

Newsalert *

Tax and Legal Services

Malta

24 November 2004

The measures announced tonight by the Prime Minister and Minister of Finance in the budget speech for 2005 include:

- Publication of the White Paper on Pension Reform
- Removal of employees' right to additional days of leave in substitution of public holidays falling on weekends
- Introduction of incentives for research and technology and for industry
- Introduction of revisable fuel surcharge on electricity bills
- Increase in Passenger Departure Tax, excise tax on cigarettes and tobacco products
- Introduction of excise duty on mobile telephony
- Alignment of tax position of inheritances of property taking place between 1992 and 2003, with post-2003 inheritances

This newsletter sets out a summary of these and of the other main budget measures. More details on the changes to tax legislation will be given as soon as the relative laws are published

Overview Budget 2005

CONSOLIDATED FUND 2004/2005

	2005	2004 (Revised)
	Lm (millions)	Lm (millions)
Recurrent Revenue		
Tax revenue	756	712
Non Tax revenue	144	112
Total	900	824
Recurrent Expenditure		
Personal emoluments	208	202
Programmes & initiatives	445	405
Contributions to Public entities	77	79
Maintenance expenditure	31	53
Interest on public debt	78	70
Total	839	809
Recurrent Surplus	61	16
Capital Expenditure	(137)	(110)
STRUCTURAL DEFICIT	(76)	(94)
Financing (excluding new loans)		
Local – Direct Loan Repayments	0	(40)
– Assets' Sales Proceeds	50	0
Net Contributions to Sinking Funds - local/foreign	(8)	(5)
	42	(45)
Public Sector Borrowing Requirement	(34)	(139)

DOMESTIC ECONOMIC PERFORMANCE

Inflation

- For the 12-month period to September 2004 the inflation rate was 2.57%, up from 1.1% at the end of September 2003

GDP

- The Maltese economy is expected to expand by 0.6% in real terms during 2004. In 2005, GDP is expected to increase by 1.5% in real terms (4.7% in nominal terms)

* connectedthinking

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Overview Budget 2005

Unemployment

- The rate of unemployment at 30 September 2004 was 5.1% with the number of unemployed persons reaching 7,382, an increase of 149 persons over the corresponding period

Tourism

- Tourist arrivals for the period January to September 2004 reached 919,728, an increase of 2.3% over the corresponding period for 2003
- Cruise passenger arrivals decreased by 31.7% over the corresponding period for 2003
- Gross income amounted to Lm203 million, representing an increase of 3.5% over the corresponding period for 2003

Foreign Trade and Balance of Payments

- During January to September 2004, imports exceeded exports by Lm319 million - an increase of Lm43.1 million over the corresponding period

WHITE PAPER ON RETIREMENT PENSION REFORM

- A White Paper dealing with the overhaul of the pension system has been published. There are two major changes in the proposed system, one dealing with the retirement age and the second with the level of contributions/pensions
- The retirement age will be increased in a scaled manner to 65 years for both men and women. This change will apply as follows:

<i>Years of age as at 1 Jan. 2007</i>	<i>Retirement age</i>
55 years and over	61 years
52 to 54 years	62 years
49 to 51 years	63 years
48 years and below	65 years

The second change provides for 3 different levels of contribution payments and 3 corresponding pension levels. The 3 levels are as follows:

- **First Pillar:** This is mandatory and aimed to provide a decent standard of living. The contributions and method of pension calculation are based on the principles of the current system but with some important amendments
- **Second Pillar:** This is aimed to enhance the standard of living during retirement. It will be mandatory by 2010 and some tax incentives shall be applicable to such scheme
- **Third Pillar:** This is a voluntary system to be introduced as from 1 January 2006 aimed to further increase the pension level. Some tax incentives shall be applicable to such scheme

INCENTIVES

Research and development (R&D) activities

- Current research expenditure tax deduction increased from 150% to 200% of relevant costs
- Definition of R&D expenditure to include purchase of property for research activity purposes
- Allowable R&D expenditure to include salaries and scholarships paid relative to employees reading for a Masters or Ph.D. degree in specified subjects
- Tax benefit for 3 years, for up to 50% of employer's share of social security contributions for employees having Masters or Ph.D. in specified subjects

Back-office industry

- Provision by ETC of educational courses for employment in the back-office industry
- Fiscal incentives for employers of such workers
- Fiscal incentives for back-office industry in Malta

Storage and distribution centre

- Identification of a 'Free-Trade Zone' within Malta
- Incentives for capital investment in this sector

Aids to small enterprises

- Incentives for enterprises having up to 6 full-timers extended to those with up to 11 full-timers:
 - Technology-related expenditure fully deductible against income earned in the same year (rather than depreciated over a number of years)
 - VAT refunds to be due within 30 days from the timely furnishing of the VAT return

Venture Capital

- Investment for creation of a Venture Capital Fund:
 - Tax Credit for providers of venture capital
 - Partial exemption on capital (gains) tax relative to such investment

Cinematography and the television industry

- Incentives for cinematography/ television industries:
 - Tax benefits relative to approved infrastructure, equipment and facilities
 - VAT refunds
 - Refund of social security contributions
 - A refund of 20% of tax on specified expenses containing more than 50% value added content

Overview Budget 2005

Information technology and Communications

- Fiscal incentives aimed at companies investing in IT to improve their productivity and sales networks

INCOME TAX AND STAMP DUTY

Income Tax – Personal

- With effect from 1 January 2005, in the case of a married couple, where any of the spouses is earning income from part-time work and such couple opts for a joint tax computation, the couple will be eligible to benefit from the fixed tax rate of 15% on income earned from part-time work not exceeding Lm3,000
- Parents, having children with special needs attending private schools, and who incur costs for a facilitator, will benefit from a tax exemption on a sum of up to Lm4,000 paid for such services

Income Tax – Capital Gains

- Cost of immovable property inherited between November 1992 and November 2003 that was not subject to a promise of sale as at 25 November 2003, may be adjusted to reflect the increase in market value of the property and such adjusted cost would become the base cost for computing the capital gain arising on a sale of the property

Persons entitled to benefit from this measure must register the adjusted value and pay the relative stamp duty (without interest and penalties) on such adjustment by 30 June 2005. This should result in an alignment of the tax treatment of such inheritances with post-2003 inheritances

- Capital gains rules implementing the measures announced in last year's Budget are expected to be issued in the short-term. The rules shall among others:
 - establish the method to be used for the valuation of shares on a transfer of a controlling interest in a company and what expenses are deductible in this respect
 - provide for exchanges of shares not resulting in a change in ultimate beneficial ownership nor in the proportion of shareholding, to remain tax-exempt

Stamp Duty

In the case of insurance policies (other than those relating to health or life insurance) subject to a premium of less than Lm5, stamp duty shall be reduced from 50% to 10%

FINANCIAL SERVICES LEGISLATION

The Trusts and Trustees Act has been enacted and is expected to enter into force soon. A law on 'Securitisations' is to be enacted in 2005

INDIRECT TAXES

Value added tax

- VAT refund on part of VAT costs for organising international conferences in Malta
- Kerosene will be subject to VAT and excise duty so as to match the price of diesel. A one-time payment of Lm12 will be paid to persons qualifying for certain non-contributory benefits
- Refund of VAT to disabled persons on certain products purchased exclusively for their needs
- A one-time non-imposition of penalties in cases of payment of outstanding VAT balances and related interest within a specified period of time

Other indirect taxes

- A 3% excise duty will apply with immediate effect on all costs related to mobile telephony
- As from 1 August 2005 the passenger departure tax will be increased from Lm10 to Lm20 for voyages departing from Malta. This increase will not apply for voyages by sea
- Exemption over a number of years on excise duty for bio fuel/diesel
- As from 1 January 2005, eco-contribution tax to be payable on other products including plastic bags, certain containers, and various electronic products
- For anti-abuse purposes, diesel intended for sale overseas which is currently exempt from excise duty, shall require payment of duty. Persons entitled to exemption will need to apply for a refund

OTHER MEASURES

Public Holidays

- Public holidays falling on weekends will not be substituted by additional leave. For 2005 this means that there will be 4 more working days

Increase in oil prices

- A fuel surcharge on water and electricity bills will be introduced from 1 January 2005. This will vary from 9% to 15.6% depending on actual consumption
- Surcharge will be revised every 6 months depending on the international price of oil
- The surcharge will not affect families being considered as social cases
- For factories and hotels, the surcharge will not exceed Lm5,000 annually

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Cost of living allowance

- The cost of living increase for 2005 is Lm1.75 weekly
- For pensioners, the increase is Lm1.17 weekly

Privatisation

- Government will continue its privatisation policy by:
 - Selling all its shares in Interprint
 - Identifying a strategic partner for Tug Malta, to reduce Government shareholding
 - Selling its shares in Malta Dairy Products
 - Selling 20% shareholding in MIA to the public
 - Selling the three hotels of Air Malta group and identifying a strategic partner for the management of Sterling Services and Air Supplies
 - Integrating Malta Oil Bunkering Co into Enemalta and leasing oil facilities to a strategic partner

Bus fares

- Bus fares to increase by 5c from 1 January 2005 – exemptions for pensioners and students

Cultural Heritage incentives

- Fiscal incentives for donations to museums and Maltese heritage organisations and for restoration of historical buildings

Music students

- Students undergoing education through a musical institution, will be refunded 15.25% on the purchase price of their musical instruments

Trustmark

- Development of a trustmark scheme to guarantee purchases over the internet from Maltese companies certified by the scheme

Solar heaters and solar panels

- A refund of 15.25% (up to a maximum of Lm50) will be due on household goods using solar energy purchased after 1 January 2005
- Enemalta to install electricity for free in new premises where solar heaters/panels are installed

Electric cars

- A refund of 15.25% (up to a maximum of Lm500) will be due on electric cars purchased as from 2005

Children's allowance

- Adjustments to be made to calculation of children's allowance for families with 4 or more children

Disabled couples

- Disabled couples to maintain full entitlement to disability benefits on marriage

The notes are designed to keep readers abreast with financial and tax developments. They are not intended to be a definitive or comprehensive analysis of the subject and should not be acted upon without prior consultation with the Partners or Senior Consultants of the firm. For further details please do not hesitate to contact:

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