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REPORT

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
Subject:	Code of Conduct Group (Business Taxation) – Report to the Council = Endorsement

Malta's notional interest deduction regime (MT014)

I/ AGREED DESCRIPTION

The following description was agreed by the Code of Conduct Group on 12 April 2018:

1. Name of the regime:

Notional Interest Deduction Rules

2. Year of introduction / entry into force:

Rules were published in October, 2017. However, these have since been revised and new superseding legislation has been published in early January 2018. The Rules are applicable as from the year of assessment 2018 (i.e. applicable for any tax period ending in 2017) and therefore the rules published in October 2017 will never have effect.

3. Please attach (or provide a link to) the relevant legislation which introduced/amended your NID regime and any administrative guidance providing clarifications (if in a language other than English, please provide a translation):

Link to the revised regime:

http://www.justiceservices.gov.mt/DownloadDocument.aspx?app=lp&itemid=28906&l=1

4. Please describe the scope of entities that can claim a NID deduction (companies based in your country / treatment of PE of foreign companies):

The Notional Interest Deductions Rules apply to:

- any company or partnership that is resident in Malta; and
- any 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.

There is no relevant data concerning the application of the regime as it is available from the year of assessment 2018 onwards in respect of financial years ending during 2017.

5. NID formula:

5.1. Reference Rate: please describe the formula to determine the deductible interest rate; provide the applicable rates for the previous years (since entry into force):

The reference rate is the risk-free rate set by reference to the yield to maturity on Malta Government Stocks with a remaining term of approximately 20 years plus a premium of 5%.

No applicable rates exist for previous years as the Rules came into force in 2017.

5.2. Equity: is your regime stock-based or an incremental regime?

The Notional Interest Deductions Rules are stock-based. Please see the definition of « risk capital » in Rule 2 and item B in the formula found in Rule 4.

5.3. Equity: please define the equity on which the interest can be deducted:

The applicable equity is as follows -

- in the case of a company or partnership resident in Malta the applicable equity is the share or partnership capital, any share premium, positive retained earnings, loans or other debt borrowed by the undertaking which do not bear interest, and any other reserves resulting from a contribution to the company or partnership, and any other positive balance which is shown as equity in the financial statements of the company or partnership;
- in the case of a permanent establishment of a company or partnership that is not resident in Malta, the applicable equity is that part of the risk capital of that company or partnership that is attributable to the permanent establishment.

In all cases, the amount of equity is to be computed by taking the total equity at the end of the particular accounting period.

6. Limitations applicable to the amount of notional interest deduction:

6.1: Does your legislation provide for a maximum amount of taxable income against which the NID can be claimed? If so, please describe the mechanism and state the lowest effective tax rate that can be achieved by using the maximum amount of NID:

The deduction for the notional interest may not exceed 90% of the company's chargeable income for the relevant year before taking into account the notional interest deduction. Any excess amount may, at the option of the company or partnership, be carried forward for deduction in the following years.

The remaining income is subjected to the tax at the standard corporate rate of 35%.

6.2: Can the NID create losses? If so, please describe how those losses can be used by the taxpayers (carry-back, carry-forward, time and amount limitations):

No. Please see reply to 6.1 above.

7. Please describe the treatment of distributions made out of profits relieved from tax through a NID claim:

Where an undertaking has claimed the NID, the shareholder or partner in the NID is deemed to have received interest income equal to the NID claimed by the undertaking (if there is more than one shareholder/partner in the undertaking, the interest income is deemed to have accrued to the shareholder/partner in proportion to the capital that they hold in the undertaking).

The second paragraph of Rule 5(3) provides that a shareholder, partner or undertaking may make a request so that the deemed interest income is allocated on a basis other than the nominal value of the risk capital held by the shareholder or partner, as the case may be. This provision is in place to address situations where it is clearly more reasonable to split the allocation of the deemed interest income on a different basis, for example on the basis of the actual profit sharing ratio, where this is different from the proportion of the nominal value of shares held by each shareholder.

The Guidelines to be issued with the legislation provide that when the Commissioner for Revenue exercises his discretion under this provision, the criteria that have led to the Commissioner's decision will be published so that the adoption of such criteria can be applied equitably and horizontally in respect of all undertakings. Any decision taken by the Commissioner in terms of the second paragraph of Rule 5(3) will, where applicable, be automatically exchanged by the competent authority in Malta with the competent authorities of all other EU Member States, as well as with the European Commission, pursuant to Regulation 13(3) of the Cooperation With Other Jurisdictions On Tax Matters Regulations [S.L.123.127]. This will also be stipulated in the Guidelines.

Such deemed interest income is brought to charge in the hands of the shareholder/partner in the same way that actual interest would be charged to tax (e.g. a shareholder that is a company resident in Malta of the undertaking claiming the NID would be subject to income tax at the standard corporate rate of 35% on such income).

At the same time, distributions of profits that have been relieved from tax at the level the undertaking that claimed the NID are not subject to further tax at the level of the shareholder/partner.

When any profits relieved from tax through a NID claim are distributed to a shareholder, no further tax is levied at the level of the shareholder.

Example:

Chargeable Income of an Undertaking pre-NID = €10,000

NID = €7,000

Chargeable Income of an Undertaking post-NID = €3,000

Tax thereon @ 35% = €1,050

Chargeable income after tax	= €1,950
Allocation to Reserves (€7,000 + €1,950)	= €8,950

The distribution to the shareholder of €7,000 representing the profits relieved from tax through a NID claim is not subject to tax in the hands of the shareholder given that under general Maltese tax law no additional tax is imposed on distributions to shareholders.

Generally, interest income derived by a person not resident in Malta is not subject to tax subject to the satisfaction of certain conditions (e.g. the interest is not effectively connected with a permanent establishment of the non-resident situated in Malta). The exact same treatment also applies to interest income deemed to be received in terms of Rule 5(1) of the Rules and hence this treatment creates symmetry between actual interest on interest bearing debt and the notional interest arising from risk capital.

8. Please describe any limitations of scope in your legislation (exclusion of some specific assets, participations, treatment of foreign PE of a domestic company):

To compute the NID the reference rate is applied to the risk capital of the company or partnership less the "invested risk capital" to the extent that such invested risk capital either produces income exempt from tax, or produces no income, but if any income was produced, such income could have been exempt from tax.

The invested risk capital is the risk capital that is directly employed in the form of securities, interest in a partnership, contributions and any other loans or debts that do not bear interest that the company or partnership holds in or provides to any other person whether resident in Malta or otherwise.

Furthermore, the NID cannot be claimed against profits derived directly or indirectly from immovable property situated in Malta.

The regime applies to foreign PEs of resident entities. However, if the income derived from a foreign PE of a resident undertaking is exempt from tax under the provisions of the Income Tax Act (Cap. 123 Laws of Malta), no notional interest deduction would be available against such exempt income. Such deduction would be disallowed because it would not satisfy the general deduction principle that deductions are only allowable to the extent that they are wholly and exclusively incurred in the production of income that is chargeable to tax.

9. Do you have specific anti-abuse provisions in your legislation that may apply in the following fields (if so, please explain the measure):

9.1: Intra-group loans and loans involving associated enterprises;

See reply to 8. This applies to risk capital that is directly employed in the form of loans and debts that do not bear interest.

Intra-group loans that carry interest do not fall within the definition of "risk capital" in Rule 2 of the Notional Interest Deduction Rules. Therefore, no NID is available in respect of an interest-bearing loan.

9.2: Cash contributions and contributions in kind;

See reply to 8. This applies to risk capital that is directly employed in the form of a contribution.

9.3: Transfers of participations;

See reply to 8. This applies to risk capital that is directly employed in the form of interest in a partnership and securities.

Furthermore, the regime is stock-based not incremental. There should therefore be less scope for abuse through the artificial creation of "new capital".

9.4: The re-categorisation of old capital as new capital through liquidations and the creation of start-ups;

See reply to 8. This applies to risk capital that is directly employed in the form of interest in a partnership and securities.

Furthermore, the regime is stock-based not incremental. There should therefore be less scope for abuse through the artificial creation of "new capital".

9.5: The creation of subsidiaries;

See reply to 8. This applies to risk capital that is directly employed in the form of interest in a partnership and securities.

Furthermore, the regime is stock-based not incremental. There should therefore be less scope for abuse through the artificial creation of "new capital".

9.6: Acquisitions of businesses held by associated enterprises;

See reply to 8. This applies to risk capital that is directly employed in the form of interest in a partnership and securities.

Furthermore, the regime is stock-based not incremental. There should therefore be less scope for abuse through the artificial creation of "new capital".

9.7: Double-dipping structures combining interest deductibility and deductions under the AGI;

See reply to 8. This applies to risk capital that is directly employed in the form of loans and debts that do not bear interest. Furthermore, Rule 5 deems the NID that is deducted under the Rules to be income in the hands of the relative shareholders/partners.

9.8: Increases in the amount of loan financing receivables towards associated enterprises as compared to the amount of such receivables at the reference date.

See reply to 8. This applies to risk capital that is directly employed in the form of loans and debts that do not bear interest. Furthermore, Rule 5 deems the NID that is deducted under the Rules to be income in the hands of the relative shareholders/partners.

10. Do you have a general anti-abuse provision in your legislation?

- Rule 6 of the Notional Interest Deduction Rules contains the following anti-abuse rule:
  "Without prejudice to the provisions of article 51 of the Act, where in relation to a transaction, or to a series of transactions, sums are determined such that the undertaking, the shareholder or shareholders thereof, or any person which is controlled and beneficially owned directly or indirectly to the extent of more than 50% by the same shareholders, is in a position to obtain an undue advantage which has the effect of reducing their liability to tax in a manner which is not reconcilable with the object and purpose of these rules, the Commissioner shall determine the relevant liability to tax in such manner and in such amount as may be necessary so as to nullify any such benefit or advantage."
- Rule 5 deems the interest that is deducted under these Rules to be income in the hands of the relevant shareholders/partners.
- Furthermore, the Maltese Income Tax Act also contains a wide general anti-avoidance rule, in Article 51 which is reproduced below:

"51. (1) Where any scheme which reduces the amount of tax payable by any person is artificial or fictitious or is in fact not given effect to, the Commissioner shall disregard the scheme and the person concerned shall be assessable accordingly.

(2) (a) Where any person, as a direct or indirect result of any scheme of which the sole or main purpose was the obtaining of any advantage which has the effect of avoiding, reducing or postponing liability to tax, or of obtaining any refund or set-off of tax, has obtained or is in a position to obtain such an advantage, the Commissioner shall, by order in writing, determine the liability to tax or the entitlement to a refund or set-off of tax of the said person, or of any other person, for any year of assessment, in such manner and in such amount as may be necessary, in the circumstances of the case, to nullify or modify the said scheme and the consequent advantage. A person who disagrees with an order served upon him as aforesaid shall have the same rights to object to that order and to appeal from a decision of the Commissioner refusing that objection as if that order were an assessment issued under the Income Tax Management Act and the relevant provisions of that Act relating to objections and appeals shall apply mutatis mutandis.

(b) The benefits of EU Council Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (as amended) shall not be granted to any arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the said EU Council Directive 2011/96/EU, are not genuine having regard to all relevant facts and circumstances. For the purpose of this paragraph -

an arrangement may comprise more than one step or part;

without prejudice to any remaining genuine steps or parts of any particular arrangement, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality; and *where a single step or part in an arrangement or a series of arrangements is, by itself and without regard to the remainder of the arrangement or series of arrangements, not genuine, the provisions of this paragraph shall apply only to such step or part that is not genuine, without prejudice to the remainder of the arrangement or series of arrangements that are genuine. The provisions of this paragraph -*

implement EU Council Directive 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States; and

shall not preclude the application of any other provision in the Income Tax Acts or any rules issued thereunder concerning the prevention of tax evasion, tax fraud or abuse.

(3) Where, as a direct or indirect result of any disposition made during the life of the disponer, any income is payable to or for the benefit of a child in the year immediately preceding the year of assessment, the income shall, if at the commencement of that year the child was unmarried or has not yet reached the age of eighteen years, be treated for the purposes of this Act as the income of the disponer for that year and not as the income of the said child.

(4) Where, as a direct or indirect result of any scheme or of any change in the shareholding of a company income has been received by or has accrued to the company in the year immediately preceding the year of assessment, then, unless it is proved that the said scheme had not been entered into, or the said change had not been effected, solely or mainly for the purpose of obtaining the benefit of any loss, or of the balance of any loss incurred by the company in any year preceding the year of assessment, or of any wear and tear or initial allowances, or of the balance of any such allowances due in respect of any year as aforesaid, so as to avoid liability on the part of that company or of any other person to the payment of any tax -

the provisions of articles 5(10)(b) and 14(1)(g) shall not apply in respect of any loss incurred by the company during the year in which such scheme was entered into or such change was effected, or in respect of any loss or balance of loss which would otherwise fall to be carried forward into that year or from that year into subsequent years;

the provisions of the second proviso to article 14(1)(f) shall not operate so as to allow any deductions to which the company may otherwise be entitled during the year in which such scheme was entered into or such change was effected, in respect of allowances contemplated under the provisions of sub-article

(1)(f) and (j) of that article, or in respect of such deductions or of the balance of such deductions which may otherwise fall to be carried forward from that year into subsequent years;

the provisions of article 24 shall be applied as though the provisions of the preceding paragraphs of this subarticle had not taken effect.

(5) In this article – "child" includes:

(a) a stepchild, or an adopted child, or an illegitimate child of the individual or of the individual's spouse; or

(b) a child orphan of or abandoned by either of the parents and living with the individual or the individual's spouse; "scheme" includes any disposition, agreement, arrangement, trust, grant, covenant, transfer of assets, increase in the share capital of a company and alienation of property, whatsoever, irrespectively of the date on which such scheme was made, entered into or set up."

11. Please describe the administrative procedures to benefit from the NID:

The administrative procedures are currently still being formulated. However, the rules require that all shareholders or partners of the undertaking must provide their authorisation for the undertaking to claim the NID.

Furthermore, it is anticipated that the required details will need to be entered in the relevant tax return. The deduction will thus form part of the self-assessment system.

Additional questions to Malta

On your recently adopted regime, for which no data is yet available, could you please provide:

- **an analysis of the policy underlying the measure, based on consultation documents, impact assessments or other sources prepared when it was introduced, and;**
- **relevant statistical information, including for example, the estimated costs and/or benefits of the measure, the number of taxpayers expected to use it, etc.**

The decision to implement a measure to address the bias between equity and debt financing was triggered by the European Council Recommendation of 9 July 2013 on the National Reform Programme of 2013 of Malta and delivering a Council opinion on the Stability Programme of Malta, 2012-2016 [http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013H0730(15)&from=EN]. The following is an excerpt from Paragraph (11) of the said document: "…*Tax incentives for companies to take on debt are still very high. In 2012, Malta stood out as the country with the second highest gap between the tax treatment of debt and equity financing of new investment. This debt bias may lead to excessively high corporate leverage and inefficient allocation of capital. Malta is among the few Member States without any provisions to counter the debt bias*." Indeed, this was also one of the action points that the Commission has identified in the Action Plan on Building a Capital Markets Union (COM(2015) 468 final). Furthermore, the need to reduce the bias towards funding with debt is also a key aspect of the CCCTB proposal (COM(2016) 685 final).

With this aim in mind, the Maltese government introduced a provision in the tax legislation in 2016 that allows for a deduction of sums in respect of risk capital as are aimed at approximating neutrality between debt and equity financing.

An analysis of the relevant provisions of Maltese income tax legislation considered whether the debt/equity bias is being addressed at the personal taxation level by Malta's full imputation system of taxation which provides a credit for the tax paid at the corporate level to a company's shareholders. In this regard, it has been noted that the full imputation system is not always effective in neutralising the debt/equity bias. In certain circumstances, in fact, certain provisions of Maltese income tax legislation place limitations on the full imputation system, while other provisions allow for a lower rate of tax in respect of interest received by bondholders. Such factors contribute towards a bias in favour of debt financing.

It is believed that the granting of a deduction for tax purposes in the form of an allowance for corporate equity would contribute towards the mitigation of the debt/equity bias at the corporate level. As both the cost of equity and debt will be allowed as a deduction it is anticipated that the tax distortions in financing and investing decisions made at the corporate level will be mitigated.

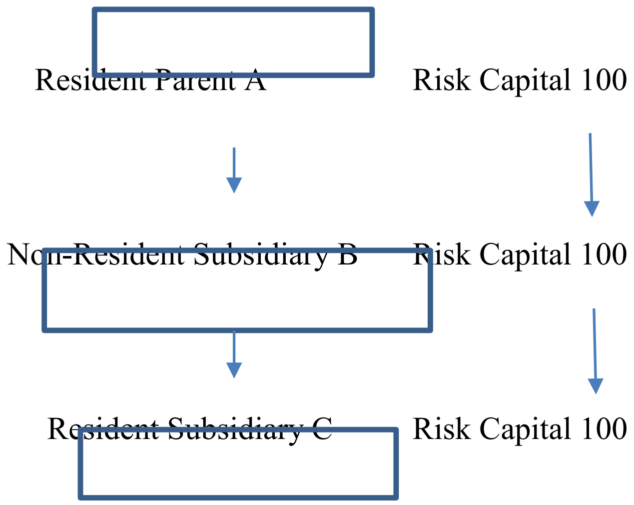
The Notional Interest Deduction Rules, which were introduced following consultations with tax practitioner representative bodies, draw upon similar regimes in other jurisdictions and the experience of others. The initial draft has been replaced by the current legislation which includes more targeted anti-abuse provisions.

Under question 9 of the questionnaire you indicate the applicable anti-abuse clauses. Are you going to issue any guidance as to how you will implement the anti-abuse clauses in practice?

Certain anti-abuse clauses are in our view self-explanatory.

By way of example, Rule 4(1) provides that the risk capital on which the notional interest deduction is calculated be reduced by an amount of invested risk capital where such risk capital produces exempt income. It also provides for such reduction when the invested risk capital produces no income but, if any income was produced, such income could have been exempted from tax. This measure targets multiple deductions on cascading risk capital in structures involving a mix of resident and non-resident undertakings.

Example



Resident Subsidiary C will be entitled to claim the NID in respect of its risk capital. At the same time, Resident Parent A will not be allowed to claim the NID given that it would have to remove the risk capital invested in Non-Resident Subsidiary B from its own risk capital when the return from such investment is exempt or when there is no income from such investment but if there were such income this could be exempted. In this case, therefore, Resident Parent A would not be able to claim the NID on its own risk capital.

The Notional Interest Deduction Rules addresses the bias between debt and equity financing. To approximate both methods of financing further, Rule 5(1) deems the interest that is deducted under these Rules to be income (i.e. notional interest income) in the hands of the relevant shareholders/partners. The tax treatment of notional interest income arising from financing through equity is identical to the tax treatment of interest income arising from debt financing. In structures involving resident undertakings this measure promotes tax neutrality.

Accordingly, we believe that the measures outlined above do not require further clarification in the guidelines. However, we do not exclude the possibility of including an illustrative example, such as the above, to clarify matters further.

This said, further limitations are being clarified in the guidelines. Such limitations follow the overarching principle that expenses are deductible for tax purposes only when these are wholly and exclusively incurred in the production of taxable income. The guidelines will specify that limitations will apply on the notional interest deductions when the risk capital is either not producing any income, is producing income that is exempt from tax or is producing income that is subject to a final rate of tax.

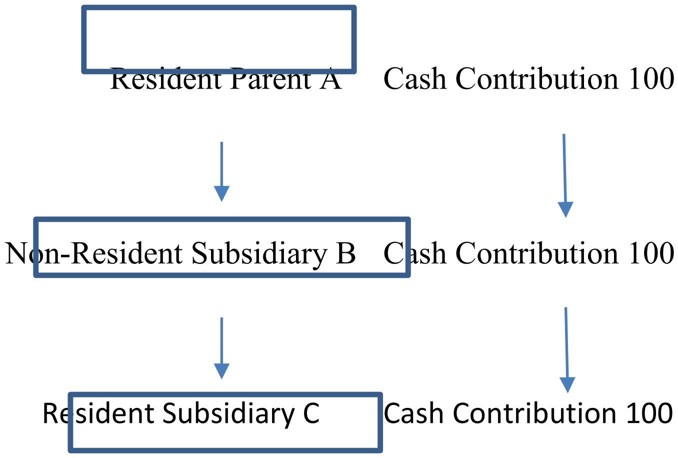
Additional question for 9.2 of the questionnaire: Are there anti-abuse rules that prevent a group from changing existing equity to incremental equity e.g., when a parent company makes a cash contribution to its subsidiary, or to relocate equity by using equity from other companies in the same group?

When a subsidiary claims the NID, any notional interest deducted at the level of the subsidiary is characterised as deemed interest income at the level of the parent. This means that if there is an increase in the equity at the level of the subsidiary there will be a corresponding increase in the deemed interest income at the level of the parent thereby curbing possible abuse scenarios that could arise from artificially increasing equity.

<u>If yes, do the rules also cover existing equity originating from abroad, when a foreign company makes a cash contribution to its subsidiary resident in Malta?</u>

As a general rule the rules apply across the board without any specific reference to whether the equity originates from Malta or outside Malta. Accordingly, irrespective of the source of the equity, if the undertaking that has received the equity claims the NID, the shareholder of that undertaking is imputed with interest income corresponding to the NID that has been claimed.

Furthermore, as noted above, the rules provide further anti-avoidance safeguards by ensuring that the notional interest deductions will be disallowed when the risk capital is not producing any taxable income. Therefore if, for example, a Maltese resident parent undertaking (A) provides a cash contribution to a non-resident subsidiary undertaking (B) which in turn passes on a cash contribution of the same amount of capital to a Maltese resident subsidiary undertaking (C) of the non-resident undertaking (B), (C) will be able to claim the NID but (A) will not be able to claim the NID because the cash contribution given by (A) to (B) is not producing any income to (A).



In any case, the rules also contain a general anti-abuse provision in Rule 6 of the Rules. The provision states that: "*Without prejudice to the provisions of article 51 of the Act, where in relation to a transaction, or to a series of transactions, sums are determined such that the undertaking, the shareholder or shareholders thereof, or any person which is controlled and beneficially owned directly or indirectly to the extent of more than 50% by the same shareholders, is in a position to obtain an undue advantage which has the effect of reducing their liability to tax in a manner which is not reconcilable with the object and purpose of these rules, the Commissioner shall determine the relevant liability to tax in such manner and in such amount as may be necessary so as to nullify any such benefit or advantage.*"

It is pertinent to note that Rule 6 makes reference to "*an undue advantage which has the effect of reducing their liability to tax in a manner which is not reconcilable with the object and purpose of these rules*". Given that the object and purpose of the Rules is the removal/mitigation of the debt/equity bias, any transaction or series of transactions, including the flow of cash contributions between group undertakings which are not reconcilable with such object or purpose of removing/mitigating the debt/equity bias, would fall within these provisions.

II / FINAL ASSESSMENT

[The following assessment was agreed by the Code of Conduct Group on 15 November 2018:]

	1a	1b	2a	2b	3	4	5
MT – Notional interest deduction rules	X	?	X	?	X	X	X

In accordance with the agreement at the meeting of the Code of Conduct Group of 12 April 2018, the following draft assessment has been prepared with regard to paragraphs 1 to 5 under letter B of the Code, based on the replies to the agreed questionnaire (see WK 4005/2018, hereafter referred to as "agreed description"). The measure is assessed against all Code criteria and relevant agreed guidance.

Explanation

Significantly lower level of taxation:

"Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code"

The Maltese Notional Interest Rules were published in October 2017. However, they were revised soon after and new superseding legislation was published in January 2018. The Rules are applicable as from the year of assessment 2018 (i.e. applicable for any tax period ending in 2017).

The general tax rate in Malta is 35%.

The Notional Interest Deductions Rules apply to:

- any company or partnership that is resident in Malta; and
- any 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 interest deduction on equity is calculated as a percentage of a company's "risk capital" (Rule 4 of L.N. 37 of 2018).

Risk capital is defined as follows:

In the case of a company or partnership resident in Malta the applicable equity is the share or partnership capital, any share premium, positive retained earnings, loans or other debt borrowed by the undertaking which do not bear interest, and any other reserves resulting from a contribution to the company or partnership, and any other positive balance which is shown

as equity in the financial statements of the company or partnership; In the case of a permanent establishment of a company or partnership that is not resident in Malta, the applicable equity is that part of the risk capital of that company or partnership that is attributable to the permanent establishment. To compute the NID the reference rate is applied to the risk capital of the company or partnership less the "invested risk capital" to the extent that such invested risk capital either produces income exempt from tax, or produces no income, but if any income was produced, such income could have been exempt from tax. The invested risk capital is the risk capital that is directly employed in the form of securities, interest in a partnership, contributions and any other loans or debts that do not bear interest that the company or partnership holds in or provides to any other person whether resident in Malta or otherwise. The deduction for the notional interest may not exceed 90% of the company's chargeable income for the relevant year before taking into account the notional interest deduction. Any excess amount may, at the option of the company or partnership, be carried forward for deduction in the following years. The reference rate is the risk-free rate set by reference to the yield to maturity on Malta Government Stocks with a remaining term of approximately 20 years plus a premium of 5%. With a yield rate of 2,01%[1] the rate of interest deduction on equity is 7,01%. This reduction of the tax base may lead to a significantly lower level of taxation. **The NID regime is therefore potentially harmful within the meaning of paragraph A of the Code.**

Criterion 1: "whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents"
Criterion 1 contains two elements. The first element is whether the measure is exclusively available to non-residents or transactions with non-residents (criterion 1a). The second element is whether it is only or mainly used by non-residents or for transactions with non-residents (criterion 1b). 1a) Criterion 1a) concerns the de jure application of the measure. The NID applies and is available to all legal entities based in Malta without any restriction in terms of shareholding (resident or non-resident shareholders) or in terms of business sector. 1b) Criterion 1b) is used to complement the assessment under criterion 1a) which only looks at the literal interpretation of the measure. It takes account of the de facto effect of the measure. Where the majority of taxpayers (or counterparties to transactions) benefitting from the measure are in fact non-residents the measure will fall foul of criterion 1b). We do not have information to determine whether the NID is pre-dominantly used by non-residents.

[1] 20 years, Yeild to maturity Q2 2018.

Criterion 2:   "whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base"
As regards criterion 2 the division between criteria 2a and 2b is done in the same way as in the case of criterion 1 (i.e. de jure interpretation and de facto analysis). In general, a measure is caught by criterion 2 if the advantages are ring-fenced from the domestic market so that they do not affect the national tax base. In most cases, the evaluation against criterion 2 follows closely that of criterion 1.   2a / 2b We refer to what is mentioned above under criteria 1a) and b).

Criterion 3:   "whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages"
According to the standard practice for the evaluation of the potentially harmful measures against criterion 3, a measure is caught by this criterion if there are no express requirements with regard to real economic activities and notably any requirement with respect to employment obligations.   Such express requirement aims at ensuring that the activities generating the income are undertaken by the taxpayer benefiting from the preferential tax regime.   Notional interest regimes such as the Maltese Notional interest deduction rules are different from other preferential tax regimes in that their tax benefits are not based on income generated or the activity performed but on the policy goal to tackle the debt bias, making it difficult to expect a correlation between income-generating activities and benefits.   Such a regime should nonetheless be properly contained by appropriate anti-abuse measures in order to tackle tax planning opportunities, especially when associated with the windfall effect of a regime based on the stock of equity (as compared to an incremental system that rewards only the increase in equity).   Paragraph L of the Code of Conduct states that: "anti-abuse provisions or countermeasures contained in tax laws and in double taxation conventions play a fundamental role in counteracting tax avoidance and evasion". In past assessments, the Code Group has taken into account, in the overall assessment of various regimes, the existence of appropriate anti-abuse provisions or countermeasures.   In order to avoid tax planning and abuse connected to notional interest regimes, the following limitations of the scope and anti-abuse measures have been identified in a previous assessment[2].

[2] Limitation of scope:

The same structure and content will be used for the assessment of the Maltese Notional interest deduction rules.

Malta's Notional interest deduction rules include the following limitations of its scope:

To compute the notional interest deduction the reference rate is applied to the risk capital (see definition under the Gateway criterion) of the company or partnership less the "invested risk capital" (see definition under the Gateway criterion) to the extent that such invested risk capital either produces income exempt from tax, or produces no income, but if any income was produced, such income could have been exempt from tax. Excess amounts may, at the option of the company or partnership, be carried forward for deduction in the following years.

The provision on scope excludes

- own shares;

- Exclusion of own shares: this exclusion prevents the possibility for a company to increase its equity and simultaneously subscribe the new shares.

- Exclusion of shares held in other resident and non-resident legal persons: this exclusion tackles the possibility to cascade the ACE through chains of equity injection.

- The application of the allowance may not create nor increase tax losses. Consequently, a negative result due to this deduction does not generate a loss carry forward.

- Assets not necessary for conducting business: this is a classical exclusion in NID systems to avoid benefiting from NID on assets that do not generate taxable income (for instance, luxury goods, artwork, etc.).

- No deduction of NID with regard to capital which is allocated to a foreign permanent establishment. If the foreign PE was a legal person (a subsidiary), the parent company holding its capital would have to exclude those shares from the ACE base.

Anti-abuse rules targeting specifically transactions between related parties: The proposal for an EU Directive on a common consolidated tax base (CCCTB) contains an allowance for growth and investment (AGI). Art. 11(6) of the CCTB reads as follows:

"*The Commission shall be empowered to adopt delegated acts in accordance with Article 66 to lay down more detailed rules against tax avoidance, and more particularly in the following fields relevant to the AGI:*

(a) intra-group loans and loans involving associated enterprises;

(b) cash contributions and contributions in kind;

(c) transfers of participations;

(d) the re-categorisation of old capital as new capital through liquidations and the creation of start-ups;

(e) the creation of subsidiaries;

(f) acquisitions of businesses held by associated enterprises;

(g) double-dipping structures combining interest deductibility and deductions under the AGI;

(h) increases in the amount of loan financing receivables towards associated enterprises as compared to the amount of such receivables at the reference date."

- shares held in other resident and non-resident legal persons;
- the application of the NID may not create not increase tax losses;
- assets not necessary for conducting business.

This is complemented by the fact that Malta's Notional interest deduction rules include a general anti-abuse provision (Rule 6). The provision is applied in cases where the taxpayer tries to obtain an "undue advantage which has the effect of reducing their liability to tax in a manner which is not reconcilable with the object and purpose of the Notional interest rules".

Concerning the fifth criterion on limitation of scope a NID deduction is allowed for capital allocated to a foreign PE (Rule 2(b)). However, if the income from the PE would be exempt from income tax under Maltese income tax law no deduction would be allowed.

Rule 2 of the Maltese notional interest regime intra-group loans that carry interest do not fall within the scope of the notional interest deduction. This avoids abuse involving intra-group loans (see (a) footnote 2).

Notional interest deducted at the level of a subsidiary is characterised as deemed interest income for the parent company (Rule 3(1)). An increase of the equity of the subsidiary resulting in a notional interest deduction would lead to taxable income for the parent company. This counters abuse concerning cash contributions and contributions in kind (see (b) footnote 2) when the parent company is resident in Malta but would not address the situation when the parent is a foreign entity as the income would not be taxable in Malta for the foreign parent company. However, this is a general feature of the Maltese tax system which does not fall within the scope of this assessment. This also addresses situations re-categorisation of old capital as new capital through liquidations and the creation of start-ups to the extent that it is relevant in the case of a stock-based regime such as the Maltese (see (d) footnote 2).

Rule 4(1) of the Maltese notional interest regime provides that the risk capital on which the notional interest deduction is calculated be reduced by an amount of invested risk capital where such risk capital produces exempt income. It also provides for such reduction when the invested risk capital produces no income but, if any income was produced, such income could have been exempted from tax. This measure targets multiple deductions on cascading risk capital in structures involving a mix of resident and non-resident undertakings (see (c) footnote 2).

Rule 2 provides that "invested risk capital" is not included in the "risk capital" which forms the basis for the notional interest deduction. Invested risk capital is defined as securities, interest in a partnership, contributions and any other loans or debts that do not bear interest that is held in or provided to any other person. This eliminates the risk of abuse through the creation of subsidiaries (see (e) footnote 2) as well as the issue relating to acquisitions of businesses held by associated enterprises (see (f) footnote 2).

Rule 5(1) of the regime deems the interest that is deducted under its provisions to be income (i.e. notional interest income) in the hands of the relevant shareholders/partners. The tax treatment of notional interest income arising from financing through equity is intended to be identical to the tax treatment of interest income arising from debt financing. This prevents double dipping combining interest deductibility and notional interest (see (g) footnote 2).

If income derived from a foreign PE of a resident undertaking is exempt from tax under the provisions of the Income Tax Act, no notional interest deduction is available against such exempt income. Deductions are only allowable to the extent that they are wholly and exclusively incurred in the production of income that is chargeable to tax. Contributions and loans that do not bear interest are not included in the equity which is the basis for the NID. Also a NID which has been deducted will be considered as income in the hands of the shareholder. This covers the situation with increases in the amount of loan financing receivables towards associated enterprises as compared to the amount of such receivables at the reference date (see (h) footnote 2).

The burden of proof for the application of the specific anti-abuse provisions of the Rules (Rule 6) is for the taxpayer. In cases where it appears to the Maltese Commissioner for Revenue that the tax payable by a person has been determined at a lesser amount than that which ought to have been charged, including through artificial arrangements, the Commissioner may make an assessment of the chargeable income of that person and the tax chargeable thereon. When the taxpayer appeals against such an assessment The onus of proving that the assessment complained of is excessive shall be on the appellant (article 35(3) of the Income Tax Management Act).

Malta also has a general anti-abuse rule in the Maltese Income Tax Act targeting any scheme which reduces the amount of tax payable by any person is artificial or fictitious or is in fact not given effect to.

On the basis of the available information the applicable anti-abuse provisions meet the requirements of the Code of Conduct to avoid a measure being used for tax avoidance.

Criterion 4: “whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD”
The measures do not contain such elements that would be relevant from the point of view of internationally accepted principles as referred to in criterion 4 of paragraph B of the Code.

Criterion 5: “whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way”
All preconditions necessary for the granting of a tax benefit should be clearly laid down in publicly available laws, decrees, regulations etc. before a measure can be considered transparent.

Overall assessment:

The regime is considered as overall not harmful.