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MEDFEST'19
RAISING EQUITY FINANCE IN MALTA

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Invest in the future

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Raising Equity Finance in Malta

Key Questions for Private Limited Companies

A note on taxation by **RSM Malta**

Raising Equity Finance in Malta – 20 Key Questions for Private Limited Companies

1. What is Equity Finance?

Equity finance is raised when a company issues new shares that are sold to investors. The money comes to the company and is used to fund growth; remember to, “use cash to make progress and not to make purchases.”

2. Who can raise Equity Finance?

Both public and private limited liability companies may issue new shares to raise equity finance from investors, however in addition to having private placements, listed public companies can do the same by offering shares on the Stock Exchange. This paper addresses the equity finance raised by private limited companies.

3. Who provides Equity Finance?

For ‘high-tech, high-growth’ companies this is usually high net-worth individuals (called ‘Business Angels’) who purchase shares in the company and therefore become owners alongside the founding shareholders.

4. When should Equity Finance be raised?

It is common for private limited companies with ‘high-tech, high-growth’ potential to be in a ‘Research and Development’ phase in the early days. Such a company may have no products on the market and so cannot generate sales revenue. In that situation, debt finance cannot be found since there is no revenue from which to repay the loan and so sourcing equity finance to fund business activities is appropriate.

5. How much Equity Finance can be raised?

When raising equity finance from Business Angels, it is quite common for high-tech, high-growth companies to raise amounts between 250,000 and 2,500,000 euro in a single round.

6. Can any private limited company raise Equity Finance in Malta?

Yes, although certain tax implications may arise for the original shareholders if the company is a property company and the issue of such shares results in a decrease in the value of shares held by original shareholders. The tax provisions seek to bring to tax the transfer of ownership of a company that is achieved through means other than a share transfer. Most high-tech, high-growth companies are unlikely to be property companies and thus should qualify for exemption of tax liabilities but always check with your professional adviser.

7. How long does an Equity Finance round take?

Allow several months for the preparation of documentation, presentations and discussions with potential investors and for the application to the Commissioner for Revenue for exemption from tax liability.

8. What documentation will my company need to create for potential investors?

Experienced investors will expect to see a short Funding Presentation (perhaps ten slides to be delivered in a ten-minute talk), a Business Plan (usually for a three-year period) and an associated Cash Flow Forecast (the business budget that covers the three-year period of the plan). You will also require some form of Shareholder Agreement that all shareholders sign by way of agreement over how the company’s owners will work together.

9. Who should be responsible for creating that documentation?

The Founders of the company should be responsible for the Funding Presentation, Business Plan and Cash Flow Forecast. The company’s legal adviser should draw up the Shareholder Agreement and its Corporate Accounting Advisers should prepare a Balance Sheet and a Profit and Loss (P&L).

10. What are the key things that investors look for in an equity finance opportunity?

Remember that investors buy new shares in the company and so become owners alongside the founders. Equity Finance is not a loan and so the investor(s) are not ‘re-paid’. Instead, the investors look to make a ‘Capital Gain’ by selling their shares after a period of time for a higher price than they paid.

11. What are the tax implications of raising Equity Finance in Malta?

There are tax implications to consider when existing shareholders sell their shares to other people and when the company issues and sells new shares to incoming shareholders. The company must seek expert advice from its professional adviser prior to issuing new shares for the purpose of raising equity finance.

12. Do CGT implications always arise when raising Equity Finance?

No. The owners of high-tech, high-growth companies that hold no 'immoveable assets' (such as buildings) should be exempted from tax liabilities but that exemption must be applied for – that should be done by the company's professional adviser ahead of any proposed new share issue.

13. What process should my company follow when it raises Equity Finance?

Ask your professional adviser if an equity finance round would result in a tax liability for the existing shareholders or whether they could benefit from an exemption. Prepare the documents set out in (8) and provide them to your professional adviser who will then undertake the process of applying for exemption of any tax liability.

14. How is the company valued for equity finance purposes?

Different valuations apply for tax and investment purposes. For tax calculations, the company valuation is based on the net assets value of the company which is calculated as all assets held by the company less its liabilities. For the investor, that value is taken into account plus a 'premium' that reflects the potential of the company moderated by an assessment of the risk involved with achieving that potential; that forms the Investor Valuation. However, the investor does not set the value – rather, that is done by the owners of the company who then present that to investors. It is then a matter for the investor to agree whether the valuation (and hence share price) is acceptable.

15. What are the professional adviser costs likely to be incurred for an equity finance round?

The costs will vary according to each situation – please consult your professional adviser.

16. What documents does the professional adviser have to submit to the authorities?

Documents required may depend on the details of the transaction agreed with investors but would normally include the application for the tax exemption and tax documentation including a letter by the Company's auditor. The corporate documentation that needs to be submitted to the Malta Business Registry would usually involve a resolution taken by the Directors of the company and the statutory forms required to notify the Malta Business Registry of the increase in share capital and the subsequent allotment.

17. How long does it take a professional adviser to prepare and submit the application for exemption?

It would take a tax adviser around two weeks from the date when it has complete information and documentation to draft the request and submit the same for the Commissioner for Revenue's consideration.

18. How long will it take for the authorities to review the application and come to a decision?

We do not anticipate that the Commissioner for Revenue should take more than 2-3 weeks in order to issue a confirmation of the exemption. However, such timeline will clearly depend on the Commissioner's availability.

19. How will the company be notified whether its request for tax exemption has been successful?

The tax authorities would usually advise the professional adviser whether the request has been approved and if so, an official letter from the Commissioner is issued for the Company's records. A copy of the official letter would need to be provided upon submission of the share allotment documents to the Malta Business Registry.

20. Is the approach described in this paper approved by the authorities?

This position paper was approved in principle by Mr Marvin Gaerty, Commissioner for Revenue, in 2019. However, always seek advice from your professional adviser as each application will be different.

The Hypothetical Example of ABC Ltd (reviewed by professional advisers RSM)

ABC Limited is a start-up in a high-tech, high growth industry and is seeking equity finance for the furtherance of its research and development activities. For the purposes of this exercise we are assuming that it does not own immovable property, it has no assets and liabilities other than the cash received from its shareholders for the shares they hold.

The founders have found investors that are willing to invest in the company at different stages and on different conditions. It is our understanding that the shares allotted at each stage of financing will be at nominal value with the difference being the share premium contributed which reflects the **Investor Valuation** based upon the investor's perception of the company's potential.

ABC Limited – Shareholder Structure at Company Formation

At incorporation ABC Limited shall be founded with an initial share capital of 2,000,000 ordinary shares at a nominal value of €0.001 each. The shares will be allocated to the founders and in the percentages as listed below.

	Issued Shares	Percentage ownership	Nominal Value per share	Nominal Value	Tax Value per Shareholder
Founder 1	1,000,000	50%	€0.001	€1000	€1000
Founder 2	720,000	36%	€0.001	€720	€720
Founder 3	280,000	14%	€0.001	€280	€280
Total	**2,000,000**	**100%**		**€2000**	

Each founding shareholder has paid the nominal value for the shares held and is looking to develop the idea through the private limited company ABC Limited.

ABC Limited – Business Angel Investment Round 1

ABC Limited has secured an investment from a business angel who is willing to invest €500,000 for a 20% interest in the Company.

	Issued Shares	Percentage ownership	Nominal Value per share	Nominal Value	Share Premium Paid	Tax Value per Shareholder	Equity Finance Raised	Investor Valuation
Founder 1	1,000,000	40%	€0.001	€1,000	-	€200,800		*€1,000,000*
Founder 2	720,000	28.8%	€0.001	€720	-	€144,576		*€720,000*
Founder 3	280,000	11.2%	€0.001	€280	-	€56,224		*€280,000*
Business Angel 1	500,000	20%	€0.001	€500	€499,500	€100,400	*€500,000*	*€500,000*
Total	**2,500,000**	**100%**		**€502,000**		**€502,000**		***€2,500,000***

Both the issued share capital of the Company and the market value of the ordinary shares have changed. The nominal value of the share capital within the Company has increased to €2,500, whilst the market value of the shares (according to tax calculations) would be of €502,000 (amount invested by Business Angel 1 together with the share capital injected at incorporation stage by the founders).

Given that the tax value of the shareholding held by the founders has increased in value, then such a transaction would not fall within the remit of the value shifting provisions put forward by Article 5(13)(b)(ii) ITA since there was no decrease in the market value of the shares held by the initial founders of the Company after such an allotment.

Whilst the above explains how taxation liability will be calculated within Malta, it is important to note that the valuation of the company by the investor (Business Angel 1) is based on a perception of the company's potential and this is especially the case for high-tech, high-growth companies still in an R&D phase without products or services on the market. In order to raise €500,000 of equity finance the company has issued new shares that account for 20% of all shares issued. There are two important points to note here:

- It is common for companies to issue new shares between 25% and 35% of total shares issued.
- Since the investor bought 20% of the shares for €500,000 that equates to the investor believing the company had an 'Investor Value' of €2,500,000. Accordingly, it follows that all shares carry the same 'Investor Value' and that is reflected in the right-hand column of the table.

ABC Limited – Business Angel Investment Round 2

Following two years of operations, ABC Limited did not achieve its technical target and requires additional financing for continued operations. In this regard the company has secured investment from a business angel who is willing to invest €200,000 for a 28.57% interest in the Company.

	Issued Shares	Percentage ownership	Nominal Value per share	Nominal Value	Share Premium Paid	Tax Value per Shareholder	Equity Finance Raised	Investor Valuation
Founder 1	1,000,000	28.57%	€0.001	€1,000	-	€200,571		*€200,000*
Founder 2	720,000	20.57%	€0.001	€720	-	€144,411		*€143,997*
Founder 3	280,000	8%	€0.001	€280	-	€56,161		*€56,003*
Business Angel 1	500,000	14.29%	€0.001	€500	€499,500	€100,286		*€100,035*
Business Angel 2	1,000,000	28.57%	€0.001	€1,000	€199,000	€200,571	*€200,000*	*€200,000*
Total	**3,500,000**	**100%**		**€702,000**		**€702,000**		***€700,035***

Although Business Angel 2 also invested a significant share premium of €200,000 in the Company and the tax value of the Company increased further – now reaching €702,000, when considering the percentage shareholding that Business Angel 2 is receiving, the tax value of the shares of each of the shareholders prior to Investment Round 2 has decreased and the tax value of Business Angel 2 is actually higher than the amount invested in the Company.

The difficulties that ABC Limited has encountered has significantly reduced the Investor Valuation of the Company. In this second investment round the investor was willing to invest €200,000 for 1,000,000 million shares representing a 28.57% interest in the company and an Investor Value of €700,035. The new shares issued (28.57%) falls within the 'typical' share round issue of 25-35%.

Investment Round 2 has therefore brought about a potentially taxable value shift. However, in terms of one of the provisos to Article 5(13)(b)(ii) of the Income Tax Act, as the ABC Limited does not own property and the Commissioner for Revenue is satisfied that the change is being made for a bona fide commercial reason and is not part of an arrangement the main or one of the main purpose of which is the avoidance of tax, no tax shall be chargeable on any such deemed transfer or value shift.

In our view the proposed value shift resulting from Investment Round 2 would appear to satisfy the bona fide commercial reason requirement and are not being carried out with a view to avoid tax, therefore we would expect that a confirmation that the value shifting provisions would not apply should be forthcoming from the tax authorities.

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PARLIAMENTARY SECRETARIAT FOR EUROPEAN FUNDS AND SOCIAL DIALOGUE

INTERREG V-A Italy-Malta Programme
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