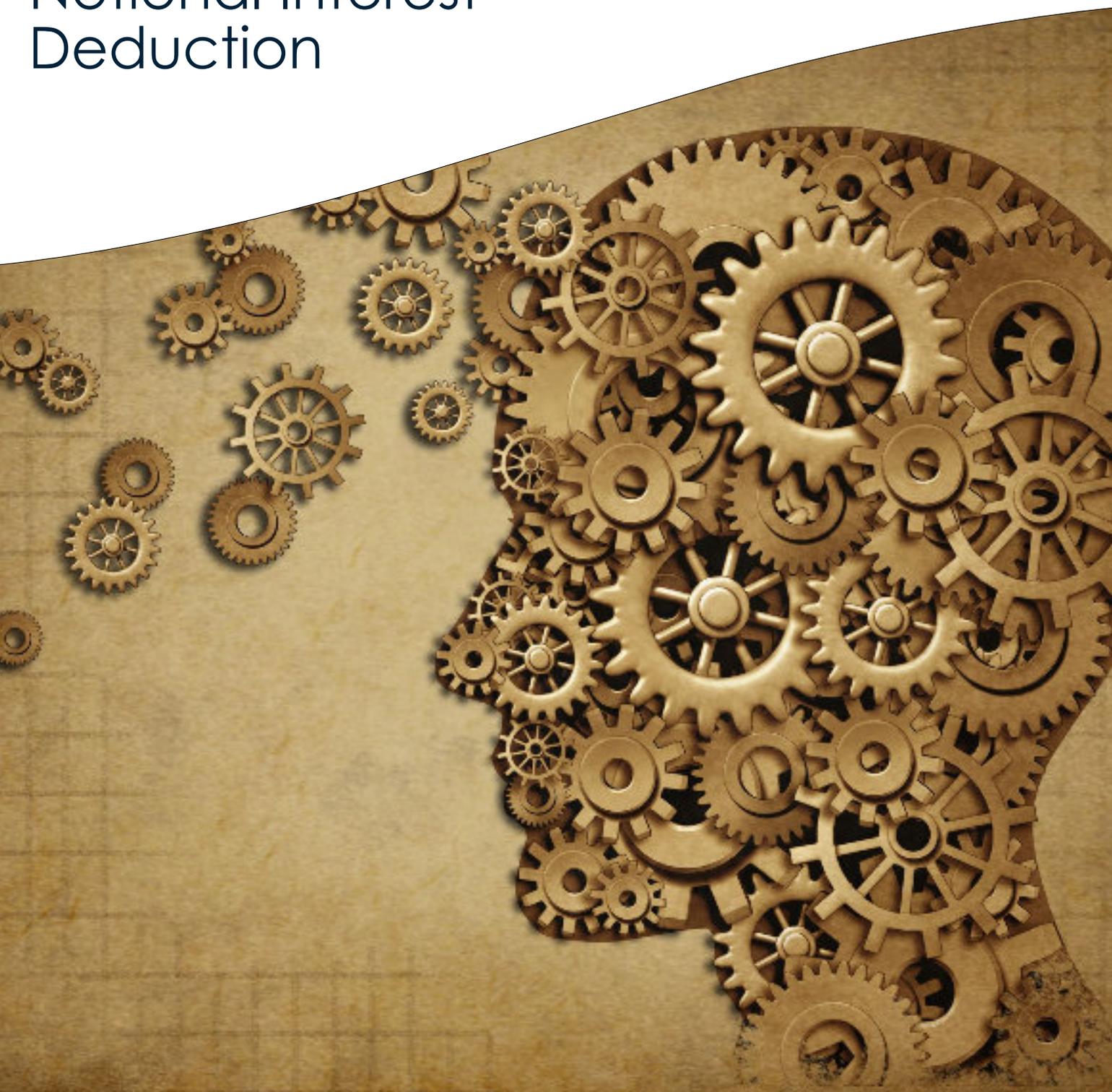


Notional Interest Deduction



Objectives

The aim of the notional interest deduction 'NID' is to approximate the tax treatment of debt and equity financing. The rationale underlying such deduction is to approximate/harmonise the tax treatment of debt and equity financing as traditionally from a Maltese tax point of view debt financing has often been regarded as a more efficient way of financing business operations.

Key Features

- In terms of Article 14(1)(o), a deduction is allowed for “such sums in respect of risk capital as are aimed at approximating neutrality between debt and equity financing, as the minister may prescribe”.
- This deduction is aimed at providing a deduction for “interest on risk capital”. The risk capital of an entity includes share capital, share premium, positive retained earnings, loans or other interest free debt (generally shareholders' loans), and any other positive balance which is shown as equity in the financial statements at the end of the accounting period forming part of the equity of a company resident in Malta, partnership resident in Malta or any other company or partnership that is not resident in Malta that derives income that is effectively connected with a permanent establishment of the company or partnership situated in Malta.
- The NID is calculated by multiplying the deemed reference rate (i.e. a rate established by reference to the current yield to maturity on Malta Government Stocks with a remaining term of approximately 20 years plus a premium of 5%) by the risk capital, less any invested risk capital which the undertaking holds in or provides to any other person to the extent that such invested risk capital is employed by the undertaking in (i) producing income which is exempt from tax in Malta or in (ii) producing income, which had it been produced, could have been exempt from tax in Malta.
- This deduction can be applied for as from year of assessment 2018.
- The adoption of the NID rules is at the discretion of the entity and the claiming of such rules requires the approval of all shareholders/partners.
- The NID may be claimed against profits which stand to be allocated to a company's foreign income account and Maltese Taxed Account (hence can be claimed on profits other than profits derived from immovable property situated in Malta). The maximum deduction is capped to 90% of the chargeable income before taking into consideration the NID deduction and any excess is carried forward to be deducted against the chargeable income of following years of assessment.
- The remaining chargeable income is subject to tax at the normal applicable rates.
- The NID is subject to a general anti-abuse condition to prevent abuses of such deduction.

Implications:

- The NID is deemed to constitute interest income in the hands of the shareholders or partners of the entity for that particular year; and such interest income is deemed to exist for income tax purposes only. Such deemed income would be taxable in the hands of any individual recipient, unless the receipt of interest income is specifically exempt in the hands of the particular shareholders or partners. In the case of non-resident shareholders or partners such interest income will be exempt from tax in Malta, in terms of the treatment of outbound interest in Malta.
- Although, such income is classified as interest income for the purposes of the Maltese Income Tax Act (thus, all provisions applicable to interest would apply), the NID rules specifically exempt the investment income provisions.
- The tax position of any non-resident individual would need to be analysed in his country of residence in respect of such deemed income.
- Profits relieved from tax using the NID must be allocated to FTA. An allocation equal to 110% of relieved profits.

The NID together with the rest of Malta's tax regime offers great opportunities for capital-oriented companies and incentivises same to increase their equity and capital structure.

Baker Tilly Sant
Level 5, Rosa Marina Seafront
216 Marina Seafront
Pieta PTA 9041
Malta

Tel: +356 20109500
Fax: +356 20109501

Email: info@bakertillymalta.com
www.bakertilysant.com

