholder, the latter benefits from a 2/3 refund of the tax paid by the company on the profits out of which the dividend was paid. This is illustrated in the following example:-

	LM
Profits of ITC, all distributed	1,000
Tax thereon at 35%	350
Dividend received by shareholder (gross)	1,000
Tax charged thereon at 27.5%, rate applicable to ITC	275
Tax paid by company on distributed profits	350
Refund of imputed tax	(75)

Refund of tax (2/3) LM 350	(233)
Total refunds to shareholder	(308)

NET TAX PAID:

Tax paid by company	350
Total refund to shareholder	308
Net tax paid	42

Effective rate of tax: 42/1000 = 4.2%

Conclusion

Malta offers a very interesting choice for investment, and this is made more interesting and viable when one considers the existing legislation related to the manufacturing and services industries and the various related benefits, whereby customs duties are relieved, payments of tax may be made in foreign currency. Refunds to shareholders in foreign currency, subsidised loan, and residence schemes are also offered.

Furthermore, Malta boasts of an excellent central location in the Mediterranean accessible to all international activities, and has state of the art telecommunication. All these features promise a very attractive investment location to non-residents and augur well for an ever growing financial services industry for Malta.

The new taxation regime should enable Maltese companies to benefit from Malta's treaty network while offering the benefit of very low overall Maltese taxes on profits distributed to non-resident investors. In particular it would appear that the new arrangements will enable non-residents to use Maltese companies to receive dividends, interest and royalties from US companies under reduced rates of withholding tax without falling foul of the investment or holding companies provisions in article 16 of the Malta/US Double Tax Treaty.