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Anti-Tax Avoidance Directive (ATAD I)

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The Anti-Tax Avoidance Directive (ATAD I)

Malta implemented the provisions of Council Directive (EU) 2016/1164, often referred to as the Anti-Tax Avoidance Directive (ATAD I) on 11th December 2018 by means of Legal Notice 411 of 2018. The EU Directive was adopted in the global context of the fight against base erosion and profit shifting and introduced four changes into the Maltese fiscal landscape.

The Legal Notice features four measures:

a. Interest deduction limitation (effective as from 1 January 2019)

b. Exit taxation (effective as from 1 January 2020)

c. Controlled foreign company rules (effective as from 1 January 2019)

d. General Anti-Avoidance Rules (effective as from 1 January 2019)

The legislation applies to all companies and other entities, trusts and similar arrangements that are subject to tax in Malta in the same manner as companies and also to local permanent establishments (PE) having a taxable presence in Malta of foreign entities.

Malta will soon introduce rules on hybrid mismatches as part of its commitment in terms of Council Directive (EU) 2017/952, the ATAD II Directive. The rules will apply as from 1 January 2020 with the exception of reverse hybrid mismatches, the implementation of which may be delayed to 1 January 2022.

Interest deduction limitation (Rule 4)

The general rule is that borrowing costs on all forms of debt, profit participating loans and other instruments net of taxable interest and other equivalent revenues are only tax deductible up to 30% of the taxpayer's earnings before interest, tax and tax adjusted depreciation and amortisation (EBITDA). Tax exempt income is excluded from EBITDA.

In the case of a group, the rule is calculated on the consolidated results.

Net borrow costs exceeding this limit are not tax deductible in the tax year in which they were incurred but may be carried forward for a maximum period of 5 years.

However, the legislation provides for certain "escape clauses", these being:

a. The rule does not apply to stand alone companies;

b. The rule does not apply to financial institutions such as banks, insurance and reinsurance undertakings, pension funds, UCITS and AIFs and similar bodies;

c. The rule does not apply where the net borrowing costs do not exceed € 3 million and where the taxpayer is a member of a group, the said amount applies on a group basis;

d. A grand-fathering clause where the rule does not apply to loans concluded before 17th June 2016 provided that the loan was not modified thereafter;

e. In the case of a group, a company is entitled to deduct all its net borrowing costs if its equity – total assets ratio is not less than 2 percentage points below the equivalent ratio of the group.

Exit tax (Rule 5)

Exit taxation is chargeable on the following operations:

- Transfer of certain assets from HO in Malta to its PE outside Malta, whereby Malta no longer has the right to tax capital gains upon the transfer of such assets due to the transfer;
- Transfer of certain assets/business from a PE in Malta to the HO/ PE 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
- Transfer of tax residence from Malta to a place outside Malta except for those assets which remain effectively connected with a PE in Malta.

The capital gain subject to tax is the market value of the transferred assets less their base cost for tax purposes. The tax becomes payable by not later than the taxpayer's subsequent tax return date. Malta gives however the right to defer the payment by paying it in instalments over five years in specific circumstances, though interest may be charged.

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Controlled foreign company rule (CFC) - article 7

CFC rules aim at allocating undistributed income of a low-taxed controlled subsidiary to its Maltese parent company. Applicability of the CFC provisions hinge on (i) the level of control by the Maltese Co., (ii) the level of taxation of the controlled subsidiary and (iii) the carrying out in Malta of significant people functions in relation to the income producing assets.

A foreign subsidiary will qualify as a CFC if:

a. The Malta company together with its associated enterprises holds directly or indirectly more than 50% of either the voting rights, or, the share capital, or, is entitled to receive more than 50% of the profits of the foreign subsidiary; and,

b. The actual corporate tax paid by the said subsidiary is less than half the tax that would be payable in Malta on its profits determined in accordance with Malta's domestic tax rules.

When the subsidiary qualifies as a CFC in terms of the above-mentioned rules, any undistributed income in proportion to the holding by the Malta company is taxable in the hands of the Malta company to the extent that the said profits are derived from non-genuine arrangements which have been put in place for the essential purpose of gaining tax advantages. The concept of non-genuine arrangement endorses the principles used in transfer pricing and seeks to allocate (more) profit to the entity where the key drivers are managed. Thus, undistributed income generated through assets belonging to the CFC is to be included in Malta's tax base to the extent that the significant people functions in relation to the said assets are carried out in Malta.

The rules also provide for a carve out provision which exclude from the scope of CFC rules when:

a. The accounting profits of the foreign entity do not exceed € 75,000 and its non-trading income does not exceed € 75,000; or

b. The accounting profits of the foreign entity amount to no more than 10% of its operating costs for the tax period.

Each foreign entity is examined on its own merits as aggregation is not required where there are 2 or more foreign entities.

General anti abuse provision (GAAR) - article 6

The GAAR is not new for Malta. Indeed, this provision is very similar to the rules contains in article 51 of the Income Tax Act.

The said provision gives right to the tax authorities to ignore arrangements put in place for the main purpose of obtaining a tax advantage that runs counter to the objects of the applicable tax law and are not genuine. An arrangement will be regarded as non-genuine to the extent that it is not put into place for valid commercial reasons which reflect economic reality.

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Conclusion

ATAD, which has been implemented by all EU member States, constitutes a first and important step towards the harmonisation of anti-abuse provisions amongst EU Member States. In 2020, Malta is expecting to implement ATAD II which will introduce new provisions to fight against hybrid mismatches and hybrid entities.

These legislations arise in a context of global changes in the tax landscape and follow the recent changes in exchange of information between states whether it is Common Reporting Standard (CRS), Foreign Account Tax Compliance Act (FATCA) or Country by Country Reporting (CbCR).

The new developments require particular attention of businesses and investors. Our tax advisors can help you to ascertain that your business is compliant with these developments and to explore any new opportunities that may arise.

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Key contact

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Austin joined the firm in 1982 and was initially mainly involved on audits in Malta. He later underwent training at the Milan office of the then Deloitte Haskins and Sells for 15 months following which he resumed his duties in the Malta office. He was admitted partner at Grant Thornton Malta in 1993 and is currently Head of Tax Services.During the past 20 years Austin has taken up further studies and specialised in the local and international taxation and in the financial services sector. He was appointed Tax Partner in 1995.

Apart from being in charge of the local tax and VAT services, Austin is also responsible for services given to foreign owned companies setting up businesses in Malta, and has provided tax advice to international clients involved in cross border business ventures.

Austin is a Fellow of The Chartered Association of Certified Accountants, a Fellow of the Malta Institute of Accountants and holds a Practicing Certificate in Auditing. Austin regularly attends tax conferences organized by Grant Thornton International, and is a customary speaker at local conferences related to VAT and tax matters, including those organised by the Malta Institute of Management and the Malta Institute of Accountants.

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Wayne is the partner responsible for the corporate and financial services team in Malta where he deals with a wide range of asset protection and cross-border regulatory and tax planning engagements for clients ranging from private clients, including family offices and high-net-worth individuals, to NASDAQ listed companies in various industry sectors. He conducts an active consulting practice on the legal and tax implications involved in the structuring of both local and international financial institutions, M&A and project finance transactions.

He is an active thought leader in the financial technology space, making regular contributions at fintech conferences, and has a passion for the security and technological aspects of distributed ledger technology. He is also a joint contributing author to "European Competition Laws: A Guide to the EC and its Member States, the leading legal compendium with respect to Competition law in Europe", published by Lexis Nexis and revised annually.

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Since 2003, Michael has been involved in Indirect and Direct tax matters, initially at the Inland Revenue Department's Tax Investigations unit, followed by his employment with Grant Thornton's tax advisory department in 2007.

Since joining Grant Thornton, Michael has been involved in providing tax assistance to a portfolio of local and international clients with special reference to the preparation of tax assessment, tax planning and consultancy services, Value Added Tax compliance, expatriate and personal tax services, tax litigation and investigations, and also buyers' and vendors' cross-border due diligence assignments.

Michael is an ACCA affiliate and has recently completed his studies with the Chartered Institute of Taxation where he obtained an Advanced Diploma in International Taxation. Michael is also a member of the Malta Institute of Accountants and the Malta Institute of Taxation.

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