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# UPDATE IN MALTA TAX LEGISLATION – ANTI-AVOIDANCE TAX

**Legal Notice 411 of 2018 was published on 11th December 2018 by the Minister of Finance (Malta), containing The European Union Anti-Tax Avoidance Directives Implementation Regulations (ATAD EU 2016/1164) of July 2016. The legal notice contains four measures:**

1. **interest limitation**
2. **general anti-abuse rule (GAAR)**
3. **controlled foreign company (CFC) rule**
4. **exit taxation**

These rules apply to all companies as well as other entities that are subject to tax in Malta in the same manner as companies, including entities that are not resident in Malta but that have a permanent establishment in Malta.

## 1. Interest Limitation Rule – effective as from 1st January 2019

Although the Income Tax Act (ITA) already contained restrictive rules with respect to deductibility of interest, further to ATAD, exceeding borrowing costs (i.e. the amount by which the deductible borrowing costs of a taxpayer in terms of the Income Tax Act, Chapter 123 of the Laws of Malta ('ITA'), were it not for the provisions of the regulations, exceed taxable interest revenues and other economically equivalent taxable revenues that the taxpayer receives) shall be deductible in the tax period in which they are incurred, up to 30% of the taxpayer's earnings before interest, tax, depreciation and amortization ('EBITDA'). Any borrowing costs beyond the 30% EBITDA threshold would be considered to be non-deductible in the tax period in which they are incurred, with a possibility to carry forward the excess, without time limitation, and with a possibility to carry forward unused interest capacity for a maximum of 5 years.

The regulations provide for several exclusions from, and derogations to, the general rule, which Malta has opted for, in particular:

- *de minimis rule*: full deductibility of exceeding borrowing costs up to EUR 3,000,000;
- The interest limitation rules do not apply to standalone entities: a full deductibility of exceeding borrowing costs if the taxpayer is a standalone entity (i.e. a taxpayer that is not part of a consolidated group for financial accounting purposes and has no associated enterprise or permanent establishment);
- exclusion from the scope of costs incurred on loans concluded before 17 June 2016 or used to fund certain long-term public infrastructure projects;
- exclusion of financial undertakings; and

- full deductibility of exceeding borrowing costs if the taxpayer can demonstrate that the ratio of its equity over its total assets is equal or higher than the equivalent ratio of the group.

### General Anti-Abuse Rule (GAAR) – effective as from 1st January 2019

The ATAD Implementation Regulations also stipulate a GAAR whereby the tax authorities have the right to ignore any arrangements which have been put into place for the main purpose of obtaining a tax advantage that defeats the objects of the applicable tax law and are not genuine.

For these purposes, a procedure shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality, and hence the tax liability shall be calculated in accordance with the provisions of the ITA.

### 2. Controlled Foreign Company Rule (CFC) – effective as from 1st January 2019

A CFC is defined in the Regulations as:

a. an entity in which a Maltese resident taxpayer alone or together with its associated enterprises holds a direct or indirect participation of more than 50% of the voting rights, or owns directly or indirectly, more than 50% of the capital or is entitled to receive more than 50% of the profits of that entity, and
b. the actual corporate tax paid by the entity is lower than the difference between the tax that would have been charged on the entity under the ITA and the actual foreign corporate tax paid.

If the abovementioned conditions are fulfilled, the non-distributed income of the CFC may be included in the tax base of the Maltese parent, or Maltese head office, if the income arises from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage. There should be no CFC charge if there are no significant people functions in Malta that are instrumental in generating the income of the CFC.

The CFC rule shall not apply to an entity or permanent establishment:

- with accounting profits of no more than EUR 750,000 and non-trading income of no more than EUR 75,000; or
- of which the accounting profits amount to no more that 10% of its operating costs in the tax period.

### 3. Exit Taxation – effective as from 1st January 2020

With effect from 1 January 2020, a taxpayer may be subject to tax on capital gains where assets are owned by the taxpayer and are transferred outside the Maltese income tax net in the following circumstances:

a. the assets are transferred from the head office in Malta to its permanent establishment outside Malta, whereby Malta no longer has the right to tax capital gains from the transfer of such assets due to the transfer;
b. the assets/business of a non-resident are transferred from its permanent establishment to the head office/ another permanent establishment outside Malta in so far as Malta no longer has the right to tax capital gains from the transfer of such assets due to the transfer; or

c. transfer of tax residence from Malta to a place outside Malta except for those assets which remain effectively connected with a permanent establishment in Malta.

In such circumstances, the taxpayer is deemed to have transferred those assets and may be considered to have derived a capital gain. The capital gain is calculated by reference to an amount equal to the market value of the transferred assets, at the time of exit of the assets, less their base cost for tax purposes.

The income tax that may become chargeable on the deemed transfer becomes payable by not later than the taxpayer's subsequent tax return date. Member States may give the right to defer the payment of an exit taxation by paying it in instalments over five years in specific circumstances, though interest may be charged.

Please do not hesitate to contact the author if you have questions or queries.

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