

SUBSIDIARY LEGISLATION 123.176**NOTIONAL INTEREST DEDUCTION RULES**

2nd February, 2018

LEGAL NOTICE 37 of 2018.

1. (1) The title of these rules is the Notional Interest Deduction Rules, 2018. Citation and commencement.

(2) These rules shall come into force from year of assessment 2018.

2. In these rules, unless the context otherwise requires: – Interpretation.

"the Act" means the Income Tax Act;

"interest on risk capital" shall have the meaning assigned to it in terms of rule 4;

"the reference rate" means 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%;

"risk capital" means:

(a) where the undertaking is a company or partnership resident in Malta, the share or partnership capital of the undertaking, 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 undertaking, and any other positive balance which is shown as equity in the financial statements of the undertaking; and

(b) where the undertaking is a company or partnership that is not resident in Malta, that part of the risk capital, as defined in paragraph (a), of that undertaking that is attributable to the permanent establishment situated in Malta; and

"undertaking" means a company or a 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.

3. (1) For the purpose of ascertaining the total income of an undertaking for a year of assessment, the undertaking shall be entitled to a deduction for sums that are deemed to be payable by way of interest on risk capital or such part thereof as may

be determined by the undertaking for the particular year:

Provided that the entitlement to a deduction in terms of this sub-rule shall apply only in respect of profits which stand to be allocated to a company's Foreign Income Account or Maltese Taxed Account or in respect of profits of any other undertaking which, had it been a company, would have stood to be allocated to its Foreign Income Account or Maltese Taxed Account. In any such case, the limitation set out in sub-rule (2) of rule 4 shall be calculated on the basis of the undertaking's income which stands to be allocated to Foreign Income Account or Maltese Taxed Account or which would stand to be so allocated if the undertaking were a company.

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(2) The deduction referred to in sub-rule (1) shall be claimed at the option of the undertaking in the return made pursuant to article 10 of the Income Tax Management Act, so however that such deduction may only be claimed if it is demonstrated that all shareholders or partners of the undertaking approve the claiming of such deduction in respect of the particular year of assessment.

The undertaking shall be entitled to a deduction against such income for sums that are deemed to be payable by way of interest on risk capital.

Calculating interest
on risk capital.

4. (1) Interest on risk capital for a year of assessment shall be calculated on the basis of the following:

$$Y = A \times B$$

Where –

"Y" represents the interest on risk capital that an undertaking is entitled to claim in the relevant year of assessment;

"A" represents the reference rate;

"B" represents the risk capital of the undertaking for the accounting period ending in the year preceding the year of assessment less any risk capital 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 undertaking holds in or provides to any other person whether resident in Malta or otherwise (hereinafter in this sub-rule collectively referred to as "the invested risk capital"), to the extent that such invested risk capital is:

(a) not employed by the undertaking in producing any income in the year preceding the year of assessment in a situation where had any such income been produced it could have been exempt from tax in terms of the Act, or

(b) employed in producing income in the year preceding the year of assessment which is exempt from tax in terms of the Act.

For the purposes of this rule "risk capital" shall be computed by taking the total risk capital at the end of the particular accounting period ending in the year preceding the year of assessment

(2) Notwithstanding the other provisions of this rule:

(a) where in respect of any year preceding a year of assessment, interest resulting from the above computation exceeds ninety per cent (90%) of the undertaking's chargeable income for the said year prior to taking into account the deduction allowable in terms of sub-rule (1) of rule 3, the amount of such excess shall not be available for deduction against the profits for the said year, but may, at the option of the undertaking, be carried forward for deduction and be added to the deduction due for the following year and deemed to be part of that deduction, or if there is no such deduction for that year, be deemed to be the deduction for that year and so on for subsequent years and any amounts carried forward as set out in this *proviso* shall be increased by such rate as may be prescribed by the Commissioner:

Provided that where a shareholder or partner of an undertaking that is a company is deemed, in terms of rule 5, to have received interest income pursuant to a deduction claimed by such undertaking, the shareholder or partner will be entitled to deduct any interest on risk capital which it is deemed to have incurred in terms of this rule against such deemed interest income without the limitation set out in this paragraph.

(b) where any risk capital results in a deduction being claimed by the undertaking in terms of any other provision of the Act or of any rules issued thereunder (hereinafter "the other provisions"), the undertaking shall be entitled to elect whether to claim a deduction in terms of these rules or in terms of the other provisions in respect of the amount which would qualify for deduction in terms of both these rules and the other provisions.

5. (1) Where an undertaking claims a deduction in terms of rule 3 in calculating its total income for a year of assessment, the shareholder or partner, as the case may be, of the undertaking at the end of the year preceding the particular year of assessment shall be deemed to have received in that year an amount of income equal to the interest on risk capital claimed as a deduction by the undertaking for the said year of assessment.

Where an undertaking claims a deduction in terms of rule 3.

(2) The income referred to in sub-rule (1) shall be characterised as interest for the purposes of the Act and all provisions relating to the taxation of interest income shall apply *mutatis*

mutandis to such deemed income:

Provided that articles 32 to 42 of the Act shall not apply to such deemed income.

(3) Where the undertaking has more than one shareholder or partner at the end of the year preceding the year of assessment, each shareholder or partner, as the case may be, shall be deemed to have received an amount of deemed income as corresponds to the proportion of the nominal value of the risk capital pertaining to each shareholder or partner, as the case may be, holds in the undertaking at the end of the year preceding the year of assessment:

Provided that on a request from a shareholder or partner of an undertaking, as the case may be, the Commissioner may, if he deems fit, direct the shareholders or partners of the undertaking to divide the deemed interest income using an alternative basis.

The Commissioner shall determine the relevant liability to tax in such manner so that no undue advantage is obtained.

6. 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.
