Maltese Implementation of the Anti-Tax Avoidance Directive

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On 11 December 2018, further to the publication of Legal Notice 411 of 2018, EU Anti-Tax Avoidance Directive (ATAD EU 2016/1164) of July 2016 was transposed into Maltese law. The Legal Notice contains four measures in relation to interest limitation, exit taxation, a general anti-abuse rule (GAAR) and controlled foreign company (CFC) rule. In addition, on 24 December 2019, further to the publication of Legal Notice 348 of 2019, Council Directive (EU) 2017/952 was transposed, targeting hybrid mismatch arrangements.

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 (PE) in Malta.

Interest Limitation Rule

Although the Income Tax Act already contained restrictive rules with respect to deductibility of interest, further to ATAD, exceeding borrowing costs shall be deductible in the tax period in which they are incurred only up to 30% of the taxpayer's earnings before interest, tax, depreciation and amortisation (EBITDA). Exceeding borrowing costs refer to net interest expense (broadly interest income less interest expense on all forms of debt and other costs economically equivalent to interest and expenses incurred in connection with the raising of finance).

The implementing subsidiary legislation includes opt outs in relation to a de minimis threshold (exceeding borrowing costs up to EUR 3 million can be deducted), a standalone entity exemption (not being part of a group of companies), grandfathering of loans concluded before 17 June 2016, an exclusion from scope of long-term infrastructure projects which are considered to be in the general public interest, as well as allows a group equity ratio carve out. This limitation will also not apply to financial undertakings (credit institutions, insurance / reinsurance companies, occupational retirement pension funds, EU social security pension schemes, AIFMs, AIFs, UCITS funds, OTC derivative counterparties).

Taxpayers may carry forward, without time limitation, exceeding borrowing costs and, for a maximum of five years, unused interest capacity, which cannot be deducted in the current tax period.

Controlled Foreign Company Rule

Another anti-avoidance rule integrated in the ATAD is the so called CFC rule, whereby income derived by subsidiaries or attributed to PEs may in certain circumstances be taxed in the jurisdiction of the parent and/or head office. The formal cumulative conditions for the CFC rule to kick in are:

1. in the case of an entity, where the Maltese taxpayer alone or together with associated entities holds a direct or indirect participation of more than 50% of the voting rights, or of the capital or is entitled to receive more than 50% of the profits of such entity; and
2. the corporate income tax (CIT) paid by the non-resident entity / PE is less than 50% of CIT payable if it were resident in Malta;
3. exceeding the minimum thresholds (non-resident entity / PE with accounting profits less than EUR 750K or with accounting profits <10% of its operating costs).

In the event that 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.

General Anti-Abuse Rule

The long-standing GAAR within the Maltese Income Tax Act (ITA GAAR) seeks to address schemes whose sole or main purpose is to obtain an advantage with the effect of, among others, reducing, avoiding or postponing liability to tax. The transposition of ATAD 1 has widened the application of the ITA GAAR by including an additional rule, addressing any arrangement(s) that are put into place with the main purpose or one of the main purposes of obtaining a tax advantage which defeats the object or purpose of the applicable tax law and are thus not genuine when having regard to all the relevant facts and circumstances. The GAAR will therefore target all non-genuine transactions (to the extent that they are not put in place for valid commercial reasons that reflect economic reality) performed in a domestic or a cross-border situation.

Albeit the wording of the ATAD GAAR is wider, reflecting the wording used in the long-standing GAAR in the Merger Directive, an analysis of case law construing the latter conveys that the Court of Justice of the EU (CJEU) has applied a strict interpretation thereof, requiring an essential or sole purpose. The result is that such interpretation may assimilate its effect to that under the current ITA GAAR at least to the extent coupled with economic substance. In practice it is possible that the tax authorities may resort to the GAAR more often due to this transposition.

Exit Taxation

Another initiative of the EU in ATAD, which is independent of the BEPS project, was the introduction of exit taxation, that is, the taxation of capital gains arising upon the transfer of assets, and the subsequent loss of right to tax any arising capital gains, in the following circumstances:

1. a transfer of assets from a head office located in Malta to a PE in another jurisdiction and vice versa;
2. a transfer of residence of a Maltese resident entity to another jurisdiction (to the exclusion of assets which remain effectively connected to a Maltese PE);
3. a transfer of business carried on in Malta by the taxpayer's PE, to another jurisdiction.

The transposed law, in an identical manner to ATAD, prescribes an immediate payment of the due tax with the possibility of payment in instalments over the period of five years in cases of transfers to an EU Member State or to a party to the European Economic Area Agreement, which might possibly require providing a guarantee.

The introduction of exit taxation in Maltese corporate income tax law is novel, however, coupled with the application of the step up of the value of assets at time of transfer to / from Malta, there should be no resultant double taxation.

Anti-Hybrid Mismatch Rules

The entry into effect of ATAD II has brought about novel obligations with respect to arrangements using hybrid instruments or hybrid entities with the aim of neutralising the resulting mismatches by means of the linking rules.

The anti-hybrid rules address the below harmful outcomes of arrangements involving hybrid entities or hybrid financial instruments:

1. Deduction without inclusion, where the amount of payment qualifies for a deduction in the payer jurisdiction but is not included in the taxable income in the payee jurisdiction. In such case, the rules lay down:
   - a primary rule: the payer state should deny the deduction of payment;
   - a secondary rule: the payee state should include payment in the taxable income of the recipient, if the deduction was not denied in the payer state.
2. Double deduction, where the same amount of payment qualifies for a deduction in two jurisdictions against income which is included as taxable income only in one of those jurisdictions. In such case, the rules lay down:
   - a primary rule: the second jurisdiction (so-called "investor jurisdiction", i.e. not the payer jurisdiction) to deny the deduction;
   - a secondary rule: if the deduction was not denied in the investor jurisdiction, the payer jurisdiction would be obliged to deny the deduction.

Key Takeaway

The transposition of ATAD significantly raises the bar of awareness and diligence which companies should exercise in order to be compliant with the reshaped tax framework. No matter what the industry of your business is, it is important to make sure that its operating model meets the new requirements. We would be happy to help you to assess the impact of the new rules on your business.

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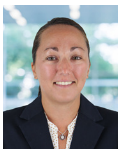

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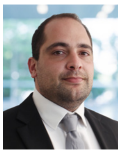

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