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CDF

ADVOCATES

Funds in Malta

Malta established a specific regime dealing with the authorisation of collective investment schemes and fund managers in the Investment Services Act (“ISA”) of 1994. The ISA paved the way for the establishment of retail funds and local fund managers. In 2000 the Malta Financial Services Authority (“MFSA”) launched specific rules for non-retail funds labelled “Professional Investor Funds” (“PIF”) with the intention of establishing Malta as a European hedge fund domicile. The number of funds registered in Malta increased steadily over the past few years and there are now over 400 hedge funds with a market capitalisation nearing € 10 billion. Malta implemented the UCITS III regime immediately upon accession to the European Union on 1 May 2004 and therefore both UCITS and non-UCITS funds may be formed.

The choice of Maltese domicile for a hedge fund is motivated by several factors, including:

- the efficiency and flexibility of the Malta Financial Services Authority
- EU membership as from 1st May 2004
- local and international stock exchange listing options
- an exemption from income tax and capital gains tax at fund level and at non-resident investor level
- quality support services
- low set-up and maintenance costs
- the possibility of ‘self-managed’ funds, i.e. the appointment of a third party fund manager is optional
- the possibility to redomicile a fund from another jurisdiction.
- fund service providers such as the prime broker, custodian, fund manager and administrator need not be established in Malta
- a fund may take any acceptable legal form while still benefiting from a full tax exemption at fund level and for non-resident shareholders and;
- a fund manager may be established as a Maltese company which will allow tax refunds upon distribution of dividends

- the provision of fund management services is exempt (without credit) for VAT purposes

At CDF Advocates we have been closely involved in the development of the Maltese financial services industry. Current partner Frank Chetcuti Dimech has direct experience of a wide spectrum of financial product development and regulation over the past ten years. CDF Advocates' expertise has been recognised by Legal 500 and the IFLR every year since 2003. We maintain close relationships with, and are held in high esteem by, the other major service providers which a hedge fund requires such as fund administrators, banks and audit firms, as well as the Malta Financial Services Authority.

We understand the hedge fund business and we can advise you on:

- the advantages of a Maltese domicile and its tax advantages
- prime brokerage arrangements
- structuring performance fees
- fund distribution and marketing
- special purpose vehicles
- obtaining a listing on the Malta Stock Exchange and on other stock exchanges
- on-going compliance arrangements and support

CDF Advocates has responded to the needs of the regulator and the market by providing specialised compliance services for professional investor funds. Malta is recommended for all types of hedge funds, and for start-up funds the possibility of a self-managed fund reduces set-up and ongoing costs. For such funds the Malta Financial Services Authority requires at least one local director and local compliance arrangements, which we already successfully provide for a number of hedge funds.

Our Funds Team



Dr. Frank Chetcuti Dimech co-founded CDF Advocates in 1993. He practices financial services, company, tax, data protection, EU and international law. His experience includes financial product development, international financial transactions, financial regulation and tax planning and has worked on behalf of banks, fund managers, investment funds and insurance companies. He lectures private international law at the University of Malta and is a member of the International Tax Planning Association. He holds a Doctorate of Laws and a Masters in Financial Services from the University of Malta and an International Investment Advice Certificate from the Securities and Investment Institute, London. He holds directorships and/or the post of compliance officer and prevention of money laundering reporting officer in a number of investment funds.



Frank Caruana joined CDF Advocates as head of compliance in 2008. Previously he was Director of the Financial Intelligence and Analysis Unit (FIAU) of the Government of Malta since its inception in October 2002. He also acted as Secretary to the FIAU Board of Governors and chaired the Joint Prevention of Money Laundering and Funding of Terrorism Committee. He also represented Malta as a member of the European Union Commission's Committee for the Prevention of Money Laundering and Terrorist Financing. Prior to his appointment with the FIAU Mr. Caruana was employed with a major Maltese credit institution where he gained experience in practically all spheres of banking from branch management to data processing and internal audit. He spent the last 9 years at the institution as the Head of its Compliance Unit, responsible for implementing and maintaining the prevention of money laundering procedures within the institution as well as for other compliance matters in relation to banking services. He also acted as Secretary to the institution's Compliance Committee. He has lectured both locally and overseas on prevention of money laundering and terrorist financing matters.

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Types of Hedge Funds

The Professional Investor Fund regime offers three types of fund: the Experienced Investor Fund, the Qualifying Investor Fund and the Extraordinary Investor Fund.

(a) The Experienced Investor Fund

An “Experienced Investor”, is a person having the expertise, experience and knowledge to be in a position to make his own investment decisions and understand the risks involved. The minimum investment threshold is € 15,000 or equivalent in another currency. PIFs promoted to Experienced Investors are not subject to any investment restrictions. An Experienced Investor Fund must have a custodian for the safe custody of the assets of the PIF and the monitoring of the activities of the PIF's manager.

Direct borrowing for investment purposes and leverage through the use of derivatives has been established at 100% of NAV (as with UCITS III). The PIF's exposure relating to derivative instruments is calculated taking into account: (i) the current value of the underlying asset; (ii) the counterparty risk; (iii) future market movements; and (iv) the time available to liquidate positions. The PIF's exposure relating to borrowing for investment purposes will accordingly be the amount so borrowed.

Where the Experienced Investor Fund has been set up as a fund of hedge funds, it shall be required to invest in at least five different hedge funds to ensure the necessary diversification. In this case there are no restrictions on the extent of leverage that the underlying hedge funds may assume.

(b) The Qualifying Investor Fund

A “Qualifying Investor” should have net assets in excess of €750,000 or be an individual who has reasonable experience in the acquisition and/or disposal of funds of a similar nature or risk profile or a senior employee or Director of service providers to the PIF. The minimum initial investment is €75,000, or equivalent in another currency. PIFs promoted to Qualifying Investors are not subject to any investment or borrowing (including leverage) restrictions other than those which may be specified in their Offering Document.

(c) The Extraordinary Investor Fund

To qualify as “Extraordinary”, an investor should have net assets in excess of € 7.5 million be an employee or director of service providers to the PIF, or be itself a PIF promoted to Extraordinary Investors. The minimum initial investment is set at €750,000 or equivalent in another currency.

A PIF targeting Extraordinary Investors may either draw up an Offering Document (minimum disclosure requirements prescribed) or a Marketing Document which should at least include certain basic information such as a list of service providers including the Directors, risk warnings, investment objectives, policies and restrictions of the PIF, fee structure and details of the classes of shares being offered.

UCITS Funds

A “UCITS” fund is a fund that complies with specific requirements set out in the EU Undertakings in Collective Investment Transferable Securities (“UCITS”) Directive. A UCITS fund is targeted at the general public. A Maltese fund that complies with the provisions of the UCITS Directive can be promoted throughout the European Economic Area (“EEA”) (which includes the 27 Member States of the EU).

The UCITS III amendments have broadened the permitted investments that a UCITS qualifying fund may invest in. However, a UCITS investment manager must still comply with restrictions such as that no more than 10% of the Net Asset Value (“NAV”) of the UCITS qualifying fund is invested in any single security. A UCITS qualifying fund can invest, subject to an overarching requirement to prudently spread the fund’s investment risk, solely in financial derivative instruments and such derivatives can be used to leverage the fund by up to 100% of the fund’s assets (i.e. up to two times the value of the fund).

By using the self-managed structure described below the fund management can be outsourced to a fund manager licensed in another EU jurisdiction and only a local custodian bank and director performing the compliance and anti-money laundering functions would be required.

Types of Legal Structures

Maltese registered funds can be formed in a number of possible vehicles such as open-ended and closed ended corporate entities, trusts and limited partnerships.

(a) Companies

The investment company with variable share capital or “SICAV” is the most widely used vehicle to incorporate open-ended funds in Malta. The SICAV, like any other Maltese company, may be private or public, the main distinguishing feature being that a private SICAV cannot have more than 50 shareholders. Although a SICAV formed as a public company is generally the preferred vehicle, a SICAV formed as a private company may be particularly advantageous in master feeder structures set up to allow the participation of United States persons.

Umbrella companies are allowed and each class of shares may be denominated in a different currency. There is no requirement to have a minimum initial capital or for the initial share capital to be organized in one or more sub-funds. The term “initial share capital” refers to the initial shares issued by the SICAV for the purposes of setting up the Scheme – i.e. before shares are offered to prospective investors. Thereafter, all new classes of shares issued by the SICAV will constitute one or more sub-funds. This option is particularly useful when the promoters wish to have a separate class of “subscriber” or “founder” shares with particular rights such as voting rights or dividend rights.

By express provision in its Memorandum and Articles of Association, a SICAV can benefit from segregation of assets and liability between sub-funds. The assets and liabilities of a segregated sub-fund are treated as a patrimony which is separate from the assets and liabilities of other sub-funds in the same umbrella structure and accordingly the creditors of a particular sub-fund cannot enforce his claim against any other assets of the company. It is also possible to provide for certain expenses, typically directors’ fees and audit fees, to be attributable to all sub-funds.

Every Maltese company is required to have a registered office and an individual acting as company secretary; however a corporate fund may also have a corporate company secretary.

(b) Self-Managed Companies

Although typically a collective investment scheme would appoint an external manager, this is not mandatory. The scheme can be established as a “self-managed” fund if its directors, or its individual investment committee members, are considered by the MFSA as having the expertise and experience in the investments in which the scheme will invest. The only material difference between a fund which is externally managed and one which is self-managed is that the latter must have an initial share capital of €125,000.

(c) Unit Trusts

Malta has a fully-fledged trust law even though it is predominantly a civil law jurisdiction. The Trusts and Trustees Act, complemented by careful amendments to the Civil Code and other legislation, enables both residents and non-residents to set up various types of trusts in Malta. The terms of the trust may select the applicable law to the trust. Furthermore through the adoption of the Hague Convention on the Law Applicable to Trusts and on their Recognition, Malta recognises trusts having a foreign proper law. Trustees resident or operating in Malta must be approved by the MFSA.

Under Maltese law trusts are tax transparent so that income attributable to a trust is not charged to tax in the hands of the trustee if it is distributed to a beneficiary. Furthermore upon a distribution of income arising outside Malta to non-resident beneficiaries there is no local tax impact. The tax position of unit trusts is exactly the same as that for any other licensed fund described below.

(d) Limited Partnerships

Malta introduced the limited partnership (LP) in 2003. It is a partnership *en commandite* with a separate legal personality which is licensed as a collective investment scheme. The capital can also be divided into shares and both the limited partners and the general partners can be limited liability companies formed in any jurisdiction.

(e) Foundations and Contractual Funds

It is possible to establish both foundations with separate personality which act as funds as well as contractual funds without separate personality.

Fund Taxation

Collective investment schemes are classified as either prescribed or non-prescribed funds. In general, a prescribed fund is defined as a fund resident in Malta, which has declared that the value of its assets situated in Malta amount to at least eighty five per cent of the value of the total assets of the fund. Other Maltese resident funds which do not have such an exposure to Maltese assets and all non-resident funds are treated as being non-prescribed. Once a fund is licensed by the MFSA, it is granted a tax exemption (subject to the rules on prescribed funds below) irrespective of the legal form of the fund i.e. whether it is a company (private or public), trust or partnership. This in itself can constitute a significant advantage over jurisdictions which limit tax exemptions to particular corporate structures only. By virtue of being tax-exempt, funds are excluded from benefiting from double-tax treaties.

(a) Prescribed fund

Prescribed funds are exempt from Maltese income tax on any income and capital gains except for a 15% final withholding tax on bank interest payable by banks licensed under the Maltese Banking Act, 1994 and a 10% final withholding tax on interest, discounts or premiums received from (a) the Government of Malta, (b) corporations or authorities established by law, (c) companies or other legal entities, whether resident in Malta or otherwise, in respect of public issues and (d) companies or other legal entities resident in Malta in respect of private issues.

(b) Non-prescribed fund

Non-prescribed funds are exempt from Maltese income tax on any income and capital gains.

Taxation of Fund Investors

1. Capital gains realised by investors who are not resident in Malta are not subject to tax in Malta. Resident investors:

(i) with respect to a prescribed fund, are exempt from tax in Malta for as long as the shares are listed on the Malta Stock Exchange and the fund remains classified as a prescribed fund

(ii) with respect to a non-prescribed fund, may opt to be subject to a 15% final withholding tax which shall be deducted at source by the fund on any realised capital gains. Alternatively, investors may opt to receive any capital gains without deduction of tax in which case such investors would be bound to declare such capital gains in their personal income tax return and would be subject to tax at the normal rates of tax which are applicable to them.

Transfers of shares in a licensed fund are exempt from stamp duty.

2. The tax treatment of dividends distributed by the fund, whether these are reinvested or otherwise, depends on the income tax status of the particular investor and on the fund's income tax accounts out of which the dividends are distributed, as set out hereunder:

(i) The distribution of profits derived by a prescribed fund from interest, discounts or premiums, which were subject to 10% or 15% withholding tax, will not attract any further tax in the hands of investors.

(ii) The distribution of profits by a fund from dividends received by that fund out of the Maltese Taxed Account or the Foreign Income Account of other Maltese companies do not attract any further tax in the hands of investors.

(iii) All other income will be allocated to the Untaxed Account of the fund. Distributions from the Fund's Untaxed Account to Maltese resident individuals are subject to a 15% withholding tax. The distribution of profits to non-residents and companies resident in Malta is not subject to withholding tax.

Fund Managers

Fund managers and persons advising on investments in or from Malta are required to be authorised by the MFSA. The private limited liability company is the typical structure used for a fund management company. In specific cases, for example a close-ended private equity fund or a real estate fund, the self-managed fund (described above) may be more cost-effective.

Presence in Malta is mandatory and no license will be issued unless there is an active presence in Malta. Furthermore the “four-eyes principle” requires at least two officers of the company to be permanently present in Malta. These individuals need not be directors of the company but must have sufficient managerial seniority. One of these individuals would be the compliance officer and/or prevention of money laundering reporting officer. It should be noted that a work permit is required for employees who are not citizens of Malta. The work permit is invariably granted in the case of a fund manager or fund licensed in Malta. The procedure would usually take around five days in the case of a national of an EU member state and around eight weeks in the case of non-EU nationals.

Taxation of Fund Managers

The corporate tax rate (subject to specific tax exemptions, as in the case of funds and holding companies) and the highest personal tax rate are both 35%. However one of the essential characteristics of the Maltese tax law is the full-imputation system. Through this system the tax paid at company level is regarded as a prepayment for the tax due by the shareholder upon the eventual distribution of profits. Hence after the dividends are paid out the 35% paid by the company is given as credit for the tax due by the shareholder, whether he is resident in Malta or not.

Non-resident shareholders who receive dividends from a Maltese company may apply for a refund of six-sevenths of the 35% Malta tax paid hence resulting in an effective Malta tax rate of 5% on such income. However, distributions of profits derived from passive interest or royalties are not subject to the six-sevenths refund but are subject to a refund of five-sevenths of the tax paid by the company.

The six-sevenths and five-sevenths refunds apply to distributions made by companies that do not claim any form of double tax relief. Dividends paid out of profits arising outside Malta (which under Maltese law are allocated to a “foreign income account”) in respect of which profits the distributing company has availed itself of any form of tax relief are subject to a two-thirds refund.

Malta has a substantial treaty network with 47 income tax treaties in force and another 10 treaties are in the pipeline awaiting signature, ratification or both. Malta’s tax treaties are mainly with European countries although it also has treaties with countries in North America, Africa, Middle East and Asia. Malta has recently signed a tax treaty with the United States of America. The tax treaties are largely based upon the OECD model. Moreover, dividends, interest and royalties may also benefit from the EU Parent Subsidiary Directive or the Interest and Royalties Directive.

Apart from treaty relief, domestic Maltese rules also allow unilateral relief and a flat-rate foreign tax credit. Unilateral relief provides relief from double taxation on a unilateral basis where the overseas tax is charged in a country with which Malta does not have a tax treaty. Such overseas tax is allowed as a credit against the tax chargeable in Malta on the gross amount up to the extent that the credit does not exceed the total tax liability in Malta. The flat-rate foreign tax credit allows relief for deemed foreign tax paid at the rate of 25% even if no actual foreign tax has been charged.

Transfers of shares in the fund manager are covered by an exemption from stamp duty. Any capital gains which may be realised on a transfer of shares would be exempt from tax if the transferor is not a resident of Malta.

The provision of management and other services by licensed fund managers to a licensed collective investment schemes is exempt without credit for Maltese VAT purposes.