MALTA'S ANTI-AVOIDANCE ASPECTS OF THE PARTICIPATION EXEMPTION PROVISION: AN ANALYSIS OF THEIR COMPATIBILITY WITH COMMUNITY LAW

Dr. Caroline Brincat[1]

1.1 Introduction

The Maltese regime offers several advantages but not at the expense of total exclusion of anti-avoidance measures from its tax system. As a Member State of the European Union, an anti-avoidance rule will be effective only if it is not struck down by the European Court of Justice on the ground that it is inconsistent with the Member States' EC Treaty obligations. The role played by the Code of Conduct for Business Taxation (hereinafter the 'Code') is examined. The Code is a political commitment with no legally binding effect. However, in practice its influence on anti-avoidance measures is not insignificant.

Malta introduced the participation exemption in its domestic legislation in January 2007. The participation exemption subject to its anti-avoidance aspects generally provides that dividends from qualifying participations are exempt from taxation. What implications do these domestic law issues provoke in a European Community context? The influence of both the ECJ and the Code are taken into consideration.

Finally, conclusions are drawn on the manner in which the concept of anti-avoidance assumes a wider spectrum of definitions and interpretations when analysed from the perspective of one of the smaller EU Member States such as Malta.

1 Author: Dr. Caroline Brincat B.A., ADIT., LL.M(London)., LL.D. Tax Lawyer, Malta. The author can be contacted on carolinebrincat@kpmg.com.mt

2.1 Participation Exemption

The participation exemption regime is an inherent feature of the most popular and even of the less renowned holding company locations within Europe.[2] The aim of such tax rule is to improve the competitive position of any country that adopts it and to attract more investments through maintaining or getting that country back on the short list of foreign investors.[3]

The participation exemption stipulates that any company registered in Malta[4] is exempt from the 35 percent corporate tax rate when deriving any income or gains from a participating holding or from the disposal of such holding. The participation exemption is extended both to dividends and capital gains.

2.2 Entitlement to the Participation Exemption

2.2.1 Recipient company

In order to benefit from the participation exemption, the entity receiving the inbound flow of income or gains must be a 'company registered in Malta'. For a company to meet the Maltese registration requirement it must fulfil any one of the following conditions: (a) be a resident in Malta[5] or (b) be a company which although not resident in Malta, carries on any activity in Malta[6] and in the case of a company which is neither incorporated nor resident in Malta, it is a company that is registered with the Commissioner of Inland Revenue.

2 A non-exhaustive list includes the Netherlands, Belgium, Italy, Austria, Denmark, Estonia, Finland, Czech Republic, Bulgaria, Luxembourg, France, Cyprus and Malta.

3 W. Thoen et al, 'Dutch Corporate Income tax reform 2007: another reason to use the Netherlands in International Structuring', (2007) Journal of International Trust and Corporate Planning Vol 14/2.

4 Income Tax Act, Art.2.

5 A company is resident in Malta for tax purposes if it is incorporated in Malta or if the control and management of its business is exercised in Malta.

6 For the purposes of this definition a branch of a foreign company carrying out an activity in Malta and registered in Malta is equally entitled to the participation exemption as a company resident in Malta subject to the same anti-avoidance provisions which will be further discussed in this Section. It must be mentioned that the scope of this new definition was the removal of any discrimination between the tax treatment of a company and a branch. This means that a branch of a non-resident company carrying on activities in Malta will be treated in the same way as a resident company with resultant tax planning opportunities including access to the participation exemption. In this context see also: C-270/83 *Commission v French Republic (Avoir Fiscal)* [1986] para 27.

2.2.2 Participating Holding

The relationship between a company registered in Malta and its holding in a company or a body of persons[7] not resident in Malta for the purposes of the participation exemption is defined by reference to a number of alternative scenarios that constitute a 'participating holding'.[8]

For ease of reference, the conditions laid down in the Maltese tax statute can be classified under the following headings:[9]

(a) *minimum shareholding percentage* set at ten per cent of the equity shares of a company not resident in Malta whose capital is wholly or partly divided into shares;

(b) *threshold levels of investment and minimum holding requirement* requiring a minimum investment of Euros 1,164,000 in a company not resident in Malta to be held for an uninterrupted period of not less than 183 days;

(c) *activity test* whereby the equity shareholding in a company not resident in Malta is for the furtherance of the recipient company's own business and the holding is not held as trading stock for the purpose of a trade; and

(d) *control test*s including options to acquire balance of equity shares, rights of first refusal in the event of a proposed disposal, redemption or cancellation of shares not held by the equity shareholder and right to sit on the Board or appoint a person to sit on the Board of that company as a director.

All the aforementioned conditions demand that the receiving company is an equity shareholder in a company not resident in Malta. For clarity and

---

7 Income Tax Act, proviso to Art. 2, definition of 'participating holding' states that a participating holding may also be held in a non-resident body of persons which is not a company. This applies when such body of persons is similar to a Maltese partnership *en commandite* the capital of which is not divided into shares. The Maltese definition of a partnership *en commandite* provided in Ch 386 Art. 51 of the Companies Act reflects the characteristics of a 'limited partnership', in which the active partners have unlimited liability but the 'sleeping' partners' liability is limited (See: Sealy and Worthington *Cases and Materials in Company Law* (8th edn OUP, Oxford 2008) p 22.

8 Income Tax Act, Art. 2.

9 The minimum holding requirement, the activity test and the extension to partnerships are the result of amendments by virtue of Act II of 2007.

certainty, the law defines the term ‘equity holding’[10] as granting to the shareholder the right to vote and the right to profits available for distribution and assets available for distribution on a winding up of the foreign company.[11]

2.2.3 Anti-Avoidance provisions

An analysis of the participation exemption requires an examination of both sides of the same coin. On the one side it has already been established that it is a tax policy tactic to attract foreign investment by ensuring the avoidance of double taxation. On the flip side of the coin some countries may adopt anti-avoidance provisions that render the application of the participation exemption less automatic. In the majority of cases, the purpose behind these anti-avoidance provisions is the prevention of double non-taxation[12].

In order to qualify for the Maltese participation exemption in a cross-border situation, the participating holding must not fall within the purview of the anti-avoidance provisions.[13] The anti-avoidance mechanism will not apply if the body of persons in which the participating holding is held satisfies any one of the following conditions:

- resident or incorporated in the EU; *or*
- subject to tax of at least 15 percent; *or*
- does not have more than 50 percent of its income derived from passive interest or royalties.

10 Income Tax Act, Art. 2.

11 By virtue of Act II of 2007 the word ‘nominal’ was deleted from the definition of ‘equity holding’. Since in some jurisdictions companies can have shares with no par value, it was no longer relevant to continue to refer to the share capital of a company as having a ‘nominal value’.

12 An illustration of the subject-to-tax test suggests that the state of the recipient company which is granting the participation exemption is assuming that tax is paid at the level of the distributing company. Following this, the risk of double non-taxation is eliminated.

13 During a transitional period terminating on 1st January 2011, the date of acquisition of the holding will determine the application of the anti-avoidance provisions. If the participating holding is acquired before 31 December 2006, the anti-avoidance provisions will not apply until 1st January 2011. If the participating holding is acquired on or after 1st January 2007, the anti-avoidance provisions apply with effect from 1st January 2007.

If none of the abovementioned conditions is satisfied, then *both* of the following two conditions must be satisfied for the non-application of the anti-avoidance provisions:

- non-portfolio investment; *and*
- subject to tax of at least five percent.[14]

In summary these anti-avoidance provisions can be reclassified[15] according to three categories:

1. Residency test;
2. Subject to tax provisions;
3. Geographically mobile income.

Although the participation exemption is a common feature of most EU holding company locations, there is a variance in the requirements that must be met in order to be entitled to the participation exemption. Under the most generous systems, these requirements tend to be minimal.[16]

2.2.3.1 Implications of the Anti-avoidance provisions on the Refund System

Upon distribution of dividends caught by these anti-avoidance provisions which exclude the entitlement to the participation exemption, the shareholder can claim a tax refund of five-sevenths of the tax of the distributing company.[17] This is in contrast to the six-sevenths refund that applies in all other circumstances. Therefore when the participation exemption does not apply as a result of the application of anti-avoidance rules, distributable dividends are taxed at a higher rate, at 10% rather than at 5%.

---

14 Income Tax Act, proviso to Art. 12 (1) (u).

15 This reclassification is not intended to disregard the specific order imposed by the Maltese tax statute.

16 For example, in Cyprus there is no subject-to-tax test and only a very limited activity test whilst in Slovakia anti-avoidance provisions are non-existent.

17 Income Tax Management Act, proviso to Art. 48(4A)(a).

2.3.2 Compatibility with Community Law

2.3.2.1 Freedom of Establishment

In the context of the Maltese participation exemption, a participating holding exists where the Maltese company holds at least 10 percent of the shares in the subsidiary or a lesser percentage holding subject to other conditions being fulfilled. Therefore, which freedom applies?

A cross-border shareholding in a company may be covered by the right of establishment or by the free movement of capital. In *Baars,*[18] the ECJ held that if the holding gives the Member State national 'definite influence over the company's decisions and allows him to determine its activities'[19] then the predominant freedom is the freedom of establishment. To the contrary, if the holding does not confer on the Member State national definite influence, then the free movement of capital is applicable. A shareholding equal to or greater than 10 percent allows the company registered in Malta to exercise definite influence over the foreign subsidiary. At the same time, it can be argued that the alternative scenarios defining a participating holding including a threshold level of investment, minimum holding requirement, activity tests and control tests [20] were intended to cover instances involving direct investments where a certain level of control is always perceptible and the holding is not portfolio in nature. In this case, it can be held that the Maltese legislation in these instances is intended to apply only to those shareholdings which enable the holder to have a definite influence on a company's decisions and to determine its activities. Following this, the freedom of establishment seems to be the predominant freedom at stake.

The Maltese participation exemption affects the dividends received from the state of establishment therefore in establishing whether the foreign-sourced dividends are treated less favourably than the domestic-sourced dividends the tax rule should be analysed from an origin state perspective.

The origin state rule at issue applies a different treatment depending on whether a Maltese registered company is receiving dividends from another Maltese registered company or from a company

18 C-251/98 *Baars* [2000].

19 Ibid para 22.

20 See Section 2.2.2.

resident in another Member State. From an origin state perspective, the ECJ, if the rule is challenged, will apply its migrant/non-migrant test[21] – also referred to as the national treatment principle – to determine whether the difference in treatment conflicts with the freedom of establishment.

In exercising the freedom of establishment, the migrant (i.e. the Maltese registered company with foreign-sourced dividends) should not be treated less favourably than the non-migrant (i.e. the local company that is not exercising the freedoms guaranteed by the Treaty).

2.3.2.2 Restriction Analysis

In *FII GLO* the Court dealt with an inbound dividend situation inversely analogous to the Maltese rule at issue. In *FII GLO* domestic sourced dividends were exempt from taxation in the hands of the UK recipient company. On the other hand, foreign-sourced dividends were subject to UK corporate tax, but a credit was granted for any withholding tax levied by the source state and for any underlying tax paid by the distributing company, if the recipient company held a 10 percent shareholding in it.

In applying the Court's reasoning[22] to the Maltese scenario, it can be argued that the migrant and the non-migrant companies are in the same situation because in both cases, the dividend paying companies are subject to corporation tax, either in the paying-company's member state or in Malta. When comparing Maltese registered companies with foreign-sourced dividends with Maltese registered companies with Maltese-sourced dividends, the Court will determine whether the participation exemption system represents less favourable tax treatment of the Maltese registered companies that set up a subsidiary in another EU Member State.

Analogously to the *FII GLO* case, the Maltese system adopts two different methods for the elimination of double taxation. The first principle that emanates from the *FII GLO* judgment is that the Member States are free to adopt either the exemption or the credit method because both mechanisms aim to eliminate economic double taxation or 'a series of charges to tax' on the same income stream, first at the corporate level and then at the shareholders' level.

---

21 T. O'Shea, 'From Avoir Fiscal to Marks & Spencer' (2006) Tax Notes Int'l, May 15 p 587.

22 C-446/04 *FII Group Litigation* [2006] paras 87-9. See also: C-319/02 *Manninen* [2004] paras 35-37.

The Court imposes an important rider on the aforementioned principle. The first proviso states that foreign source dividends cannot be subject to a higher rate of tax than the rate that applies to domestically sourced dividends. This matter was referred back to the UK national court to determine.

Under a fully operational exemption system the overall tax burden is maximised to the tax rate in the country of the subsidiary. In the Maltese situation, the foreign sourced dividends will be subject to a higher rate of tax only if the source country imposes a higher rate of tax. In any case this would not render the origin state rule restrictive or discriminatory because since both the credit and exemption methods aim to relieve double taxation or a series of charges to taxes, the use of either is equally permitted. Both mechanisms may lead to different results but this is the result of differences between the legal systems of two or more Member States.[23] The ECJ has dealt with these disparities reiterating the fact that the latter are outside the scope of the prohibitions of the Treaty Freedoms[24]. The second proviso is specific to the application of the credit method in a cross-border situation.

At this point one can conclude that following a restriction analysis based on settled case-law principles, the Maltese tax rule does not render the treatment of foreign-sourced dividends less favourable than that of domestic-sourced dividends. Therefore, despite the use of different methods of relief, the law does not hinder the Maltese parent company from exercising its freedom of establishment by setting up subsidiaries in other Member States.

2.3.3 Anti-avoidance provisions

The residency test, the subject-to-tax provisions and the geographically mobile income test constitute the anti-avoidance mechanism that conditions the entitlement to the participation exemption. The influence of both the ECJ and of the Code of Business Conduct on these anti-avoidance provisions will be examined.

23 Terra & Wattel, *European Tax Law* (4th edn Kluwer Law International 2005) p 57.

24 See C-336/96 *Gilly* [1998] paras 46-47; C-403/03 *Schempp* [2005] para 34. In this context see also: T. O'Shea, 'EU Cross-Border Loss Relief: Which view will prevail?' (2008) WTD 66-3 p 5; T. O'Shea, 'ECJ rejects Advocate General's advice in case on German Loss relief' (2008) WTD 123-2 p 6-7.

2.3.3.1 Residency test

The law expressly states that it is only holdings in bodies of persons that are resident or incorporated in an EU member state that will not be held to be abusive[25] and therefore qualify for the participation exemption.

In requiring the foreign subsidiary to be resident or incorporated in an EU Member State, the Maltese tax rule treats inbound dividends differently depending on whether the distributing company is established in an EU Member State or in a non-EU Member State. Whether this different treatment conflicts with the fundamental freedoms requires a discussion on the rights that third country persons enjoy under Community Law.

A third country MNE is only entitled to exercise its free movement of capital and payments rights. Under Articles 56 to 60 EC, all restrictions on the movement of capital and on payments between Member States and between Member States and third countries are prohibited. Let us assume that it exercises this freedom by investing capital in a holding company in Malta. If the economic link with the Maltese economy is genuine then the Maltese company set up by the third country MNE will be considered to be a Community national. In *Überseering* the ECJ held that a company validly incorporated in the Netherlands and having its registered office there is entitled under Article 43 and 48 to exercise its freedom of establishment in Germany[26]. As such the Maltese company can exercise the freedom of establishment by setting up subsidiaries in the EU territory.

As a result, a third country MNE – albeit indirectly[27] - may be entitled to the Maltese participation exemption which is granted exclusively in intra-community situations. In *Halliburton*[28] a US parent company held all the shares in its German subsidiary and Netherlands subsidiary. Following reorganisation of its business activities, the German subsidiary sold to the Netherlands subsidiary its permanent establishment in the Netherlands. The German subsidiary exercised its right of establishment by setting up a branch

25 This is to be understood as not falling within the scope of the anti-avoidance provisions.

26 C-208/00 *Überseering BV* [2002] para 80.

27 T.O'Shea 'Thin Cap GLO and Third Country Rights: Which Freedom Applies?' Tax Notes Int'l April 27, 2007 p 373.

28 C-1/93 *Halliburton Services BV* [1994].

in the Netherlands. The ECJ held that the Netherlands rule which denied exemption on the transfer in a cross-border situation hindered the exercise of the freedom of establishment.

In *Halliburton* the formation of German and Netherlands subsidiaries involved the exercise of free movement of capital rights. Thereafter, the transfer by the German subsidiary allowed the third country parent company to benefit indirectly from the Community's freedom of establishment rights.

MNEs that have subsidiaries in third countries and make a direct investment in a holding company in Malta will not benefit from the participation exemption upon distribution of profits or gains unless it qualifies as a non-portfolio investment *and* is subject to foreign tax of at least five percent. If these rules were to be analysed in the light of the protection of Article 56 EC, the more burdensome treatment would need to be justified by an imperative requirement in the public interest. As illustrated in the *A*[29] case, a restriction on the free movement of capital between a Member State and a non-Member State may be justified in circumstances where it would not represent a valid justification on capital movements between Member States. The absence of mutual administrative agreements in third country situations increases the risk of tax avoidance through third-country capital flight[30]. However in this context only the protection of Article 43 EC is applicable. It follows that if the anti-avoidance provision is analysed under the freedom of establishment principle as in this case, it cannot be held to be discriminatory because the third country nationals are only entitled to the free movement of capital and payment rights.

2.3.3.2 Subject-to-tax provisions

The purpose of these subject-to-tax provisions[31] is to ensure that the participation exemption in the home state is granted only if the income in question is subject to tax in the State of source. Therefore, while the participation exemption aims to eliminate double taxation, the subject-to-tax provision has a counter-balancing effect oriented

29 C-101-05 *A* [2007].

30 C. Panayi, *Double Taxation, Tax treaties, Treaty Shopping and the European Community* (Eucotax Kluwer Law International 2007) p 215.

31 The Commentary on the OECD Model Convention has envisaged subject-to-tax provisions as a means to deal with the issue of conduit companies and as a measure to counteract the improper use of tax treaties.

towards avoiding a situation of double non-taxation. If a subsidiary of a Maltese holding is not taxed in the foreign state of establishment; it does not require to be exempted in the residence state because it would not suffer double taxation if taxed in Malta.

Some commentators argue that the requirement of some kind of subject-to-tax condition for a foreign participation seems an 'inevitable condition' [32] for the application of the participation exemption. Consequentially, as a provision in the tax laws of a Member State, the subject-to-tax provision has to comply with the principles and fundamental freedoms of the Community.

Taking into consideration the fact that the Maltese anti-avoidance provisions are not cumulative but the fulfilment of either condition is sufficient to ensure application of the participation exemption, it is evident that the subject-to-tax rule would not apply in an intra-Community context because if the foreign subsidiary is established in an EU member state then the requirement of the residency test would be met and that would be sufficiently exhaustive. For example, if the distributing company is an Irish subsidiary taxable at 12.5 percent, the anti-avoidance provision requiring it to be subject to any foreign tax of at least 15 percent would not be fulfilled rendering the participation exemption inapplicable. However, since the Irish subsidiary is a resident of an EU member-state, the subject-to-tax requirement becomes irrelevant. Therefore, it can be concluded that this anti-avoidance provision does not hinder the exercise of the freedom of establishment.

2.3.3.3 Geographically mobile income

Alternatively the anti-avoidance provisions target both 'passive interest or royalties' and 'portfolio investments'. The law states that interest or royalty income is deemed to be passive when it is not derived, directly or indirectly, from a trade or business, or alternatively it has not suffered any foreign tax, or if it has suffered any foreign tax, directly, by way of withholding, or otherwise, the rate of tax is less than five per cent.[33] The main characteristic of passive income is that it is easily mobile income. Therefore, this type of income usually accrues in low tax jurisdictions. The aim of

32 J Muller, *The Netherlands in International Tax Planning* (2nd edn IBFD 2007) p 196.

33 Income Tax Act, Art. 2.

anti-avoidance rules is to prevent low-taxed foreign sources of income from qualifying for the exemption.[34]

The law defines 'portfolio investments' first of all by distinguishing it from direct investments and secondly by highlighting the fact that these type of investments are 'made with no interest in and without the intention of influencing the management of the company invested in'[35] and with the sole intention to maximize investment returns at any time which seems most profitable. For the purposes of the anti-avoidance provision, the law states that when the foreign subsidiary derives more than fifty per cent of its income from portfolio investments, any income derived from such participating holding shall be deemed to be a portfolio investment.

The nature of an anti-avoidance provision that focuses on geographical mobile income suggests that it is targeting a type of arrangement that does not entail the carrying out of a genuine business activity. Moreover, one can perceive an intention to convert passive income into exempt dividend income receivable by the Maltese resident company. The objective of the freedom of establishment requires the foreign subsidiary to exercise a genuine business activity. The foreign company will need substance, shareholders should ensure that the management of the company is real and must be able to justify its creation by reasons other than exclusively fiscal

In practice, where a Maltese holding company sets up a subsidiary in an EU Member State, this anti-avoidance provision requiring the foreign subsidiary to derive less than 50 percent of its income from passive interest or royalties will not apply because upon fulfilment of the residency test, the participating holding would have already earned its right for the participation exemption.

2.4 The impact of the Code of Business Conduct on anti-avoidance provisions

The Maltese legislator enacted the so-called anti-avoidance provisions on the application of the participation exemption and with respect to certain passive income at the Community's request.[36] Although the Code is a political non-binding

---

34 B.J. Arnold & M.J. McIntyre, *International Tax Primer* (2nd edn Kluwer Law International 2002) p 35.

35 Income Tax Act, Art. 2.

36 J. Brockdorff, 'Malta introduces measures agreed to by the EU' (2007) 6 EC Tax Review p 293.

agreement, in practice its influence on the introduction of the Maltese anti-avoidance provisions has been felt. It was only upon reaching a consensus with the Code Group that the Code Group approved without further questions the Maltese tax system. One could possibly argue that if it was for the Maltese legislator no anti-avoidance provision would have been introduced rendering the participation exemption more attractive and widely accessible. So what is the rationale behind the Community's request encroaching on a Member States' competence?

Though Malta did introduce anti-avoidance provisions upon examination one realises that other Member States' anti-avoidance provisions in relation to the participation exemption are even more relaxed. For example, dividends distributed out of profits derived from 1 January 2004 are not subject to tax in Slovakia. At the same time there are no anti-avoidance provisions accompanying this tax-free system.

Diagrams I and II compare the Maltese anti-avoidance provisions with the Cypriot and French rules. With reference to Diagram I it is evident that the Cypriot anti-avoidance provisions are less cumbersome. For instance there is no subject-to-tax test. It is also arguable whether the limited activity test applies to foreign subsidiaries established in an EU Member State? In practice the end result of both the Maltese and Cypriot anti-avoidance rules can be very similar.

Diagram II illustrates the application of the French CFC rules in relation to the entitlement to the participation exemption. It is evident that in an inter-Community situation, the French legislator has designed its CFC rules to target exclusively 'artificial arrangements'. On the other hand, the safe harbours that apply in the case of a CFC established in a third country include very limited activity tests. However, the definition of a CFC itself presents a significant loophole. Since the French anti-avoidance provisions apply only where the French company has at least 50% of the capital of the foreign company, any other person resident in an EU member state can set up a French company which may have less than 50% (e.g. 49%) of the capital of the tax haven company. In this case the reduced French threshold of 5% will not apply as there is only one French company holding shares in the tax haven company and the non-French company holding shares in the tax haven company and the non-French entity or entities holding the remaining 51% will not be controlled or owned, directly or indirectly, by French entities or individuals. Therefore, EU persons have the facility of receiving 49% of a tax haven company's passive income exempt from tax through a French company. In similar circumstances, the Maltese anti-avoidance provisions disallow such exemption. Does the Code adopt a 'consistent' approach in relation to anti-avoidance provisions with all Member States? Is a single loophole better than having several loopholes? Or is it equally harmful?

In theory Member States are at liberty to design their tax systems in any way they prefer, in a different way or similar to other Member States' tax systems. However, if it can be argued that the Code is not 'consistent' in its approach, this would contrast sharply with the principle of equal treatment which should always be upheld.

The Code should not use two weights and two measures in requesting Member States' to adopt varying types of anti-avoidance provisions or target certain loopholes in one particular tax system and ignore other existing loopholes. If this is so the effectiveness and integrity of the Code will be undermined and the Member States will feel that proceedings are unfairly prejudiced in favour of one or more Member States.

Concluding Remarks

3.1 The Participation Exemption and a new principle: anti-avoidance resulting in a more burdensome rate

The most perceptible trait of the participation exemption is that it offers a tax advantage, more precisely a cash-flow advantage. It follows that when the anti-avoidance provisions apply, the consequence should be the denial of such advantage. However, in the Maltese case when the anti-avoidance provisions apply, not only the participation exemption does not apply but the dividend is taxable at a more burdensome rate. Upon distribution of profits – not derived from a participating holding – the shareholder is entitled to claim a tax refund of 6/7ths of the Malta tax charge at 35% on those profits. Therefore the tax suffered in Malta on such profits will generally be of 5%. However, where the income falls within the scope of the anti-avoidance provisions the refund is of 5/7ths of the Malta tax charge, in which case the tax suffered in Malta will be generally of 10%.

No other EU Member State adopts a similar principle of counter-balancing the grant of a tax advantage against the possibility of tax avoidance by going as far as imposing a more burdensome tax rate. Competence in relation to direct tax matters remains with the Member States; this means that they can set their own tax rates, even a zero rate as long as the establishment benefiting from such rate is not a wholly artificial arrangement. So what is the rationale of requesting the introduction of this new principle? Was it because the Code could not swallow a 5% rate? Is this really the case? And what if this principle were to be imposed on the other Member States?

In the Maltese case, upon application of the anti-avoidance provisions the tax rate was doubled from 5% to 10%. By analogy it can be argued that if the same principle is taken on board the Dutch corporate tax rate which is 25.5% will multiply by two and the tax rate consequential to the application of anti-avoidance provisions would increase up to a phenomenal rate of 51%. Even in the case of such an unlikely occurrence it is evident that the exercise of the concept of equal treatment is somewhat blurred.

3.2 Anti-avoidance: consistency?

It was argued that the Code does not adopt a consistent approach with all EU member states. In order to substantiate this assertion I compared the Maltese anti-avoidance rules with those of Cyprus and France. A similar exercise was not possible in the case of Slovakia because it does not have any anti-avoidance rules. The lack of anti-avoidance provisions is a key element that enhances the attractiveness of a holding company location. So what is the reason that Slovakia does not feature as one of the prominent holding company locations in Europe? Building a reputation as a preferred holding company is a matter of combining multiple tax considerations and non-tax related factors. Furthermore, in these circumstances one must not undermine the importance of effective marketing.

3.3 There's a hole in the bucket!

Another point that emerges from this discussion is that the lack of a consistent approach in relation to anti-avoidance provisions may succeed in blocking the route for dividends to flow through a particular EU member state structure tax free but at the same time leave other possible routes in other EU member states unhindered. If this is so, the aim of anti-avoidance provisions from a Single Market perspective is equally defeated in its entirety. If we compare this situation to a bucket full of water with a hole drilled through its bottom representing a loophole in the anti-avoidance provisions of one single Member State with a similar bucket with 27 holes representing deficiencies in all Member State, the end result is the same. Both buckets will become empty at some point in time. This definitely calls for a consistent anti-avoidance policy with particular focus on certain loopholes that tend to be ignored across all European Member States.

3.4 Domestic Anti-avoidance provisions: the way forward

Malta, one of the smallest Member States and a preferred holding company location is bound by Community law in the design of its anti-avoidance provisions. However, in the process of achieving a compatible anti-avoidance target, the trajectory path may be different from that of other member states. It is perhaps these differences which are perceptible upon in-depth examination that may point towards maintaining a status quo in direct tax matters without making an effort at further harmonization attempts especially where anti-avoidance measures are at stake.