

# Taxation Newsflash

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## Tax Credit for Venture Capital Fund Investors

The Maltese Government has recently enhanced its efforts to increase the use of venture capital as an alternative means of financing by providing a tax credit of up to 30% of the investment to unit holders in designated venture capital funds.

A designated venture capital fund must have the purpose of providing venture capital for Malta-based companies and the designated authority must approve as well as hold units in the fund. The fund must be structured as a collective investment scheme, obtain a listing on the Malta Stock Exchange and at least 85% of its total assets must be invested in assets situated in Malta. These factors already lead to an exemption from income tax on the income of the fund and an exemption from capital gains tax on disposals made by investors. The fund may take any corporate form though the INVCO (investment company with fixed share capital) appears to be the most appropriate vehicle.

The fund would require to be licensed as a collective investment scheme by the Malta Financial Services Authority (MFSA) and considering the level of risk associated with venture capital operations, it is likely that the MFSA would require the fund to be restricted to qualifying or experienced investors (minimum investment US\$ 100,000 or US\$ 20,000 respectively). If the fund is restricted to qualifying investors it would also benefit from the tremendous flexibility afforded by Malta's PIF regime (see [http://www.cdf.com.mt/pages/hedge\\_funds.htm](http://www.cdf.com.mt/pages/hedge_funds.htm)).

A tax credit certificate is issued by the Commissioner of Inland Revenue to persons holding a fully paid-up subscription in a designated venture capital fund. The certificate will entitle the person identified on it to a tax credit of 30% of the total nominal value shown on the said certificate. The tax certificate may be utilized only after the lapse of three years from date the securities were acquired and the tax credit cannot exceed in the aggregate 150,000 Maltese Lira (approximately US\$ 420,000).

If the fund is structured to distribute dividends, non-residents may, in addition to the two-thirds refund allowed under normal rules for any tax withheld on dividend payments, also claim the venture capital tax credit.

Venture capital is still at an embryonic stage in Malta. However the above tax incentives will certainly serve as a catalyst for further developments of the venture capital market. ❖

## Focus on UCITS

Malta implemented the UCITS III regime immediately upon accession to the European Union on 1st May 2004. After a slow start, there is an increasing interest from fund managers to choose Malta as the domicile for their UCITS-compliant funds and the first UCITS fund has been licenced by the MFSA in August.

In line with the current interpretation of the UCITS Directive, the preferred methodology entails the utilisation of self-managed funds and delegation arrangements. Self-managed funds formed as corporate entities (usually a SICAV) are managed by the Board of Directors, which can in turn delegate a number of management functions to an external management company which is authorised in any EU Member State and recognised in Malta.

At licensing stage the Board is expected to clearly indicate the proposed delegation arrangements. Current practice suggests that as a minimum the Board must have at least one but preferably two local directors who satisfy the "fit and proper" competence criteria and must meet periodically in Malta. The Board should also retain the ultimate supervision of the risk management process through regular reporting to and from the management company and be involved in setting the fund's policies.

Amongst the foremost reasons to choose Malta as the base for a UCITS fund one can certainly cite the MFSA's growing reputation as a serious yet flexible regulator and the cheaper set-up and listing costs.

As regards taxation, Malta imposes no tax on a UCITS' income or capital gains and investors are not taxed unless they are resident in Malta in which case there is a straightforward withholding tax of 15% on income and realised capital gains. This compares favourably with the more established fund domiciles which impose either a tax on the UCITS' net asset value or on investors' income and capital gains at personal tax rates, or a combination of both. ❖

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## INSIDE THIS ISSUE

- 1 **Tax Credit for Venture Capital Investors**
- 1 **Focus on UCITS**
- 2 **Pre-Budget Document and International Taxation**

## Pre-Budget Document and International Taxation

The Pre-Budget document issued in August 2006 gives an indication of the government's intentions regarding the Maltese tax system. The main focus of the document is to set out the vision for internal fiscal policy over the coming five-year time frame. The pre-budget document is non-binding in nature and the budget itself is usually published in the first week of November, although recently an October budget is gaining preference.

The Document contains a Supplementary Paper entitled 'Streamlining company taxation' which sets out the Government's intentions for the current international tax system.

The Supplementary Paper illustrates Malta's use of the full imputation system and this system's advantages over 'classical tax systems' of other EU Member States. The full imputation system avoids the double taxation of company profits as any tax paid at company level is perceived as a prepayment of tax on behalf of the shareholder. Eventually upon distribution the tax will be calculated according to the individual shareholder's tax liability, which directly depends on his status and position. Hence any tax paid at company level is credited to the shareholder and if upon evaluation of such shareholder's status it emerges that extra tax was paid, the shareholder is given a refund. The Paper emphasizes that Malta utilises the complete imputation system unlike other states which utilised the imputation system only to a certain extent.

Also in light of recent ECJ judgements, the Paper clarifies that Malta's full imputation system does not fall foul of the anti-discrimination provisions of European law. The only amendment necessary to make the system fully compliant is to allow a credit for foreign underlying corporate tax to individuals in addition to companies where such a credit is already available. This would eliminate the only instance of discrimination in our system since individuals could not make use of a credit for foreign tax paid unless such relief is available under a tax treaty provision.

The use of tax accounts for companies will be retained so as to differentiate the source of the profits and hence clearly identify their eventual tax treatment. The three tax accounts utilised are the Maltese taxed account, the foreign income account and the untaxed account. The maximum tax refund which can be claimed by non-resident shareholders upon distribution of dividends by a company will be slightly reduced, thus leading to a marginal increase of the net tax paid in Malta which would become 5%. Interest and royalties paid to non-residents will remain exempt from local tax.

The regime for holding companies will also be retained with the tax refund being of potentially 100% when the profits are derived by the distributing company from a participating holding. The current criteria for qualification of a shareholding of a Maltese company in a non-resident subsidiary will be predominantly retained. The only amendment is that with regards to acquisitions of participating holdings made on or after 1 January 2007, where the non resident company, is not resident or incorporated in a tax treaty, EU or EEA jurisdiction or a country which levies a tax on corporate profits at a rate which is at least 50 per cent of the Maltese corporate income tax rate (hence currently 17.5% since the Maltese corporate rate stands at 35%), the following additional conditions must be satisfied:

- (a) the shares in the non-resident company must not be held as a portfolio investment. In any event a participation of at least 25 per cent in the capital of a non-resident company 90 per cent of the assets of which consist of portfolio investments and non-trading financial assets shall be deemed to be a portfolio investment; and
- (b) the non-resident company or its passive income must have been subject to tax at a rate which is not less than 5 per cent.

Any participating holdings existing on the 31st December 2006 and which are not compliant with the amendments may continue to benefit of the participating holding qualification until the end of 2010.

Finally also in the field of holding companies, as from 1st January 2007, Malta will introduce a participation exemption which will exempt from tax dividends and capital gains derived from participating holdings.

The above changes should ensure that all the positive aspects of Malta's taxation system are retained thus ensuring that it continues to be a reputable and efficient international financial centre. ❖

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