Chapter 11
Tax System
**Principal taxes**

The principal taxes under Maltese law are:

- Income tax, which includes tax on income and on capital gains of individuals, companies and other entities
- Value Added Tax
- Duty on documents and other transfers (stamp duty), including tax on the inheritance of property and shares
- Customs duty
- Excise tax

Other taxes include the eco-contribution, motor vehicle registration tax, the oil bunkering tax and a number of licence and registration fees.

Social security contributions are payable by employees and their employers and by self-occupied and self-employed persons. There is no tax on capital, other than stamp duty and there are no local taxes. A final withholding tax applies in respect of transfers of immovable property situated in Malta (ref. chapter 12 for further details). However, in certain cases the taxpayer may elect not to be taxed on the final withholding tax but be subjected to the normal charge to income tax at the rates applicable to the particular taxpayer.

The government revenue from taxation during 2015 amounted to €2,961 million and was spread as follows:

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>Percentage of Total Tax Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax (€1,253 million)</td>
<td>42.3</td>
</tr>
<tr>
<td>Value Added Tax (€684 million)</td>
<td>23.1</td>
</tr>
<tr>
<td>Customs and Excise (€453 million)</td>
<td>15.3</td>
</tr>
<tr>
<td>Social Security contributions (€504 million)</td>
<td>17.0</td>
</tr>
<tr>
<td>Others (€67 million)</td>
<td>2.3</td>
</tr>
</tbody>
</table>

**Income Tax**

The laws regulating income tax are the Income Tax Act and the Income Tax Management Act. Subsidiary legislation under these laws includes rules on capital allowances, the final settlement system (FSS), provisional tax, fringe benefits and capital gains. Provisions relevant to income tax are contained in a number of other laws, such as the exemption for shipping activities under the Merchant Shipping Act. Tax incentives are available in terms of the Business Promotion Act, Business Promotion Regulations and the Malta Enterprise Act.

As a member of the European Union, Malta has adopted all EU tax directives which include the parent-subsidiary directive, the mergers directive and the interest and royalties directive.

**The scope of the tax**

**Source of income and capital gains**

Income tax is levied on income in general and on certain specified capital gains.

Income is categorised under the following headings:

- income from a trade, business, profession or vocation
- income from an employment or office
- dividends, premiums, interest or discounts
- pension, charge, annuity or annual payment
- rents, royalties, premiums and any other profits arising from property
- income not falling under the above categories
- Capital gains are subject to tax if they are derived from the transfer (including any alienation under any title) of:
  - immovable property
  - securities, defined as shares and stock and such like instruments that participate in any way in the profits of the company and whose return is not limited to a fixed rate of return, units in a collective investment scheme and units and such like instruments relating to linked long term business of insurance
  - business, goodwill, business permits, copyright, patents, trademarks and trade-names
  - beneficial interest in a trust
  - interest in a partnership
  - securities which were subject to an intra-group exemption, which group ceases before the lapse of six years
  - market value of shares through a change in the issued share capital or voting rights of a company
There are different rules for determining the taxable amount of income and the taxable amount of capital gains. Similarly, certain provisions apply or do not apply in the computation of the taxable amount falling under specific categories of income or capital gains. But the tax is charged on a unitary basis and, as a rule, a taxpayer is liable to one tax on the total amount of his taxable income and capital gains for the respective year. Saving those cases where special rules apply, “income” is used to denote income and capital gains.

Persons subject to tax

Tax is charged on the income and capital gains of every person. A “person” includes an individual, a company and any other body of persons and there is no separate law for the taxation of corporations. Rules that apply specifically to corporations are discussed in chapter 13 while rules that apply specifically to individuals are discussed in chapter 15.

Year of assessment

Tax is charged for every calendar year (year of assessment). As a rule, the income chargeable to tax for a year of assessment is the income for the preceding calendar year. However, the basis period for companies whose financial year does not end on the 31 December is (subject to the authorisation of the Commissioner of Inland Revenue) the financial year ending in the year preceding the year of assessment. A number of provisions require taxpayers to make payments of tax on account of their tax liability for a year of assessment during the basis period.

Basis of taxation

Persons who are ordinarily resident and domiciled in Malta are liable to tax on their world-wide chargeable income and capital gains.

A person who is resident but not ordinarily resident and domiciled in Malta is subject to tax on chargeable income and capital gains arising in Malta and on income (but not capital gains) arising outside Malta and received in Malta. A person who is not resident in Malta is subject to tax on chargeable income and capital gains arising in Malta.

Exemptions

The Income Tax Act provides for a number of exemptions. These include an exemption from tax on:

- interest, discounts, premiums or royalties derived by a non-resident person as long as the income is not connected with a permanent establishment situated in Malta
- gains or profits derived from transfers of units in a collective investment scheme, units relating to the linked long term business of insurance, any interest in a partnership, shares or securities by a non-resident person as long as they are not derived from the transfer of shares in a company/partnership whose assets consist principally of immovable property situated in Malta
- royalties, advances and similar income derived from (i) patents in respect of inventions (ii) copyright which income is also exempt from tax in the hands of the shareholders and (iii) trademarks.

A non-resident person qualifies for these exemptions if he is the beneficial owner of the interest, royalties or capital gains in question and is not owned or controlled by, nor acts on behalf of, an individual who is ordinarily resident and domiciled in Malta.

Exemptions from tax on capital gains include an exemption on the disposal of one’s sole ordinary residence and of certain securities listed on a recognised Stock Exchange. An exemption also applies to income or gains derived by a company registered in Malta from a participating holding or from the disposal of such holding (also known as the participation exemption) as long as the applicable conditions are satisfied.

Certain tax exemptions are provided for in other laws, such as the exemption for shipping companies under the Merchant Shipping Act and the tax incentives under the Business Promotion Act and the Malta Enterprise Act.

Exemptions may also be granted by the Minister of Finance by means of an exemption order. A number of specific tax exemptions are referred to in other chapters of this Guide.
**Deductions**

**General rules**

In the determination of his taxable income a taxpayer is allowed to deduct expenses and outgoings to the extent that they are incurred wholly and exclusively in the production of the income. This test requires a very close connection between the expense and the income against which it is claimed, and it is not enough to show that the expense is a business expense or that it is connected with the income. Pre-trading and post trading expenses do not satisfy this test. The law generally disallows expenditure of a capital nature or for a capital purpose (except in the computation of taxable capital gains). This general rule is subject to a number of specific provisions. These include:

**Interest**

Interest on any borrowed money is an allowable deduction if it is paid on capital employed in acquiring income. The expense is allowable even though the borrowing would have been made for a capital purpose but it is deductible only against the income derived in the same year from the employment of that capital. This special rule is in addition to the deduction for interest paid on money due on revenue account, such as interest on trade debts or charged on normal business overdraft facilities.

**Bad debts incurred in a trade, business, profession or vocation**

Bad debts of an income nature are allowed in the year they become bad if proved to the satisfaction of the tax authorities. No deduction is given for provisions for bad debts and for bad debts incurred in activities other than a trade, business, profession or vocation. Bad debts of a capital nature may be allowed as a deduction against capital gains (see below). Any bad debt that is later recovered is deemed as income for the year in which it is received.

**Loss incurred in a trade, business, profession or vocation**

Losses incurred in a trade, business, profession or vocation are allowable as a deduction against income from any other source and against capital gains. If they cannot be absorbed by income and capital gains for the year, they are carried forward indefinitely to be deducted against subsequent years’ income and capital gains (where applicable) until they are fully absorbed.

Losses are calculated in the same manner as income. Any losses incurred outside Malta that would not have been subject to tax had they been income are not deductible. Company trading losses may be surrendered under the group relief provisions (see Chapter 13). Generally, capital losses may be deducted against subsequent capital gains (see below).

**Capital allowances**

A taxpayer is not allowed to claim accounting depreciation as a deduction but may claim the statutory capital allowances on fixed assets used in the production of his income. The assets that qualify for capital allowances are:

- Plant and machinery, including machinery, equipment, fixtures, motor vehicles and similar fixed assets
- Industrial buildings and structures, including hotel buildings, car park or offices but excluding the cost of land

Capital allowances on plant and machinery are granted at the rates laid down in the Deduction (Wear and Tear of Plant and Machinery) Rules (Appendix II). Capital allowances on industrial buildings and structures, including hotel buildings, car park or offices, consist of an initial deduction of 10% and an annual deduction of 2% of the cost of acquisition of the asset or additions. Capital allowances are allowed in full for the year of acquisition and no allowances are allowed for the year of disposal.

When an asset that qualified for capital allowances is sold, transferred, destroyed, or otherwise put out of use, a balancing statement is to be prepared. If the tax written down value is higher than the value on disposal, the difference is allowed as a further capital allowance (balancing allowance). If the tax written down value is lower, the difference represents a balancing charge, but the charge cannot exceed the total capital allowances granted on that asset. The balancing charge is either added to the taxpayer’s chargeable income or, at the option of the taxpayer and subject to specific conditions, deducted for capital allowances purposes from the cost of acquisition of any fixed asset replacing the asset that has been disposed of. No balancing statement is to be prepared and no right to a balancing allowance or liability to a balancing charge arises if the asset is disposed of after the source of income in respect of which it had been used has ceased to exist.

Capital allowances may only be deducted from income derived from the activity in which the respective assets are used. When, apart from and before taking capital allowances into account, there is a tax loss or insufficient tax profits to absorb the capital allowances for the year, the unabsorbed amount is not added to the trading losses but is carried forward separately until it is fully absorbed against the same source of income. If the related source of income is discontinued before the unabsorbed balance has been fully utilised, the balance is lost, even if the taxpayer is still in business.

No depletion allowances are available in Malta. The statute specifically disallows any deduction for loss, diminution, exhaustion, or withdrawal of capital.
Leasing agreements

Leasing costs are normally fully deductible, except in the case of leased motor vehicles. Deductions for lease payments on vehicles are restricted when the market value of a vehicle exceeds €14,000. In such cases, the allowable lease payment is calculated by using the following formula:

\[
\text{ Lease payment } \times \frac{€14,000}{\text{Market value of vehicle}}
\]

Capital allowances on leased assets can be taken by the owner or by the person making use of the asset, depending on the terms of the lease agreement as to which party assumes the burden of wear and tear. Specific rules apply to assets leased in terms of a finance lease when the lessor is a company licensed as a financial institution and the lease is a qualifying finance lease (as defined).

Expenditure on scientific research

A deduction is available for expenditure on scientific research. If the expenditure is of a capital nature, then the expenditure is allowed as a deduction over a period of six consecutive years from the date in which the expenditure was incurred. At the option of the taxpayer, a deduction equal to 150 percent of the expense is allowed in the year in which the expense is incurred, subject to the condition that the inflated expense does not exceed 5 percent of total turnover in the same year. Any portion of the inflated amount which cannot be absorbed in a particular year may be carried forward to future years until it is fully absorbed.

Intellectual property and intellectual property rights

Expenditure of a capital nature on intellectual property and any intellectual property rights is allowable as a deduction over a reasonable number of years, according to its expected life span, but in any case over a minimum period of three consecutive years. Whenever expenditure on intellectual property and intellectual property rights has been allowed as a deduction, any sums receivable from the sale of the relative asset are taxable as income in the year in which they are received.

Expenditure on business promotion and market research

A deduction is specifically allowed in respect of expenditure incurred for the purpose of promoting a trade, business, profession or vocation including any expenditure on market research and obtaining market information, advertising or other means of soliciting business, providing samples and participating in fairs and exhibitions.

Employee remuneration

The cost of emoluments, including fringe benefits, is allowed as a deduction to the extent that it has been correctly reported under the Final Settlement System Rules. Social security payments that a taxpayer makes on behalf of its employees are deductible in full. Contributions towards a private pension scheme are allowed as a deduction only if the scheme is approved. If the scheme is not approved the contributions may be treated as fringe benefits and deductible as costs of emoluments.

Payments made to employees on the termination of their employment or on dismissal are deductible against the employer’s income if they satisfy the general rule as payments of a revenue nature incurred in the production of the income. Such payments are usually regarded as taxable emoluments and are deductible against the employer’s income if properly recorded for the purposes of the Final Settlement System Rules. Their classification, however, is not always clear and the classification in the employee’s hands is not necessarily valid for the employer.
Other deductions and non-deductible items

Exchange gains and losses are taken to the tax computation when realised.
Expenses on repairs of fixed assets used in the production of the income are allowed as a deduction. Repairs must however be distinguished from improvements. Improvements to fixed assets are expenses of a capital nature and the right of deduction would be regulated by the rules on capital allowances.
Expenses in the category of travel and entertainment are only deductible as long as they relate to the business. Any expenses of a personal nature are to be added back in the tax computation. It is therefore advisable for such expenses to be scrutinised, itemised and well-documented.
Charitable and philanthropic contributions are generally not deductible, unless the donation is to certain approved institutions. A donation may qualify for deduction if it can be shown that it has a promotional value and may therefore be treated as advertising costs.

Legal and accountancy fees paid in the normal course of the trade or business are deductible. Professional fees connected with the setting up or the restructuring of a business and similar capital expenditure are not deductible. Fees connected with the purchase of capital items may, in appropriate circumstances, be capitalised into the cost.
In general, it is more difficult to claim deductions connected with unearned income, such as dividends, interest and rents since income in such cases is deemed to arise from the investment and the costs would be merely attributable to the holding and management of the investment. Deductions in such cases would typically be limited to any interest paid on capital used to acquire the investment, and would be subject to the restrictions mentioned above on deductions for interest.

Special rules apply to rent from immovable property. The deductions in this case are limited to interest on loans used to acquire the property, ground rent and similar burdens on the property, licence fees and a 20% “further deduction”. These special rules do not apply to rent from property used in the holiday business on short lets. In such cases the income would normally qualify as business income and the relative expenses would be allowed without the limitation of these special rules. As from year of assessment 2017, any person renting a tenement to third parties may opt to tax its gross rental income received at the rate of 15%. Such tax shall be final and no set-off or refund shall be granted to any person.
Double Taxation Relief

Taxpayers satisfying the relevant conditions are entitled to double taxation relief on income arising outside Malta that is included in their chargeable income. Relief is granted in the form of a credit. The foreign income is grossed up with the foreign tax and taxed at the applicable Maltese rate. The foreign tax is then deducted from the Maltese tax but the deduction cannot exceed the Maltese tax on the doubly taxed income and there are no provisions for pooling of relief or for carrying forward unutilised relief.

Double taxation relief is available in terms of the relative tax treaty or, on the absence of a treaty, in accordance with the unilateral relief provisions of the Income Tax Act. Subject to certain conditions, companies may claim relief under the flat rate foreign tax credit method, where the foreign tax is deemed to amount to 25% of the income received in Malta.

Qualifying taxpayers receiving dividends from foreign investments also qualify for relief for the underlying tax (see Chapter 13), subject to satisfying the applicable conditions.

Deductions that may be claimed in the computation of capital gains

As a general rule, transfers of property are subject to tax at a final withholding tax on the transfer value. There are very few instances where a taxpayer may opt out of the final withholding tax. In such instances, gains derived from the transfer of immovable property qualify for the following deductions:

- The cost of acquisition and the cost of improvements
- Costs related directly to the acquisition, such as notarial fees and stamp duty
- A deduction for maintenance of 0.4% per annum
- A deduction for inflation calculated by reference to the published cost of living index
- Costs directly related to the transfer, such as commissions, not exceeding 5% of the sale price

The taxable gain on a transfer of securities is the excess of the transfer price over the cost of acquisition, but special relief is available in the case of securities acquired before 1992.

Detailed rules apply to transfers of shares held in a company, when a holding is considered a “controlling interest” (as defined). Capital gains/losses upon transfers of a “controlling interest” are determined by reference to the higher of the “market value” (as defined) of the shares being transferred and their actual consideration. The Rules also provide for the manner in which the cost of the shares being transferred is to be determined.

Generally, losses and bad debts of a capital nature are allowed as a deduction against subsequent capital gains as long as they were incurred in transactions that were subject to tax on capital gains. Losses incurred in a trade, business, profession or vocation are deductible from gains or profits from other sources, including capital gains.

Tax computation

Tax is charged on the chargeable income, which is the total of the taxable income and capital gains after excluding exemptions and allowing for deductions. In the case of companies and other business concerns, the computation takes the form of adjustments to the accounting profits. An example of a computation is given in Appendix III.