

# Budget 2006

Tax Newsletter

November 2005

Avanzia

The Prime Minister and Minister of Finance presented his Budget for 2006 on 31 October 2005. In his review of Malta's economic performance he indicated that the budget deficit will be reduced from 5.1% of GDP to 4% of GDP in 2005 so that the Government will be able to meet the target of a budget deficit of less than 3% of GDP by the time it introduces the Euro on 1 January 2008.

During the first nine months of 2005 economic growth was equivalent to 1.7% in real terms and there was an increase in local consumption, notwithstanding that the Government has reduced its expenditure by 3.8% in real terms.

According to the Harmonised Retail Price Index, inflation reached 2.2% which is at the same level as the EU average. The unemployment rate of 5% of the labour force also compares well with the EU average.

Apart from looking at various sectors of the economy the Prime Minister and Minister of Finance announced a series of measures for 2006.

Our review of some of the main budget features are included hereunder.

## **Cost of living adjustment**

The cost of living increase for 2006 will be of Lm2.25 per week. This will increase the weekly minimum gross wage to Lm57.88 per week.

Pensions will increase by Lm1.67 per week.

## **Capital gains tax on transfers of immovable property**

The capital gains provisions contained in the Income Tax Act will be amended to reflect the following changes:

- a reduced rate of Capital Gains Tax (CGT) on the transfer of immovable property acquired 'causa mortis' after 1992;
- the introduction of a Final Withholding Tax (FWT) on the transfer of immovable property.

## *Reduced rate of CGT on the transfer of immovable property acquired 'causa mortis' after 1992*

The CGT on the transfer of immovable property which was inherited after 1992 will be reduced from 35% to 12%. CGT at the rate of 12% will continue to be calculated on the total profit made, that is, on the difference between the selling price and the value shown on the deed of transfer 'causa mortis'.

Immovable property which was inherited before 1992 will continue to be subject to a FWT of 7% on the consideration declared on the contract of sale.

## *Introduction of a FWT on the transfer of immovable property*

As from 1 November 2005, the CGT regime which taxes profits on the sale of immovable property at the taxpayer's applicable income tax rate, will be replaced by a FWT of 12% on the value of the property. Any expenses and allowances applicable under the former CGT rules shall no longer be allowable. The FWT is payable upon the contract of sale.

Where a promise of sale in respect of immovable property has been registered with the Public Registry or is in the hands of a Notary Public by 20 November 2005, the seller may opt to pay tax under the former CGT regime or the FWT introduced in the budget provided that the contract of sale is published by 31 December 2005.

There will be no changes to existing exemptions including the transfer of own residence, the transfer of property resulting from separations and the sale of immovable property by court order.

In addition, the Capital Gains (Amendment) Rules enacted in January 2005, shall continue to apply to transfers of immovable property between companies forming part of the same group.

## **Other tax incentives**

Companies who pay for the studies of their employees will be entitled to tax credits whilst those individuals who pursue their studies in science subjects will be entitled to tax credits calculated on the study costs.

These two measures have already been included in the legal notices published on 11 October 2005 on various tax credits under the Income Tax Act.

The six legal notices contain a number of tax credits and incentives for companies that set up back office operations, operate in a free zone, are involved in eBusiness activities in Malta, incur qualifying expenditure in research and development or reinvest their profits in particular projects. The Prime Minister and Minister of Finance has now announced that the Government is allocating Lm4 million in tax credits as incentives associated with research and development, Lm500,000 in tax credits for companies that set up back office operations in Malta and another Lm500,000 in tax credits for companies that set up eBusinesses in Malta. Most of the tax incentives included in the said legal notices are effective from 1 January 2005.

The Government is committing itself to explore the possibility of establishing business parks that cater for particular market sectors such as science and technology, pharmaceutical and laboratory research, financial services and back office operations.

Apart from these areas the film making industry also stands to benefit from certain tax incentives. Persons who invest in the facilities and services for the production of films may claim certain tax credits. Indeed every film production may benefit from a refund of up to 20% of the expenses incurred in Malta.

## **Other incentives**

### *Solar energy*

The Prime Minister and Minister of Finance pointed out that investment has been and will continue to be made in the environment sector. A number of fiscal measures to promote the use of alternative energy were introduced in the budget speech. These include:

- a refund of 25% subject to a maximum of Lm100 of the expenditure incurred on solar energy equipment. This scheme is extended to encompass wind energy as well as roof insulation of private homes;
- a refund of 25% subject to a maximum of Lm500 on the purchase of photovoltaics;
- free meter installation where photovoltaic technology is installed;

In addition Enemalta will absorb any excess energy generated from the photovoltaic technology and will purchase any extra energy at a rate of 3 cents/Kwh.

### *Aid to NGOs and small enterprises*

The concept of 'inclusive society' once again features in the budget speech. NGOs and small enterprises installing a lift to make the premises more accessible may claim a refund of 10% of the purchase price of the lift.

### *Assistance to small and medium enterprises*

Government will provide support to small and medium enterprises particularly at start up and early stages of business. An office will be set up to help small businesses identify foreign partners, whilst land has been identified for development of seven zones for small and medium enterprises. Government will allocate funds to initiate infrastructural works associated with the delivery of essential services to these sites.

Funds will be allocated for micro enterprises to support restructuring and training of investors and employees.

### *Reduction in registration tax of commercial vehicles*

The registration tax of new commercial vehicles exceeding five tonnes will be reduced from 36% to 24% of the vehicle value.

## **Value Added Tax**

The Government is lobbying to introduce a favourable VAT rate for home care services for the elderly, disabled persons and other persons who are in need of home support as well as for child minding services.

## **Tax Review Commission**

Government is to set up a Tax Review Commission under the leadership of the Parliamentary Secretary for Finance which will present its report by June 2006. The Commission's terms of reference are:

- to assess the current taxation framework and provide a comparison of work incentives, growth, savings and competitive advantage with competitors and other EU Member States;
- to assess the manner in which the current taxation framework affects individuals and companies with a view to implementing a shift from direct taxation to indirect taxation on consumption, environment and use of natural resources;
- to suggest ways in which incentives for the production of employment and economic growth particularly in relation to small enterprises and the area of research and development can be incorporated into the current taxation system;

- to review the legislative framework with the intention of eliminating excessive administrative burdens and anomalies and simplifying processes.

### **Enforcement and fiscal evasion**

- Government remains committed to increasing participation in the employment market and will continue to employ proactive measures in this regard, however it is also committed to controlling as far as possible employment in the black economy. To this end, it plans to strengthen enforcement of relevant regulations through collaboration between the various agencies Employment and Training Corporation, Social Security Department, Inland Revenue Department, Tax Compliance Unit and Value Added Tax Department.
- Government intends to consider regulation of temporary work in order to ensure that this sector is not being abused by employers to avoid their duties towards their employees.
- Government is committed to reduce tax evasion and ensure that all persons meet their tax obligations. For this reason, it will continue to invest heavily in the Social Benefits Anti-Fraud Directorate and will strengthen the investigative power of this directorate and the Tax Compliance Unit by introducing legislation to enable the sharing of tax and social benefits information between the two units.
- During 2006 the Ministry of Finance will implement a mechanism to protect consumers against VAT receipt abuse and to facilitate reporting of such abuse.
- Government will continue to review its anti-abuse and evasion structures to determine whether these may be made more effective and coordinated.
- Amendments will be introduced so that money loaned by financial institutions and banks will only be released upon presentation of the contract of acquisition of the property and fiscal receipts for works done.

- The Department for Social Security will make reforms to invalidity pensions.

### **Means test**

Government acknowledges the need for a uniform “means test” mechanism and maintains that a situation where different departments apply different means test yardsticks is no longer reasonable. This creates duplication of work and resources and is not equitable vis-à-vis the persons seeking benefits. For this purpose Government is setting up an inter-ministerial Working Group to recommend a standard “means test” benchmark. The working group shall also evaluate the option of having a single register for people with special needs.

### **Privatisation and liberalisation**

Government will continue its privatisation policy by identifying strategic partners for Bank of Valletta, Maltacom, Tug Malta, Kordin Grain Terminal and identifying a new partner for Maltapost.

Government is also committed to privatising the yacht marinas to provide new opportunities for investment as an international centre for yachting. To this effect legislation will be enacted for the registration of yachts and the Malta Maritime Authority and the Department for Civil Aviation will be amalgamated into one Authority – the Port Authority.

It is also the Government’s intention to liberalise the importation and distribution of energy products including petrol, diesel and gas. As part of this process Government will, in 2006, implement the commercialisation of the Petrol Division of Enemalta Corporation.

### **Euro**

The Prime Minister and Minister of Finance indicated that the Government is in line with targets and benchmarks for Malta to adopt the Euro on 1 January 2008. The Government is now considering adopting legislation to oblige all those showing dual prices on products and services to do so at an established exchange rate so as to minimise abuse and inflation risks.

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For further details please contact:

**Avanzia**

Cobalt House, 2nd Floor, Notabile Road, Mriehel QRM 09, Malta.

Telephone: +356 2149 3313 Facsimile: +356 2149 3318 E-mail: [info@avanzia.com.mt](mailto:info@avanzia.com.mt)