

Taxing negotiations

Taxation proved to be one of the most sensitive negotiating areas – particularly because of Malta's requests on VAT exemptions. A final compromise was only reached at the Copenhagen Summit on December, 13, 2002.

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Negotiations on Justice and Home Affairs: A Snapshot

Screening of EU laws	October 1999
Opening of negotiations	June 2001
Negotiations closed	December 2002

Negotiations on VAT: At a glance

Malta Requested	Outcome
To keep zero VAT-rate on	
Foodstuffs	YES. These products will remain VAT-free until January, 1, 2010. Malta agreed on condition that by that time, Ireland and UK would have given up their exemption.
Pharmaceuticals	YES. Request agreed.
International passenger transport	YES. Request agreed.
Regular inland passenger transport	YES. Request agreed.
Passenger transport between the Maltese Islands	WITHDRAWN. VAT will be introduced at a reduced rate of 5%
Printed matter	WITHDRAWN. VAT will be introduced at a reduced rate of 5%.
Medical equipment	
Keep exempt without credit	
Water supplied by public authorities	YES. Request agreed.
New buildings and building land	YES. Request agreed.
Gas in cylinders	WITHDRAWN. VAT introduced at 15% but will be paid by Enemalta, not consumers.
Electricity	WITHDRAWN. VAT introduced at 5% but will be paid by Enemalta, not consumers.
Small Businesses and self-employed: Request to apply exemption	
<ul style="list-style-type: none"> SMEs selling goods - maximum of Lm14,189. SMEs selling services (low value added) - maximum of Lm10,000. SMEs selling services (high value added) - Lm6,000. 	<p>YES. Request agreed.</p> <p>SMEs not exceeding these ceilings will remain exempt, same as today.</p>

EU policy on Taxation

The EU's competence on taxation is still limited and where it does have competence, its power of action is highly conditioned by the need for unanimous agreement among all EU member countries to adopt decisions in this area. As a result, the EU has only made headway in limited areas of taxation – the most successful being VAT. EU law also governs some other areas of taxation policy such as Excise Duties and certain other limited aspects. EU laws do not cover tax areas such as income tax, whether personal or corporate tax, eco-taxes or car registration taxes. Nor does it cover social security issues.

Value Added Tax

EU countries agreed on a common system of Value Added Tax (VAT) and this applies in all EU countries. The main EU law on VAT is known as the Sixth VAT Directive. However, the system is not altogether harmonised. For instance, there is no harmonisation of VAT rates and instead, EU law just sets a minimum standard rate of 15%. As a result, EU countries remain free to set their own rates provided they are not lower than 15%. VAT rates in EU countries still vary considerably, from 25% in Denmark, down to 15% in Luxembourg. Nor is there total harmonisation on the VAT base. Some member states still exempt certain goods and services which are taxed in others, although to an increasingly limited extent. Equally, there is no agreement yet on shifting the system to one that is based on origin. Within a single market, one would expect VAT to be paid directly at the origin where goods are supplied and not at the country of destination. Instead, to date, VAT is still charged at the EU country of destination even for supplies within the EU itself.

There have been various attempts to take the current EU VAT system to a "definitive system" which is fully harmonised and integrated. However, these attempts have so far been unsuccessful, largely owing to the fact that unanimous agreement - among all EU countries - to move forward to this final stage has been consistently lacking.

Countries that will join the EU, including Malta, are required to align their laws with the EU VAT laws. In Malta's case, our law is already largely aligned to the EU model. Changes are minimal, except with respect to the exemption of certain goods and services as shall be explained below. However, Malta can still retain its VAT standard rate of 15%. This rate does not need to be changed or increased.

VAT Exemptions

EU law identifies the list of goods and services that should be charged VAT as well as those that may be exempt and those that may be taxed at a reduced rate. For instance, EU law allows exemption from VAT on services related to education, culture and sports. This means that these services may remain free from VAT in EU countries, including Malta.

Maltese law differs from EU law by exempting certain goods and services that are not automatically exempt under EU law or that should be taxed at either the standard or the reduced rate. In Malta's



case, the standard rate is our main rate of 15%. A reduced rate means a VAT rate of at least 5%.

Malta identified those areas where it wanted to keep a VAT exemption and submitted negotiating requests to this effect. The two most sensitive items on Malta's list were foodstuffs and pharmaceuticals. But there were also the following goods and services: international passenger transport, regular inland passenger transport, passenger transport between the Maltese Islands (including the Gozo ferry), printed matter, medical equipment, water supplied by public authorities, gas in cylinders, electricity, new buildings and building land.

VAT on food and pharmaceuticals

This was the most important issue in negotiations in this area and this is the main reason why agreement on closure of negotiations could not be reached until the Copenhagen Summit in December, 2002. Under EU law, these products should be charged VAT at least at a reduced rate of 5%. By way of exception, Ireland and the UK do not apply VAT on food and pharmaceuticals. Instead, they have an indefinite transitional period which can only come to an end with their agreement. This arrangement is covered under the terms of Article 28(1) of the main EU law on VAT, the Sixth VAT Directive.

During negotiations, Malta requested that food and pharmaceuticals should remain exempt from VAT and certainly as long as these items are exempt in the UK and Ireland. The EU's response remained firmly negative. Another candidate country, Cyprus, had made a similar request but settled for a five-year transitional period. This arrangement weakened Malta's position and created significant pressure on Malta to accept a similar arrangement as Cyprus.

After long negotiations on this point, an agreement was finally reached during the Copenhagen Summit that Malta should continue to apply a zero-rate on food and medicines for a seven-year transitional period until January, 1, 2010. In addition, however, it was also agreed that a declaration will be attached to the Accession Treaty stating that Malta agrees to this arrangement on the premise that by the end of the transitional period no other country would still apply an exemption on these two items. In other words, if by 2010, the UK and Ireland would still exempt VAT on food and pharmaceuticals, Malta may consider the basis for the agreement to have changed and request an extension to its transitional period beyond 2010. On its part, the Maltese Government also declared that should VAT at a reduced rate of 5% be introduced in 2010 on food and medicines, it would be prepared to provide a cost of living compensation.

Malta Declaration on VAT to be annexed to Accession Treaty

"Malta's acceptance of a transition period until 1 January 2010 for the maintenance of its VAT 0 % rate instead of the standard rate of 5 % on the supplies of foodstuffs and pharmaceuticals is based on the premise that the transitional period referred to in Article 28 (1) of the Sixth VAT Directive would expire on that day."

Other requests for VAT exemption

As far as other negotiating requests are concerned, Malta secured an exemption on international passenger transport, inland passenger transport and on passenger transport between the Maltese islands. Malta also secured an exemption on water supply and on new buildings and building land. This means that Malta will continue to exempt these items from VAT for an indefinite period and as long as any other EU country retains a zero-rate. Most EU countries exempt some or all of these items and unanimity is required to change this situation.

However, Malta withdrew its requests on printed matter and medical equipment where VAT will now be introduced at a reduced rate of 5%. Malta also withdrew its request on gas and electricity and VAT has already been introduced on these two supplies, although this will be paid by Enemalta and not by consumers. (15% on gas and 5% on electricity).

Request on Scheme for Small businesses and self-employed

Malta also secured a continued exemption from VAT for small businesses and self-employed individuals whose supply of goods and/or services does not exceed a certain value stipulated in our VAT law. The thresholds are a maximum of Lm14,189 for SMEs selling goods; a maximum of Lm10,000 for SMEs selling services (low value added) and Lm6,000 for SMEs selling services (high value added).

VAT and Maltese traders and importers

There are a number of important points that are relevant to importers with regard to the operation of the VAT system upon membership.

Firstly, in the EU, VAT is charged according to the destination, not the origin, of goods. This means that VAT is charged in the country of destination of the goods and not in the country from where they originate. As a result, VAT on goods bought from the EU will continue to be charged in Malta and not in the country of origin. This system has been a "transitional system" since 1993 until it eventually changes to a definitive system based on "origin". However, this change requires unanimous agreement between EU countries and this agreement has never been reached. So the destination system continues to apply and there is no change from what happens today in this respect.

Secondly, the VAT rates that apply are the rates of the country of destination. In other words, VAT on goods entering Malta from the EU will be charged in Malta at Maltese rates. Equally, the VAT charged on goods entering Italy from Malta would be charged according to the Italian rates. Again, no change in this respect.

Thirdly, however, there will be an important change with respect to the method of collecting VAT upon clearance of goods in Malta. Currently, when goods enter Malta, importers pay VAT up-front in order to clear and release the goods. This VAT payment is later refunded back to the importer. This system will change and no VAT payment will be necessary from membership with respect to imports from the EU. This is because there can be no tax frontiers within the EU. Nor will the very concept of import and export continue to exist. As such, there can be no import and export when we speak of trade within the EU because it is trade within one single market. It would simply be internal trade. As a result, VAT can no longer be collected at the point of entry into Malta but at later stages in the supply chain. So VAT will still be paid in Malta, but not upon clearance of goods at it is now.

This is how a typical transaction would work: The Maltese trader receiving the goods from the EU will quote its VAT identification number with a Malta (MT) prefix and no VAT will be charged by the trader in the other EU country selling to Malta. Upon arrival of the goods in Malta, VAT will not be charged or paid at point of entry in Malta. There will also be no customs formalities since the goods have freedom of movement within

the EU. The goods are cleared without payment of VAT. But VAT will still be declared on those goods at the time of filing the VAT return. At the same time, notional input VAT declared on those acquisitions, will be claimed back, leading to a neutral payment. In other words, a consignment will be declared in the return. Notional VAT is added and neutralised by a claim for refund taking place at the same time. No payment, but full declaration. This system will give Maltese traders who buy goods from the EU more flexibility and an added 15% cash flow that until today, they deposited in the form of VAT.

The same also applies with respect to goods sold from Malta to traders based in the EU. However, it is important to note that the above only applies to commercial transactions, not to private purchases.

Direct Taxation

Although the EU has no laws on direct taxation, such as income tax, there is a degree of co-operation. This deals mostly with requests for information on income tax issues. Malta already does this through bilateral tax agreements signed with most of the EU countries. The EU also has certain laws, such as the Parent/Subsidiary Directive, that seek to prevent double taxation of companies that have subsidiaries in other EU countries.

More recently, the EU adopted a Code of Conduct for business taxation to discourage unfair tax competition among EU countries. The code, which is not legally binding, deals with tax provisions that might result in harmful tax competition and urges member countries to remove them. During negotiations, Malta committed itself to comply with the principles of the Code of Conduct for Business Taxation and to introduce only new tax measures, which are in conformity with these principles.

Import Levies and food prices

Malta still applies import levies on certain agricultural and agro-industrial products, in particular on imported products that compete with locally-produced goods. Levies are often referred to as "protective" levies. However, they are also a form of taxation paid by taxpayers, the consumers. To this extent, levies also featured in talks under this chapter.

On this issue of levies Malta is committed to remove all remaining import levies by membership at the latest. Levies have already been removed on all industrial products, such as on furniture, where they were removed in October 2002.

The removal of the remaining levies will take away protection and expose the local agricultural sector and the agro-food industry to competition. To help the sector adapt and cope with competition, Malta will dedicate a financial package of Lm77 million over a twelve year period (2002 - 2014). Although, this package will be co-funded by the EU, it will still come at a cost for taxpayers.

However, the removal of levies will also bring about a corresponding reduction in the price of affected products. And to the extent that the removal of levies opens up the market, it can also increase trade all round because consumers tend to buy larger quantities of a given product if the price is right, especially in the case of food. Here are some examples of what Maltese consumers will save on selected imported products. Similar savings are also expected on local goods that compete with these products.

Lower prices as a result of the removal of levies

Consumers will save

- 15 cents on every kg of pig meat
- 10 cents on eggs (per dozen)
- 4 cents on every kg of poultry
- 81 cents on every kg of tomato polpa
- 45 cents on every kg of pasta
- 50 cents on every kg of peaches, plums
- 70 cents on every kg of ice-cream
- 15 cents on every litre of juices
- 25 cents on every litre of beer
- Lm1.50 on every litre of wine



Excise duties

Excise duties are taxes that are imposed on certain specific goods, usually to discourage their use whether for reasons of public health or environmental concerns. Excise duties are commonly applied on tobacco, on alcoholic drinks and on mineral oils. The EU has a common system of excise duties. It establishes a clear definition of the products concerned, guarantees

their freedom of movement, and also sets a rate - although just a minimum excise duty rate, not a harmonised rate - on these products. On its part, Malta is already in line with EU law on excise duties, including on the minimum rates of applicable duties.

EXCISE DUTIES IN MALTA AND IN THE EU ON CERTAIN MAJOR PRODUCTS

PRODUCT	EXCISE DUTY RATE IN MALTA	COMPLIES WITH EU MINIMUM LEVELS?
Cigarettes	53.1% of retail price plus Lm0.07c7 but not less than Lm0.66c1 (per packet of 20)	YES
Cigars, cheroots, cigarillos and pipe tobacco	Lm 5.00 per 1000 units	YES
Hand-rolling Tobacco	Lm 22.25 per kg	YES
Other Smoking Tobacco	Lm 8.00 per kg	YES
Chewing Tobacco and Snuff	Lm 11.60 per kg	Not applicable
Leaded petrol	Lm 154 per 1000 litres	YES
Unleaded Petrol	Lm 133 per 1000 litres	YES
Gas oil	Lm102 per 1000 litres (some exemptions apply if used for fishing purposes as laid down by the Department of Fisheries and if used for power generation both at 0% and at if used in certain maritime commercial activities at Lm61 per 1000 litres)	YES
Heavy Fuel Oils	Lm 6 per 1000 kgs	YES
Liquid petroleum gas (LPG) and Methanes	Lm 15 per 1000 kgs	YES
Kerosene	Lm 102 per 1000 litres (exemptions apply if used for air navigation between Malta and Gozo at Lm 31 per 1000 litres and if used for heating purposes at 0%)	
Beer:		
1) If produced by breweries whose annual production exceeds 200,000 hectolitres	32c per hectolitre per degree Plato	YES
2) If produced by small & independent breweries whose annual production does not exceed 200,000 hectolitres	16c per hectolitre per degree Plato	YES
3) Products containing a mixture of beer with non-alcoholic beverages	8c per hectolitre per degree Plato	YES
Wine	0	YES
Fermented beverages	0	YES
Intermediate products	Lm20 per hectolitre	YES
Ethyl Alcohol (including products with an actual alcoholic strength by volume exceeding 1.2% volume	10c per % vol. per litre	YES

The Excise Duty Act (Cap.382) contains the complete list of excise duty rates

See also more information on: • **Aggornat Special Edition on the Financial Package** • **Aggornat Special Edition on Agriculture**
• **Aggornat Special Edition on Regional Policy** • **Malta's negotiating position paper on taxation**



Malta's official negotiating position paper on this area is also available from MIC or from:
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