Guidelines in relation to the Anti-Tax Avoidance Directives Implementation Regulations. S.L. 123.187.

For the purposes of the European Union Anti-Tax Avoidance Directives Implementation Regulations, 2018 (hereinafter in these guidelines referred to as "regulations") the Commissioner for Revenue determines, in line with the provisions of article 96(2) of the Income Tax Act, the following:

Interest Deduction Limitations

(i) Scope of Regulation 4 (Sub-regulation 4(3) and 4(7), S.L. 123.187)

1.1. Interest deduction limitations are applicable as from the basis year starting on or after 1st January 2019. Thus, for example, a taxpayer with a 1st July 2018 till 30th June 2019 basis year will not be within the scope of these regulations for that basis year.

1.2. The EBITDA shall be calculated after all actual and deemed deductions provided in the Income Tax Acts.

(ii) Fiscally Consolidated Group (Regulation 4(1)(a), S.L. 123.187)

2.1. In the case of a fiscal unit in terms of the Consolidated Group (Income Tax) Rules (S.L. 123.189), the calculation of the exceeding borrowing costs and the tax-adjusted EBITDA shall be made at the level of the fiscally consolidated group, taking into consideration only the entities which are in scope in terms of regulation 2(2).

2.2. It is pertinent to note that should the fiscally consolidated group include financial undertakings; the results of the financial undertaking shall be excluded from the determination of the exceeding borrowing costs and the tax-adjusted EBITDA as provided in regulation 4(7).

(iii) Non-Fiscally Consolidated Group (Regulation 4(1)(b), S.L. 123.187)

3.1. It is hereby being clarified that regulation 4(1)(b) refers to an entity that forms part of a group as defined in article 16 of the Income Tax Act.

3.2. The entities in a group may elect, annually, to be construed as a single taxpayer in terms of regulation 4(1)(b) in order to calculate the exceeding borrowing costs and the tax-adjusted EBITDA. However, for such election to be valid, all entities within the group must opt-in for this election during the same year of assessment and report their results individually in their appropriate tax return.

3.3. In the event of an election as defined in guideline 3.2., the *de minimis* rule in terms of regulation 4(3)(a) may only be utilised once for the whole non-fiscally consolidated group. It is within the discretion of the group to allocate the €3,000,000 or equivalent in another currency, as applicable, between the entities that make up the group.

3.4. Once the election in terms of guideline 3.2. is made, each entity within the group needs to, subject to guideline 3.5., surrender any excess unused interest capacity to any other entity within the same group.

3.5. An entity within a group may only claim excess unused interest capacity from another entity within the same group to the extent that the former entity has exceeding borrowing costs which are subject to interest deduction limitations within the meaning of regulation 4.

3.6. In the event a taxpayer prepares its tax return in a currency other than Euro, the €3,000,000 shall be converted to that denomination using the annual average exchange rates.

(iv) The Calculation of the Exceeding Borrowing Costs (Regulation 4(4), S.L. 123.187)

4.1. The determination of the amount of exceeding borrowing costs shall be carried out at the level of the taxpayer by taking into account the deductible borrowing costs and taxable interest (and other economically equivalent) revenues derived from/attributable to all sources.

4.2. Deemed deductions calculated as a percentage of the risk capital of an entity as defined in the Notional Interest Deduction Rules (S.L. 123.176) are not treated as being borrowing costs. In this regard, notional interest deductions do not fall within the scope of this regulation.

4.3. Where the grandfathering clause on exceeding borrowing costs incurred on loans concluded before 17 June 2016 is applicable, in case of a subsequent modification, the grandfathering would not apply to any increase in the amount or duration of the loan but would be limited to the original terms of the loan.

4.4. Where a taxpayer is engaged in a long-term public infrastructure project, a taxpayer may apply in writing to the Commissioner for a determination in terms of Regulation 4(4)(b). This letter shall be addressed and sent to the International & Corporate Tax Unit. Based on this determination, exceeding borrowing costs and the corresponding income from the tax adjusted EBITDA on the loans used to fund the project may be excluded. In this regard, the taxpayer would need to demonstrate that:

a. The project is circumscribed by written contractual dispositions which oblige the project operator/s to maintain the economic destination of the project to that of a general public interest. A general public interest is understood in the wide sense to mean a project from which the welfare or well-being of the general public benefit from; and

b. The loan or loans made to the operator/s do not exceed the value or estimated value of the assets at acquisition or once constructed, unless additional investment is made to maintain or increase their value. Furthermore, it would need to be shown that the financing arrangement has special features which justify such treatment.

(v) Equity-Escape Carve-Out (Regulation 4(5), S.L. 123.187)

5.1. Where the taxpayer is part of a group that files consolidated financial statements, and all the conditions for the equity-escape carve out as set out in regulation 4(5) are satisfied, a taxpayer may exclude the application of regulation 4.

5.2. In terms of regulations 4(5)(b) and 4(8), the Commissioner is hereby determining that consolidated financial statements may be drawn up using any accounting standard as sanctioned by the Accounting Professions Act or those that would satisfy the requirements of article 174(2)(a) or (b) of the Companies Act.

5.3. A group within the meaning of Guideline 3.1. that has elected to be construed to be a single taxpayer within the meaning of Guideline 3.2. may not apply the equity-escape carve-out to carve-out an entity from the group.

(vi) The Calculation of deductible Exceeding Borrowing Costs and *Carry forwards (Regulation 4(6), S.L. 123.187)*

6.1. The determination of whether the deductibility of exceeding borrowing costs is limited by this regulation shall be carried out at the level of the taxpayer, that is, by aggregating all taxable income and all exceeding borrowing costs from all sources.

6.2. The aggregate amount of deductible exceeding borrowing costs shall be allocated against different sources of income at the discretion of the taxpayer provided that the amount so allocated does not exceed the exceeding borrowing costs attributable to each respective source.

6.3. The amount by which exceeding borrowing costs for each source of income exceed the allocated deductible exceeding borrowing costs shall be a disallowed expense for the current year of assessment and may be carried forward to subsequent years of assessment.

6.4. The unused interest capacity shall be construed to mean the excess tax-adjusted EBITDA capacity which was not used during the year of assessment. The unused interest capacity may be carried forward up to five years and shall be utilised on a first-in-first-out basis.

<u>Example demonstrating the allocation of deductible exceeding borrowing costs (EBC) against different sources of income:</u>

	Trading *[Art. 4(1)(a) ITA]*	**Interest** *[Art. 4(1)(c) ITA]*	**Royalties** *[Art. 4(1)(e) ITA]*	**Total**
	€	€	€	€
Taxable income before interest limitation	4,500,000	0	1,500,000	6,000,000
<u>EBC calculation</u>				
Taxable interest revenues	0	4,000,000	0	4,000,000
Deductible borrowing costs	4,000,000	4,000,000	1,000,000	9,000,000
Exceeding borrowing costs	**4,000,000**	**0**	**1,000,000**	**5,000,000 (Guideline 4.1)**
<u>Tax-adjusted EBIDTA[1] and deductible EBC calculation</u>				
Taxable income before interest limitation				6,000,000
Exceeding borrowing costs				5,000,000
Tax-adjusted EBITDA				11,000,000
x fixed ratio				x 30%
Deductible EBC				**3,300,000**

[1] Income subject to final withholding tax in terms of the Income Tax Acts shall be excluded from this amount.

				(Guideline 6.1)

Allocation of deductible EBC

Example 1

Exceeding borrowing costs	4,000,000	0	1,000,000	5,000,000
Deductible exceeding borrowing costs *[Note]*	2,550,000	0	750,000	3,300,000 **(Guideline 6.2)**
Disallowed EBC carried forward to subsequent years	**1,450,000**	**0**	**250,000**	**1,700,000 (Guideline 6.3)**

[Note] Allocated against each source of income at the discretion of the taxpayer provided that the amount so allocated does not exceed the exceeding borrowing costs attributable to the respective source.

Example 2

Exceeding borrowing costs	4,000,000	0	1,000,000	5,000,000
Deductible exceeding borrowing costs *[Note]*	3,300,000	0	0	3,300,000
Disallowed EBC carried forward to subsequent years	**700,000**	**0**	**1,000,000**	**1,700,000**

Example 3

Exceeding borrowing costs	4,000,000	0	1,000,000	5,000,000
Deductible exceeding borrowing costs *[Note]*	2,300,000	0	1,000,000	3,300,000
Disallowed EBC carried forward to subsequent years	**1,700,000**	**0**	**0**	**1,700,000**

Exit Taxation

(i) Applicability in Relation to Capital Gains

7.1. Subject to specific provisions in the regulations, the Income Tax Act and subsidiary legislation thereto shall apply *mutatis mutandis* to the unrealised capital gains on which exit taxation is levied as from 1st January 2020.

(ii) Right to Tax *(Regulation 5(1), S.L. 123.187)*

8.1. Where it needs to be determined whether *"Malta no longer has the right to tax the capital gains"*, reference needs to be made to the Income Tax Acts. Therefore, in the determination of whether Malta no longer has the right to tax, overriding arrangements concluded in terms of article 76 of the Income Tax Act shall also be taken into consideration.

8.2. Similarly, where Malta has the right to tax in terms of international tax principles but chooses not to tax, then it follows that there is no effective loss of right to tax for Malta. By way of example, a taxpayer which is not taxed on foreign capital gains will not be subject to exit taxation on foreign unrealised capital gains if its place of effective management is shifted away from Malta.

Controlled Foreign Company (CFC)

(i) Temporal and Material Scope

9.1. CFC regulations are applicable as from the basis year starting on or after 1st January 2019. Thus, for example, a taxpayer with a 1st July 2018 till 30th June 2019 basis year will not be within the temporal scope of these regulations for that basis year.

(ii) CFC Characterisation (Regulation 7(1), S.L. 123.187)

10.1. Controlling Threshold: A taxpayer would firstly need to determine if the participation in the voting rights or ownership of capital or entitlement to profits in a foreign company constitute a controlling interest in the CFC. If there were changes during the CFC tax year regarding the direct and indirect participation in the voting rights, ownership of capital and entitlement to profits, it is only during the periods during which the requirements of regulation 4(1)(a) are satisfied that the taxpayer shall be in scope.

In order to determine whether a taxpayer has met the controlling threshold in respect of a foreign company, such taxpayer would need to adopt the following two-step process:

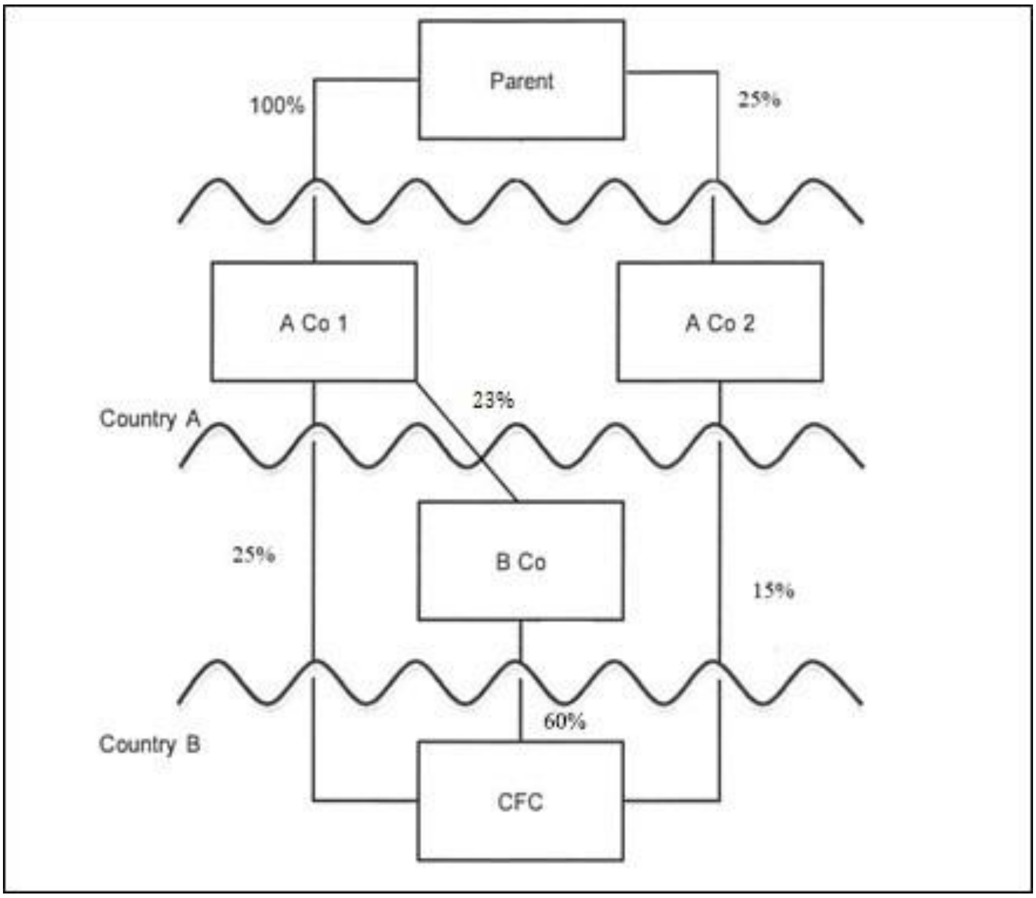
Step 1: Determination of Associated Enterprises

The determination based on the definition of an associated enterprise only requires one criterion to be satisfied. By way of example, an associated enterprise classified as such through ownership of capital would also be considered an associated enterprise for participation in voting rights and this notwithstanding that the participation in voting rights would be lower than the 25% threshold.

Step 2: Anti-Fragmentation Mechanism

The anti-fragmentation mechanism objectively aggregates the direct and indirect interests of the taxpayer together with the direct and indirect interests of any associated enterprises, if any, in order to ensure that the economic reality is reflected. In this regard, the associated enterprises' direct and indirect participation in the voting rights, ownership of capital and entitlement to profits should be attributed to the respective taxpayer's participation in the voting rights, ownership of capital and entitlement to profits in the foreign company. Should this anti-fragmentation exercise be necessary, any double counting shall be excluded.

10.2. The following example illustrates the application of the above-mentioned approach. In this regard, the percentages captured in this example show the percentage holdings of ownership.



1. A Co 1 holds a direct interest of 25% in the CFC.

2. In line with the above-mentioned principles, A Co 2 is an associated enterprise of A Co 1. This in view of the fact that A Co 1 and A Co 2 are owned in common by a Parent which has a direct participation of at least twenty-five per cent (25%) in the respective entities. As explained above, the 15% direct interest of A Co 2 in the CFC shall be attributed to A Co 1.

3. The Parent is an associated enterprise of A Co 1 since the entity holds a 100% participation in A Co 1. Nevertheless, indirect interest of the Parent in the CFC both through A Co 1 and A Co 2 are not counted to ensure there is no double counting.

4. A Co 1 also holds a further indirect interest of 13.8% (23% of 60%) through its holding of B Co.

Therefore, A Co 1 holds an effective Controlling Interest of 53.8% which means that the minimum Controlling Threshold is satisfied through the application of the anti-fragmentation rule. In this regard, there is no need for the exercise to be re-computed on the basis of voting rights and entitlement to profits since the test has been satisfied in respect of the rights of ownership of capital.

10.3. Effective Taxation Threshold: A taxpayer would also need to determine if the CFC's effective tax paid in the CFC jurisdiction is lower by more than 50% of what would have been payable in Malta in terms of the Income Tax Acts.

For all intents and purposes, the "actual corporate tax paid" shall be deemed to mean corporate tax paid or borne, whether by way of withholding or otherwise, and without regard to the jurisdiction in which such income and/or corporate tax was suffered. Therefore, "actual corporate tax paid" shall not take into account any deferred tax assets and liabilities recognised in the entity's financial statements.

The computation of the *'corporate tax that would have been charged in Malta'* needs to be made on the basis of taxation of the taxpayer. In this regard, all income arising in the CFC jurisdiction shall be deemed to be arising in Malta. Income arising outside of the CFC jurisdiction shall be deemed to be income arising outside of Malta.

In comparing the actual corporate tax paid with the corporate tax that would have been charged in Malta and unless directed otherwise by the Commissioner, the currency conversion is pegged to the conversion rate at the date of actual corporate tax payment. If this is not due by the date of the statutory reporting date in Malta, the average annual conversion rate for the CFC basis year shall apply.

(iii) The Determination of a Non-Genuine Arrangement (Regulation 7(2), S.L. 123.187)

11.1. The regulations adopt a substance proportionate approach in the determination of non-genuine arrangements. A non-genuine arrangement is defined in such a manner as to require a factual analysis of the arrangement. In this regard, it is necessary that the taxpayer understands the role played by itself and the CFC respectively. In general, the more important role a party plays, the more attribution of profits will arise to that party. This underlying rationale of the arm's length principle corresponds to what would usually happen between independent enterprises taking part in any type of business activities.

11.2. Unless directed otherwise by the Commissioner, the authorised OECD approach constitutes a valuable source of interpretation for the purposes of a correct characterisation of the significant people's functions. It should be noted that the significant people's functions focus on the physical presence of persons performing the functions.

(iv) Essential Purpose (Regulation 7(2), S.L. 123.187)

12.1. Should a non-genuine arrangement be ascertained following the aforementioned analysis, it needs to be determined further whether the essential purpose of the CFC is intended to obtain a tax advantage.

12.2. In line with the jurisprudence of the Court of Justice of the European Union (CJEU) on this subject-matter, a case-by-case analysis would need to be undertaken in order to determine whether the essential purpose of the CFC is such to obtain a tax advantage.

(v) Computation of CFC Income *(Regulations 7(3) and 8, S.L. 123.187)*

13.1. Should there be a non-genuine arrangement and the *de minimis thresholds* as delineated in the regulations are not satisfied, then the taxpayer shall ensure that sufficient documentation that would enable it to determine the profits/loss of the CFC in terms of the Income Tax Acts are maintained.

13.2. To the extent that a CFC prepares its financial statements based on accounting standards not identified in the Accountancy Professions Act then adjustments would need to be made in order to bring such financial statements in line with any accounting standard as sanctioned by the Accounting Professions Act before applying the provisions of the Income Tax Acts.

13.3. Non-distributed income for a basis year shall mean the income of the CFC as calculated in terms of regulation 8(1) less the profits derived during that year distributed up to the tax return date as determined by rule 2 of the Income Tax (Statutory Dates) Rules (S.L. 372.16).

(vi) Allocation of CFC Income *(Regulation 8, S.L. 123.187)*

14.1. Where a taxpayer is attributed CFC taxable income on the basis of the aforementioned computation, the allocated income to be included in the tax base shall be calculated on the basis of the highest applicable criterion under regulation 7(1)(a).

14.2. Should the allocation during the CFC tax year vary for the taxpayer, a pro-rata approach would need to be reflected in the allocation during the periods the CFC is within scope as described in section (ii) above. Therefore, a taxpayer shall only allocate income during periods when the underlying entity constitutes a CFC in terms of the regulations.

14.3. The following examples illustrate the application of the above-mentioned approach. In all cases the figures hereunder are for illustration purposes only:

Example 1: CFC tax year aligned to taxpayer basis year.

	"Highest applicable criteria"
1 January 2020 – 14 April 2020 (105 days)	60%
15 April 2020 - 14 August 2020 (122 days)	40%
15 August 2020 - 31 December 2020 (139 days)	55%

Hence, the allocated income to the taxpayer would be as follows:

(105/366 x 60% x Computed CFC Income) + 0 + (139/366 x 55% x Computed CFC Income).

To be reported in the year of assessment 2021.

Example 2: CFC tax year not aligned to taxpayer basis year.

CFC Tax Year	*"Highest applicable criteria"*
1 October 2018 – 14 February 2019 (137 days)	60%
15 February 2019 - 14 May 2019 (89 days)	40%
15 May 2019 - 30 September 2019 (139 days)	55%

For the purposes of this example, the basis year of the taxpayer shall be the calendar year. Since the CFC tax year is not aligned to that of the taxpayer and since the CFC tax year ends in 2019, in terms of regulation 8(c) the relevant profits earned during the whole of CFC tax period ending in 2019 shall be included in the 2019 basis year of the taxpayer. Hence, the CFC profits to be allocated to the taxpayer would be as follows:

(137/365 x 60% x Computed CFC Income) + 0 + (139/365 x 55% x Computed CFC Income).

To be reported in the year of assessment 2020.

Further Notes:

14.4. Should the income of an entity that is attributable to a specific significant people's function be a loss, no allocation shall be made to the taxpayer in view that there is no base erosion of the Maltese tax base.

14.5. Unless directed otherwise by the Commissioner, if currency conversion is necessary for the allocated income, this is pegged to the annual average conversion rate for the CFC basis year. The allocated income does not change nature and is subject to the Income Tax Acts on the basis of the fiction that it has been received directly by the taxpayer.

14.6. Unless stated otherwise in these guidelines, reference needs to be made to the basis of taxation of the taxpayer in the allocation of the CFC income. In this regard, all income arising in the CFC jurisdiction shall be deemed to be arising in Malta. Income arising outside of the CFC jurisdiction shall be deemed to be income arising outside of Malta.

14.7. For avoidance of any doubt in the case of permanent establishments the "highest applicable criteria" shall be 100%.

(vii) Relief of Double Taxation *(Regulation 8, S.L. 123.187)*

15.1. Should a taxpayer incur double taxation on allocated CFC income, the regulations afford double tax relief through established mechanisms in the Income Tax Acts. In this regard, double taxation relief is afforded to underlying corporate taxation incurred in proportion to the income allocated from the CFC. In view of the undistributed nature of the income, the incidence of double taxation will for the most part be relieved through a credit for the actual underlying tax in terms of articles 77 and 82 of the Income Tax Act.

15.2. The relief provided for under regulation 8(e) shall apply where the taxpayer disposes of a CFC and any part of the gain on such disposal includes CFC income chargeable to tax in the hands of the taxpayer in terms of the regulations, irrespective of whether such CFC income is included in the tax base of the taxpayer prior or subsequent to the relative date of disposal.