

KEY FACTS

NOTIONAL INTEREST DEDUCTION RULES

NOTIONAL INTEREST DEDUCTION OR “NID”, IS AN OPTIONAL DEDUCTION THAT MAY BE APPLIED BY COMPANIES OR PARTNERSHIPS RESIDENT IN MALTA, AS WELL AS NON-RESIDENT COMPANIES OR PARTNERSHIPS THAT HAVE A PERMANENT ESTABLISHMENT SITUATED IN MALTA. THIS OPTION IS AVAILABLE ON A YEARLY BASIS.

WHY NID?

For many years businesses have been highly dependent on debt to finance their operations. Primarily, this is because interest expense on such debt is a tax-deductible expense, thereby making debt a tax efficient source of finance. In this respect, the introduction of the NID aims to equalise the tax treatment of equity financing and debt financing by providing companies and partnerships with a deduction of interest they are deemed to have incurred on such equity.

HOW TO CALCULATE NID

NID is calculated by multiplying the reference rate by the risk capital of the company or partnership as follows:

$$Y = A \times B$$

where the following values hold

Y Represents the interest on **risk capital** that may be claimed

A Represents the **reference rate**

B Represents the **risk capital** of the company or partnership at the end of the accounting period.

Reference Rate

The NID rules state that, for the purposes of computing NID, the risk-free rate is determined by the current yield to maturity on Malta Government Stocks with a remaining term of approximately 20 years. The reference rate is calculated by taking the risk-free rate and adding a premium of 5%.

Risk Capital

For companies and partnerships resident in Malta, risk capital comprises the share capital of the company or partnership capital, and share premium, any retained earnings, loans or other debt borrowed by the company or partnership that do not bear interest, and any other reserves resulting from the contribution of the company or partnership, as well as any other item shown as equity in the company's or partnership's financial statements.

For companies and partnerships that are not resident in Malta, the risk capital comprises the capital of the company or partnership that is attributable to the permanent establishment situated in Malta.

CAPPING OF NID

NID is capped at a maximum of 90% of the chargeable income of the company or partnership in question. This means that the company or partnership cannot use the NID deduction to eliminate entirely its tax liability. Any excess may then be carried forward to the following year. As a result of this, any remaining chargeable income is subject to tax in Malta at the standard tax rate.

IMPACT OF NID ON TAXED ACCOUNTS

Where a company or partnership claims NID, an amount equal to 110% of the profits relieved from tax is to be allocated to the company's or the partnership's final tax account instead of being allocated to any other taxed account. By so doing, the company or partnership is restricting the shareholders' or partners' ability to claim, under the refundable tax credit system, a refund of that portion of the Malta tax paid to those profits for which NID has not been claimed.

If, however, the company or partnership has insufficient profits to allocate the amount of profit as required by the NID rules, then that portion not allocated shall be ignored.

IMPACT OF NID ON SHAREHOLDERS AND PARTNERS

The NID rules provide that any amount claimed as NID by the company or partnership should also give rise to an equal deemed interest income, such deemed interest income is subject to Maltese tax in the hands of the company's or partnership's shareholders or partners in proportion to the nominal value of the risk capital relating to each shareholder or partner unless otherwise allowed by the Commissioner.

The deemed interest income will be treated as interest for tax purposes and all provisions related to the taxation of interest (excluding the investment income provisions) shall apply.

Therefore, shareholders or partners receiving this deemed interest income are entitled to deduct against it any NID that they are eligible for, subject to their own risk capital. However, in this scenario the 90% limitation referred to above does not apply in this respect.

Furthermore, if the shareholder or partner is a non-resident, then they are entitled to claim the non-residents' exemption on this deemed interest income for Maltese tax purposes.

HOW WE CAN ASSIST

For more information, please contact Albert Cilia, Managing Director of our Malta office, at acilia@tridenttrust.com, or either of our Trustee and Corporate Services Directors, Josianne Cascun Montebello at jcascunmontebello@tridenttrust.com or Janice Copperstone at jcopperstone@tridenttrust.com.

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