

**LEGAL UPDATE**

**TAXATION OF FOUNDATIONS UNDER THE  
FOUNDATIONS (INCOME TAX) REGULATIONS**

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These notes provide an overview of the tax treatment of foundations under Maltese income tax legislation, particularly the Foundations (Income tax) Regulations of 2010 (hereinafter ‘Regulations’) issued in terms of legal notice 312 of 2010.<sup>2</sup>

While foundations are not new to the Maltese legal system, it was only recently, through the enactment of Act XIII of 2007, which amended Chapter Sixteen of the laws of Malta (hereinafter ‘Civil Code’), that an appropriate and clearly defined legal framework within which foundations could operate was established. The notion of a foundation under Maltese law is two-pronged. This means that a foundation may either be set up as a ‘private’ foundation and therefore be established for the benefit of one or more persons or a defined class of persons, or alternatively, as a ‘purpose’ foundation and therefore be created for any purpose which is lawful.<sup>3</sup> Even though a foundation may be set up for any lawful purpose it may not be established to trade or carry on commercial activities. Notwithstanding the above, a foundation may be endowed with commercial property or a shareholding in a profit-making enterprise, a franchise, a trade mark or other asset which gives rise to income.<sup>4</sup> This essentially means that commercial activities may be undertaken via underlying corporate entities which are owned by the foundation.

In terms of the Second Schedule to the Civil Code<sup>5</sup> a foundation is defined as an organisation consisting of a universality of things, constituted by virtue of a public deed, *inter vivos* or by a will, by a

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<sup>2</sup> Subsidiary Legislation 123.114, Foundations (Income Tax) Regulations 2010.

<sup>3</sup> Chapter 16 of the laws of Malta, Civil Code, art. 26(7).

<sup>4</sup> Ibid art. 32(A)(1).

<sup>5</sup> Act XIII of 2007.

founder or founders, whereby assets destined either for the fulfilment of a specified purpose or for the benefit of a named person or class of persons are entrusted to the administration of a designated person or persons (hereinafter the ‘administrator/s’).<sup>6</sup> Following the introduction of the Second Schedule to the Civil Code in 2007, the deed of foundation must, on pain of nullity, satisfy the formal requirements stipulated in the Second Schedule to the Civil Code.<sup>7</sup> The administrators of a foundation are obliged, in terms of the Second Schedule to the Civil Code,<sup>8</sup> to register such foundation within three months from the date of the public deed where the foundation is created by a public deed *inter vivos*, or within three months from the date of the death of the founder where the foundation is created in terms of a will. Upon registration, as aforesaid, the foundation will acquire separate legal personality which is distinct from that of its founders, administrators and beneficiaries; it may therefore enter into legally binding obligations and act in its own name and on its own behalf.

The charging of taxes on income is, in terms of local legislation, essentially regulated by the Income Tax Act, Chapter 123 of the laws of Malta (hereinafter ‘ITA’) and the Income Tax Management Act, Chapter 372 of the laws of Malta (hereinafter ‘ITMA’). Additionally, Malta has, currently in force, fifty-eight double taxation treaties based on the Organisation for Economic Co-operation and Development (hereinafter ‘OECD’) Model Convention.<sup>9</sup>

All persons,<sup>10</sup> whether natural or legal, are generally subject to the same system of taxation in Malta and there is no separate system of taxation appertaining to legal or natural persons alone.

The relevant factors in determining the applicable taxable base are the notions of residence and domicile. While persons are charged to tax in Malta on a worldwide basis if both ordinarily resident and domiciled in Malta, persons who are neither ordinarily resident, nor resident, nor domiciled in Malta would only be chargeable to tax in Malta on a Malta source basis, that is, on income or gains derived

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<sup>6</sup> Chapter 16 of the Laws of Malta, , Civil Code, Second Schedule, art. 26(1).

<sup>7</sup> Ibid art. 29(4).

<sup>8</sup> Ibid.

<sup>9</sup> OECD Model Tax Convention on Income and on Capital.

<sup>10</sup> Under the ITA, Chapter 123 of the laws of Malta, a ‘person’ includes a body of persons. A body of persons means any body corporate, including a company, and any fellowship, society or other association of persons, whether corporate or unincorporate, and whether vested with legal personality or not.

from or arising in Malta. Persons who are resident/ordinarily resident but not domiciled in Malta, or vice versa, would be chargeable to tax in Malta on a Malta source and remittance basis, that is, on any income derived from or arising in Malta and on any income arising outside Malta which is received in or remitted to Malta. In this respect, note that capital gains arising outside Malta to a person who is not both ordinarily resident and domiciled in Malta are not chargeable to tax in Malta irrespective of whether the gain is received in Malta or otherwise.

In addition, Malta operates a full imputation system for the taxation of profits distributed by companies whereby imputation credits are available to shareholders, whether resident in Malta or otherwise. This is intended to ensure that Malta tax is levied only once on profits derived by companies.

The Regulations are applicable to foundations as defined therein.<sup>11</sup> A foundation is defined, for the purposes of the Regulations,<sup>12</sup> as ‘a foundation created in terms of the Second Schedule of the Civil Code or as recognised thereunder and which has submitted evidence to the Commissioner of its registration or recognition, as the case may be, in accordance with the relevant provisions of the Civil Code’.<sup>13</sup> Foundations which are not registered under the Second Schedule to the Civil Code<sup>14</sup> are not endowed with separate legal personality and therefore do not fall within the purport of the Regulations.<sup>15</sup> Moreover, a foreign organisation established in terms of foreign law which is registered as a legal person under the Second Schedule to the Civil Code,<sup>16</sup> would, provided that it has submitted evidence to the Commissioner of its registration or recognition, as the case may be, fall within the purport of the Regulations.<sup>17</sup> In this respect, it is worth noting that any foreign or international organisation which carries out an activity in Malta for a duration of more than three months or which activity is carried out through a permanent establishment in Malta, is obliged to register as a legal person in Malta and would consequently fall within the purview of the

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<sup>11</sup> Subsidiary Legislation 123.114, Foundations (Income Tax) Regulations 2010.

<sup>12</sup> *Ibid.*

<sup>13</sup> *Ibid* art. 2.

<sup>14</sup> *Ibid.*

<sup>15</sup> *Ibid.*

<sup>16</sup> Chapter 16 of the laws of Malta, Civil Code.

<sup>17</sup> *Ibid.*

Regulations.<sup>18</sup> It is interesting to point out that, from the wording of the law, it appears that the foreign or international organisation would be treated, for tax purposes, as a company ordinarily resident and domiciled in Malta and would thus, subject to the application of a double taxation treaty in force between Malta and the jurisdiction where the foreign organisation is established, be taxed on a worldwide basis.

Foundations are, as a general rule, treated, for the purposes of the ITA,<sup>19</sup> in the same manner as a company that is ordinarily resident and domiciled in Malta<sup>20</sup> and any rules pertaining to the taxation of income<sup>21</sup> applicable to companies shall equally apply to foundations. This means that, subject to certain exceptions, any chargeable income or gains derived by the foundation would be taxable in Malta at the standard tax rate of 35%. Alternatively, the administrators of a foundation may, in terms of Article 4(1) of the Regulations<sup>22</sup> and by notice in writing to the Commissioner, irrevocably elect that the foundation be treated under the same provisions of the ITA<sup>23</sup> applicable to trusts.

Income and/or gains derived in the context of a trust are taxed, in terms of Maltese law, in accordance with the ITA,<sup>24</sup> which provisions also allow for the possibility of the trustee of a trust to irrevocably elect that the income derived by the trust is to be treated for tax purposes as income derived by a company ordinarily resident and domiciled in Malta.<sup>25</sup> Where such an election is made all provisions under the ITA<sup>26</sup> applicable to companies would be applicable to the so called 'election trust'. Such an election is only possible where the

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<sup>18</sup> Ibid.

<sup>19</sup> Chapter 123 of the laws of Malta.

<sup>20</sup> Subsidiary Legislation 123.114, Foundations (Income Tax) Regulations, art 3(1).

<sup>21</sup> See definition of 'income' under the Income Tax Act, Chapter 123 of the laws of Malta. 'Income' except for the purposes of article 4 (1) and Part V of the Income Tax Act, chapter 123 of the laws of Malta, shall include capital gains (as defined under Article 5).

<sup>22</sup> Ibid.

<sup>23</sup> Chapter 123 of the Laws of Malta, Income Tax Act.

<sup>24</sup> Ibid.

<sup>25</sup> Ibid art. 27D(1)(a).

<sup>26</sup> Ibid.

income attributable to the trust consists solely of dividends, interest, royalties, rents, capital gains and/or income from investments.<sup>27</sup>

The tax implications applicable to foundations, whether treated, for income tax purposes, in the same manner as companies ordinarily resident and domiciled in Malta or whether an election has been made for the foundation to be treated under the provisions of the ITA<sup>28</sup> applicable to trusts (hereinafter ‘election foundations’) are set out below, as follows:

1. Malta Tax Implications Upon Creation of the Foundation
2. Malta Tax Implications Upon Income derived by the Foundation
3. Malta Tax Implications Upon a Transfer of Asset by the Foundation in favour of Third Parties
4. Malta Tax Implications Upon a Distribution of Assets by the Foundation in favour of the Beneficiaries
5. Malta Tax Implications Upon Winding-up of the Foundation
6. Malta Tax Implications Upon a transfer of a Beneficial Interest in a Foundation

### **Malta Tax Implications Upon Creation of the Foundation**

Cash is not a chargeable asset for Malta capital gains tax purposes, as a result, no Malta tax implications would arise where a foundation is established, in terms of the Second Schedule to the Civil Code, with an initial endowment of cash<sup>29</sup> or where an endowment of cash is made subsequent to the creation of the foundation. Malta tax implications will only arise upon an initial or subsequent endowment<sup>30</sup> if the endowment consists of property which constitutes chargeable property for the purposes of Article 5 of the ITA, such as immovable property or any right thereon, securities, business goodwill, intellectual property and any beneficial interest in a foundation the underlying assets of which include chargeable property.

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<sup>27</sup> Ibid art. 27D(1)(b).

<sup>28</sup> Chapter 123 of the laws of Malta, Income Tax Act.

<sup>29</sup> In terms of Article 29(2) of the Second Schedule to the Civil Code, the deed of foundation must, on pain of nullity, contain an initial endowment of money or property worth €1164.69.

<sup>30</sup> Ibid art. 34.

In the case of foundations which elect, for tax purposes, to be treated under the provisions of the ITA applicable to trusts, an endowment in favour of the foundation consisting of chargeable property for the purposes of Article 5 of the ITA, would, in principle, be taxable under article 5(1) of the ITA. However, the said endowments may, in certain circumstances, be exempt from tax, or the tax thereon may be deferred, through the application of Article 5 (18) of the ITA. Such circumstances include, *inter alia*, where the sole founder is also the sole beneficiary of the foundation or where the property is deemed to be donated directly by the founder to the beneficiaries since such beneficiaries are either the founder's spouse or his descendants, ascendants in the direct line and their relative spouses, or in the absence of descendants, the founder's brothers or sisters and their descendants, and include persons who are in existence at the time of the establishment of the foundation and who, in terms of the deed of foundation, have an irrevocable vested right to receive all the property of the foundation.

An endowment of chargeable property in favour of the foundation, falling under Article 5 of the ITA, would constitute a deemed sale at fair market value, being the price which that asset would fetch if sold on the open market at the time of the transfer. The chargeable gain is then taken as being the difference between the cost of acquisition of the property by the founder or donor and the fair market value of the property at the time of the establishment of the foundation or the endowment of the property, as the case may be, unless article 5A of the ITA applies in which case a flat rate property transfer tax of twelve per cent would be levied. A provisional tax payment equivalent to seven per cent of the consideration (or fair market value) becomes payable upon the transfer.

## **2. Malta Tax Implications Upon Income Derived by the Foundation**

As outlined above, a foundation is, by default, treated, for Malta tax purposes as a company that is ordinarily resident and domiciled in Malta. As a general rule, any chargeable income or gains derived by the foundation would, subject to certain exceptions, be taxable at the level of the foundation at the standard tax rate of 35%.

Treating foundations as companies for tax purposes, may create an interesting fiscal environment when earning certain types of income in an international context. This is especially true in view of the applicability of Malta's *Tax Payment and Refund System* and the

participation exemption regime applicable to qualifying companies as introduced in 2007.

### **2.1 The Tax Payment and Refund System**

Where the assets of the foundation consist of shares in a company registered in Malta, that company must maintain five separate tax accounts, namely, the Maltese Taxed Account, the Foreign Income Account, the Immovable Property Account, the Final Tax Account and the Untaxed Account to which its distributable profits must be allocated.<sup>31</sup> Provided that the foundation is created for the ultimate benefit of individuals who are not ordinarily resident and domiciled in Malta, insofar as the foundation, in its capacity as shareholder of that company, receives a distribution of profit which has been allocated to the Maltese Taxed Account or the Foreign Income Account, the foundation would be entitled to claim a six-sevenths refund of the Malta tax paid on those profits at the level of the company, thus resulting in a combined overall Malta effective rate of tax of five per cent.<sup>32</sup> The refund may be reduced to five-sevenths, resulting in a combined overall Malta effective rate of tax of ten per cent, where the dividend is paid out of profits consisting of 'passive interest or royalties.'<sup>33</sup>

### **2.2 The Participation Exemption Regime**

No tax would be levied in Malta on income derived by the foundation that qualifies under the conditions for the application of the participation exemption, provided that the relevant compliance requirements outlined below are also met. Any profits or gains derived by the foundation from a participating holding will be exempt from tax in Malta if the body of persons in which the participating holding<sup>34</sup> is held, not being a property company<sup>35</sup> as defined in the ITA, satisfies any one of the following conditions:

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<sup>31</sup> Refer to definition of 'distributable profits', Income Tax Act, art. 2.

<sup>32</sup> The average effective tax rate of five per cent will only apply to non-resident individuals. In the case of resident individuals, certain 'claw-back' provisions under the Income Tax Act, Chapter 123 of the laws of Malta may apply.

<sup>33</sup> Passive interest or royalties are defined as interest or royalties which are not derived, directly or indirectly, from a trade or business and which have suffered foreign tax at a rate less than five per cent.

<sup>34</sup> Ibid art. 2. See definition of 'participating holding'.

- (i) Is resident or incorporated in a country or territory which forms part of the EU; or
- (ii) Is subject to any foreign tax of at least fifteen per cent; or
- (iii) Does not have more than fifty per cent of its income derived from passive interest or royalties.<sup>36</sup>

In the context of foundations, a participating holding would arise where one of the following tests is satisfied:

- (i) The foundation holds at least ten per cent of the equity shares of the company, where the capital of the company is wholly or partly divided into shares, which holding confers an entitlement to any two of the following:
  - (a) right to vote;
  - (b) profits available for distribution;
  - (c) assets available for distribution on a winding up.
- (ii) The foundation is an equity shareholder of the company and the foundation:
  - is entitled at its option to call for and acquire the entire balance of the equity shares;
  - is entitled to first refusal in the event of the disposal, redemption or cancellation of all the equity shares which are not held by the foundation;
  - is entitled to either sit on the Board or appoint a person to sit on the Board as director; and
  - holds an investment representing a total value of a minimum of €1,164,000 in the company, for an uninterrupted period of 183 days.

The last participating holding test mentioned under the ITA, which refers to the holding of shares for the furtherance of a company's own business,<sup>37</sup> which is not held as trading stock, would fail to find application in the case of foundations, primarily because a

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<sup>35</sup> Ibid. In terms of the ITA, 'property company' means a company which owns immovable property situated in Malta, or any rights over such property, or a company which holds, directly or indirectly, shares or interests in a body of persons which owns immovable property situated in Malta or any rights over such property.

<sup>36</sup> Ibid art. 12(1)(u).

<sup>37</sup> Ibid art. 2(f), see definition of 'participating holding'.

foundation may not be established to carry on commercial activities directly. Therefore, a foundation may not hold shares for the furtherance of its own business activities.

In this regard, the distributable profits of the foundation must be allocated in the same manner applicable to companies.<sup>38</sup> This means that the foundation, like a company, must maintain separate tax accounts, as explained above.

Where, on the other hand, a foundation elects, for tax purposes, to be treated as a trust and at least one of the administrators of the foundation is a person resident in Malta, Malta tax would be payable on any income attributable to the foundation at the rate of thirty-five per cent. 'Income attributable to a foundation' means income referred to in Article 4 of the ITA (whether in the form of profits or gains arising from a trade or business, employment, dividends, interest, annuities, rents, royalties and premiums) which has accrued to or is derived by the administrator/s from the endowment of property in favour of the foundation, property acquired in the course of the administration of the foundation and any income from the employment of property of the foundation. Also included are capital gains derived from the transfer of property of the foundation in the administration of the foundation or in the distribution and upon reversion of such property.

However, where the foundation operates in an international context, the ITA contemplates a number of exceptions to the general rule applicable to trusts as described above, which would similarly apply to foundations that elect to be treated, for tax purposes, as trusts. Where all the income attributable to the foundation consists of:

- income arising outside Malta or;
- income referred to in Article 12 (1) (c) of the ITA i.e. interest, discounts, premiums or royalties, or gains or profits on a disposal of units in a collective investment scheme, units and such like instruments relating to linked long term business of insurance (including the surrender or maturity of linked long term policies of insurance), as well as shares or securities in a company the assets of which do not wholly or principally consist of immovable property situated in Malta;

and all the beneficiaries are persons who are not ordinarily resident and domiciled in Malta, the income would not be deemed to be income attributable to the foundation. Another exception, where the income would not be deemed to be income attributable to the foundation, applies where the income comprises solely of income

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<sup>38</sup> Ibid art. 3(2).

referred to in article 12 (1) (c) of the ITA or dividends distributed out of profits allocated to any of the taxed accounts of a company registered in Malta and all the beneficiaries of the foundations are persons not resident in Malta.<sup>39</sup> In these circumstances, the foundation would be treated as a transparent entity for Malta tax purposes and the income would be deemed to have been derived directly by the beneficiaries.<sup>40</sup>

### **3. Transfer of Assets By The Foundation to Unrelated Third Parties**

Gains derived upon the transfer of assets of the foundation to unrelated third parties would, insofar as the asset constitutes a chargeable asset for Malta capital gains tax purposes, fall under Article 5 of the ITA and would be taxed at the standard tax rate of thirty-five per cent, unless the asset consists of immovable property, in which case a twelve per cent flat rate property transfer tax may apply in terms of Article 5A of the ITA.

The above treatment would equally apply where a foundation elects, for tax purposes, to be treated as a trust.

### **4. Distributions by the foundation in favour of the beneficiaries**

Where the distribution constitutes profits allocated to the foundation's tax accounts, the distribution of such profits shall be treated as dividends distributed to shareholders of a company. Where chargeable property falling under Article 5 of the ITA is distributed by the administrators in favour of the beneficiaries, the distribution would be taxed at the standard tax rate of thirty-five per cent, unless the transfer falls under Article 5A of the ITA, in which case a twelve per cent flat rate property transfer tax may apply.

In the case of foundations which elect for tax purposes to be treated as trusts, capital gains derived from the transfer of property of the foundation on the distribution of such property, are deemed to form part of the income attributable to the foundation and are therefore taxed at the level of the foundation. In light of the above, as a rule, a distribution by the administrators in favour of a beneficiary is treated in the same manner as a transfer by the administrators of the

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<sup>39</sup> Ibid art. 27D(3)(c).

<sup>40</sup> Ibid art. 27D(3)(b).

foundation of property in favour of third parties in the administration of the foundation. As a result, the distribution is treated as a deemed sale at fair market value at the time of distribution and any deemed gains would be taxable in the hands of the administrators by taking into account the difference in the market value of the property at the time of the distribution and the cost of acquisition of the property at the time of acquisition of the property by the administrator/s, unless Article 5A of the ITA applies, in which case a flat rate of twelve per cent would be levied.

Notwithstanding the above, in terms of the ITA no transfer is deemed to take place where the endowment of the relevant property under the foundation was exempt, in terms of Article 5(18)(b) (that is, for instance close relatives or philanthropic institutions having an irrevocable vested right to receive all the trust assets) of the ITA applicable to trusts, and the said property is distributed to beneficiaries who were not founders of the foundation.

If the endowment of the property was exempt under Article 5(18)(c) of the ITA (and therefore where the beneficiaries include the persons referred to in Article 5(2)(e)(i) of the ITA, that is close relatives, including a person limited in his ability to administer his property), the distribution would not, under Article 5(21)(b)(i) of the ITA give rise to tax implications, in view of the fact that the property is deemed to have been donated directly by the founder to that beneficiary.

## **5. Winding up of the foundation**

Upon the dissolution and winding up of a foundation, unless stated otherwise in the deed of foundation, the assets of the foundation are to be either distributed to the beneficiaries or returned to the founder's estate.<sup>41</sup>

The Regulations<sup>42</sup> do not cater for the situation where there is a reversion of property of the foundation, treated for tax purposes as a company, to the founder. This author posits that such a transfer would fall within the purport of the definition under Article 5(1) of the ITA, especially since the definition of 'transfer' as set out in Article 5(1)(b) of the ITA is non-exhaustive and includes 'any alienation under any title'. It is submitted that the definition should be amended to cater for foundations.

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<sup>41</sup> Chapter 16 of the Laws of Malta, Civil Code, Second Schedule, art. 60(2).

<sup>42</sup> Subsidiary Legislation 123.114, Foundations (Income Tax) Regulations 2010.

As the law stands today, any transfer of property in a foundation to the founder would constitute a transfer under Article 5(1) of the ITA, which transfer would be equated with a 'donation'. As a result, Article 5(2)(g) of the ITA would apply and any gains derived from the transfer would be determined by reference to the difference between the fair market value at the time of the transfer by the foundation in favour of the founder and the cost of acquisition of the property at the time of acquisition of the property by the donor (that is the foundation).

On the other hand, in the case of the reversion of property of a foundation which elects to be treated for tax purposes as a trust, a reversion is deemed to take place where there is a transfer to the founder of foundation property which had, immediately before the establishment of the foundation, been owned by that same founder. In terms of Article 27D(3)(d) of the ITA capital gains derived from the transfer of property settled in trust upon a reversion such property is deemed to form part of the income attributable to the trust and is therefore taxed in the hands of the trustee. The same would apply in the case of foundations which elect, for tax purposes, to be treated as a trust and, provided that the 'transparency models' under Article 27D(3)(b), (c) of the ITA are not applicable, upon a reversion, such property is deemed to form part of the income attributable to the foundation and is taxed in the hands of the administrator. Notwithstanding the above, where the endowment of property was exempt under Article 5(18) of the ITA, then no tax implications should arise upon a reversion and it should be deemed that the foundation had never been endowed with such property.

## **7. Transfers of Beneficial Interest**

If the foundation deed so provides, a beneficiary of a foundation may, by instrument in writing, sell, charge, transfer or otherwise deal with his interest (i.e. his beneficial interest) in any manner.<sup>43</sup> Any transfer of a beneficial interest in a foundation by a beneficiary is deemed to be a transfer of a security for income tax purposes.<sup>44</sup>

Tax implications may also arise upon the transfer of a beneficial interest in a foundation which elects to be treated as a trust. If the assets of the foundation are classified as 'taxable trust property' (i.e.

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<sup>43</sup> Chapter 16 of the Laws of Malta, Civil Code, Second Schedule, art. 33(18).

<sup>44</sup> Subsidiary Legislation 123.114, Foundations (Income Tax) Regulations 2010, art. 3(4).

chargeable assets referred to in Article 5(1)(a)(i) (ii) of the ITA<sup>45</sup> and the transfer of the said taxable trust property directly by the beneficiary constitutes a chargeable event, then Malta tax would be chargeable upon gains derived pursuant to a transfer of a full or partial beneficial interest in a foundation and any alienation of any such full or partial interest as a result of a disclaimer of such interest or as a result of a person not remaining a beneficiary of a foundation. The gain is equivalent to the consideration paid and is chargeable at the rate of thirty-five per cent.

### **Concluding Remarks**

The great deal of flexibility which foundations offer is envisaged particularly through the conversion provisions under the Second Schedule to the Civil Code<sup>46</sup> which are also complemented by the election provisions under the ITA.<sup>47</sup> In general terms, the Second Schedule to the Civil Code<sup>48</sup> allows the conversion of a registered organisation<sup>49</sup> into a trust for the benefit of the persons beneficially interested in the organisation.<sup>50</sup> When a legal person is converted into a trust, the trustee shall succeed to all rights and obligations of the legal person and it shall not be required to dissolve and wind up the legal person. The legal person shall be struck off from the register in which it is registered, subject to certain conditions as may be laid down by regulations.

The Second Schedule to the Civil Code<sup>51</sup> specifically caters for the conversion of a foundation into a trust and a trust into a foundation.<sup>52</sup> Even though the ITA<sup>53</sup> recognises the conversion under the Second Schedule to the Civil Code<sup>54</sup>, there are, under the ITA,

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<sup>45</sup> Chapter 123 of the laws of Malta, Income Tax Act.

<sup>46</sup> Chapter 16 of the laws of Malta, Civil Code.

<sup>47</sup> Chapter 123 of the laws of Malta, Income Tax Act.

<sup>48</sup> Chapter 16 of the laws of Malta, Civil Code.

<sup>49</sup> Ibid Second Schedule, art. 26(1). Note that a foundation is defined as an 'organisation'.

<sup>50</sup> Ibid art. 21(3).

<sup>51</sup> Chapter 16 of the laws of Malta, Civil Code.

<sup>52</sup> Ibid Second Schedule, art. 47.

<sup>53</sup> Chapter 123 of the Laws of Malta, Income Tax Act.

<sup>54</sup> Chapter 16 of the Laws of Malta, Civil Code.

certain limitations linked to irrevocability. The Regulations<sup>55</sup> clearly state that the administrators of a foundation may by notice in writing to the Commissioner irrevocably elect that a foundation shall be taxed under the same provisions applicable to trusts.<sup>56</sup> A trust may also, in terms of the ITA<sup>57</sup>, irrevocably elect to be treated for tax purposes as a company.

Even though a foundation which is taxed, by default, as a company may access the tax refunds under the *Tax Payment and Refund System* and may benefit from the participation exemption as discussed above, it does not benefit from the transparency model set out under the 'look-through' provisions applicable to trusts in terms of the ITA.<sup>58</sup> On the other hand, where the foundation is taxed as a trust, the beneficiaries of the foundation would not be entitled to any refunds of the tax paid at the level of the foundation or to the application of the participation exemption.

By virtue of the conversion provisions under the Second Schedule to the Civil Code,<sup>59</sup> it is possible for a foundation (established and treated for tax purposes as a company in accordance with the general rule found under Article 3 (1) of the Regulations)<sup>60</sup> to change its legal form, in accordance with article 47 of the Second Schedule to the Civil Code,<sup>61</sup> and convert into a trust whereby the newly created trust will be taxed, for tax purposes, under the provisions applicable to trusts.

The new legal form (i.e. the trust), treated for tax purposes as a trust may subsequently, in terms of Article 27D of the ITA,<sup>62</sup> elect to be taxed in accordance with the provisions applicable to companies. The ITA<sup>63</sup> permits this election by virtue of Article 27D, whereby the trust shall retain its legal form but changes the way it is treated for tax

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<sup>55</sup> Subsidiary Legislation 123.114, Foundations (Income Tax) Regulations 2010.

<sup>56</sup> *Ibid* art. 4(1).

<sup>57</sup> Chapter 123 of the Laws of Malta, Income Tax Act.

<sup>58</sup> *Ibid* art. 27D(3).

<sup>59</sup> Chapter 16 of the Laws of Malta, Civil Code.

<sup>60</sup> Subsidiary Legislation 123.114, Foundations (Income Tax) Regulations 2010.

<sup>61</sup> Chapter 16 of the Laws of Malta, Civil Code.

<sup>62</sup> Chapter 123 of the Laws of Malta, Income Tax Act.

<sup>63</sup> *Ibid*.

purposes. This election is irrevocable for tax purposes in terms of Article 27D of the ITA.<sup>64</sup>

In conclusion, while the income tax implications arising in the context of a foundation are, in certain circumstances, not entirely straightforward, the Regulations<sup>65</sup> have, in essence, addressed the degree of uncertainty which existed prior to 2010 and have provided a necessary and fundamental legal context within which the tax treatment of foundations may be determined. Moreover, owing to the efficiency of these interesting vehicles, particularly with respect to asset protection and estate planning, and to the flexibility of foundations from an income tax perspective, principally on account of the potential access to the Malta *Tax-Payment-and-Refund-System* and the application of the participation exemption or the application of the ‘transparency models’ applicable to trusts, as discussed in this article, the potential of the institute of foundations must not be overlooked.

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<sup>64</sup> Ibid.

<sup>65</sup> Ibid.