SECOND SUPPLEMENT TO THE GIBRALTAR GAZETTE
No. 4530 of 20 December, 2018

LEGAL NOTICE NO.287 OF 2018.

INTERPRETATION AND GENERAL CLAUSES ACT

INCOME TAX ACT 2010 (AMENDMENT NO. 3) REGULATIONS 2018

In exercise of the powers conferred upon it by section 23(g)(ii) of the Interpretation and General Clauses Act, and in order to transpose into the law of Gibraltar, Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, the Government has made the following Regulations-

Title.

1. These Regulations may be cited as the Income Tax Act 2010 (Amendment No. 3) Regulations 2018.

Commencement.

2.(1) These Regulations come into operation on the 1st January 2019.

(2) The amendments made by these Regulations apply in relation to accounting periods commencing on or after 1 January 2019.

Amendments to the Income Tax Act 2010.

3.(1) The Income Tax Act 2010 is amended in accordance with the provisions of this Regulation.

(2) After Schedule 4 Part III paragraph 8 insert:

> “8A. For the purposes of Part V to Part VII unless the context otherwise requires –
>
> “associated enterprise” means:

(a) an entity in which the taxpayer holds directly or indirectly a participation in terms of voting rights or capital ownership of 25% or more or is entitled to receive 25% or more of the profits of that entity; or

(b) an individual or entity which holds directly or indirectly a participation in terms of voting rights or capital ownership in a taxpayer of 25% or more or is entitled to receive 25% or more of the profits of the taxpayer;

If an individual or entity holds directly or indirectly a participation of 25% or more in a taxpayer and one or more entities, all the entities concerned, including the taxpayer, shall also be regarded as associated enterprises.

"borrowing costs" means interest expenses on all forms of debt, other costs economically equivalent to interest and expenses incurred in connection with the raising of finance, including, without being limited to, payments under profit participating loans, imputed interest on instruments such as convertible bonds and zero coupon bonds, amounts under alternative financing arrangements, such as Islamic finance, the finance cost element of finance lease payments, capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest, amounts measured by reference to a funding return under transfer pricing rules where applicable, notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings, certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance, guarantee fees for financing arrangements, arrangement fees and similar costs related to the borrowing of funds;

"EBITDA" means a taxpayer's taxable revenues before interest, tax, depreciation and amortisation;

"entity" means a company, partnership, trust or foundation;

"exceeding borrowing costs" means the amount by which the deductible borrowing costs of a taxpayer exceed taxable interest revenues and other economically equivalent taxable revenues;

"financial undertaking" means any of the following entities:

(a) a credit institution or an investment firm as defined in point (1) of Article 4(1) of Directive 2004/39/EC of the European Parliament and of the Council or an alternative investment fund manager (AIFM) as defined in point (b) of Article 4(1) of Directive 2011/61/EU of the European Parliament and of the Council or an undertaking for collective investment in transferable securities (UCITS) management company as defined in point (b) of Article 2(1) of Directive 2009/65/EC of the European Parliament and of the Council;

(b) an insurance undertaking as defined in point (1) of Article 13 of Directive 2009/138/EC of the European Parliament and of the Council;

(c) a reinsurance undertaking as defined in point (4) of Article 13 of Directive 2009/138/EC;

(d) an institution for occupational retirement provision falling within the scope of Directive 2003/41/EC of the European Parliament and of the Council;

(e) pension institutions operating pension schemes which are considered to be social security schemes covered by Regulation (EC) No 883/2004 of the European Parliament and of the Council and Regulation (EC) No 987/2009 of the European Parliament and of the Council as well as any legal entity set up for the purpose of investment of such schemes;

(f) an alternative investment fund (AIF) managed by an AIFM as defined in point (b) of Article 4(1) of Directive 2011/61/EU or an AIF licenced, authorised or otherwise regulated under the laws of Gibraltar;

(g) an undertaking for collective investment in transferable securities (UCITS) in the meaning of Article 1(2) of Directive 2009/65/EC;

(h) a central counterparty as defined in point (1) of Article 2 of Regulation (EU) No 648/2012 of the European Parliament and of the Council; or

(i) a central securities depository as defined in point (1) of Article 2(1) of Regulation (EU) No 909/2014 of the European Parliament and of the Council.

"long-term public infrastructure project" means:

(a) a recognised public interest project to provide, upgrade, operate and/or maintain a large-scale asset; or

(b) buildings (or parts of buildings) that are let (or sub-let) (the "Property"); and

a. the taxpayer exclusively carries on a property business in relation to the Property, being a business to let real property and/or interests in land, within or Gibraltar; and
b. the borrowing costs in question are incurred in the purchase, development or renovation of the Property; and
c. the debt or financing arrangement in question is secured against the Property; and
d. at the date of the loan or other relevant liability which generates the borrowing costs in question, the Property is expected to generate income for a minimum of ten years; and
e. the Property is recognised in accordance with the International Financial Reporting Standards in force from time to time in the financial statements of the taxpayer for the relevant accounting period; and
f. any lease or other similar interest in land granted by the taxpayer on the Property is granted for less than 50 years; and
g. all transactions carried out by the taxpayer in relation to the Property are carried out in accordance with the arm's length principle; and
h. any income generated by the Property is taxable in Gibraltar.

"standalone entity" means a taxpayer that is not part of a consolidated group for financial accounting purposes and has no associated enterprise or permanent establishment situated in a country other than Gibraltar;

"taxpayer" means an ordinarily resident company which has assessable income under the provisions of this Act or a permanent establishment of any such company resident in another European Union Member State or a third country; and

"tax period" means a tax year, calendar year or any other appropriate period for tax purposes."

(3) After Schedule 4 Part IV insert-

"PART V

INTEREST LIMITATION RULE

Interest limitation rule

18. (1) Financial undertakings, including where financial undertakings are part of a consolidated group for financial accounting purposes, and standalone entities shall be excluded from the scope of this Part.

(2) Consolidated groups for financial accounting purposes consists of all entities which are fully included in the consolidated financial statements drawn up in accordance with the International Financial Reporting Standards or the national financial reporting system of Gibraltar. The taxpayer shall be given the right to use consolidated financial statements prepared under other accounting standards.

(3) Exceeding borrowing costs incurred by a taxpayer shall be deductible in the tax period in which they are incurred only up to the greater of the following two amounts:

(a) 30% of the taxpayer's EBITDA; or

(b) €3,000,000.

(4) For the purposes of paragraph 18(3)(b) the amount of €3,000,000 shall be considered for the entire group.

(5) The EBITDA shall be calculated by adding back to the assessable income the tax-adjusted amounts for exceeding borrowing costs as well as the tax-adjusted amounts for depreciation and amortisation. Income not assessable in accordance with this Act shall be excluded from the EBITDA of a taxpayer.

(6) Paragraph 19(3) shall not apply to exceeding borrowing costs related to:

(a) loans that were contracted before 17 June 2016, excluding any subsequent modification of such loans; or

(b) loans used to finance a long-term public infrastructure project, where the project operator, borrowing costs, assets and revenues are all within the European Union. In this case, any income from a long-term public infrastructure project is excluded from a taxpayer's EBITDA.

(7) Where a taxpayer is a member of a consolidated group for financial accounting purposes, the taxpayer may choose to either:

(a) fully deduct its exceeding borrowing costs if it can demonstrate that the ratio of its equity over its total assets is equal to or higher than the equivalent ratio of the group and subject to the following conditions:

(i) the ratio of the taxpayer's entity over its total assets is considered to be equal to the equivalent ratio of the group if the ratio of the taxpayer's equity over its total assets is lower by up to two percentage points; and

(ii) all assets and liabilities are valued using the same method as in the consolidated financial statements,

or

(b) deduct exceeding borrowing costs at an amount in excess of what it would be entitled to deduct under paragraph 18(3). This higher limit to the deductibility of exceeding borrowing costs shall refer to the consolidated group for financial accounting purposes in which the taxpayer is a member and be calculated in two steps:

(i) first, the group ratio is determined by dividing the exceeding borrowing costs of the group vis-à-vis third-parties over the EBITDA of the group; and

(ii) second, the group ratio is multiplied by the EBITDA of the taxpayer calculated pursuant to paragraph 18(5).

(8) Exceeding borrowing costs not deductible in a tax period under paragraphs 18(3) to 18(7) may be carried forward indefinitely. Unused interest capacity which cannot be used in a given tax period may be carried forward for a maximum of 5 years.

PART VI

CONTROLLED FOREIGN COMPANY RULE

Controlled foreign company rule

19. (1) For the purposes of this Part "controlled foreign company" shall mean an entity or a permanent establishment, not resident in Gibraltar, whose profits are not taxable or are exempt from tax in Gibraltar when the following conditions are simultaneously fulfilled:

(a) in the case of an entity, the taxpayer by itself, or together with its associated enterprises:

(i) holds a direct or indirect participation of more than 50 percent of the voting rights; or

(ii) owns directly or indirectly more than 50 percent of capital; or

(iii) is entitled to receive more than 50 percent of the profits of that entity; and

(b) the actual tax paid on its profits by the entity or permanent establishment is lower than the difference between the tax that would have been charged on the entity or permanent establishment in accordance with this Act and the actual tax paid on its profits by the entity or permanent establishment. For the purposes of this subparagraph, the permanent establishment of a controlled foreign company within the meaning of this paragraph which are not taxable or are exempt from tax in the jurisdiction of the controlled foreign company shall not be taken

into account. Furthermore, the tax that would have been charged in the Member State of the taxpayer means as computed according to the rules of the Member State of the taxpayer.

(2) Where an entity or permanent establishment is treated as a controlled foreign company under paragraph 19(1), the non-distributed income of the company or permanent establishment arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage shall be included as income of the taxpayer for that tax period.

(3) For the purposes of paragraph 19(2), an arrangement or a series thereof shall be regarded as non-genuine to the extent that the entity or permanent establishment would not own the assets or would not have undertaken the risk which generate all, or part of, its income if it were not controlled by a company where the significant people functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled company's income.

(4) This Part shall not apply to a controlled foreign company:

(a) with accounting profits of no more than €750,000, and non-trading income of no more than €75,000; or

(b) of which the accounting profits amount to no more than 10% of its operating costs for the tax period.

(5) For the purposes of paragraph 19(4)(b), operating costs shall not include (i) the cost of goods sold outside the country where the entity is resident, or the permanent establishment is situated, for tax purposes and (ii) payments to associated enterprises.

Computation of controlled foreign company income

20. The income of the controlled foreign company which is to be included as income of a taxpayer in accordance with paragraph 19(2) shall be calculated as follows:

(a) the income shall be limited to amounts generated through assets and risks which are linked to significant people functions carried out by the controlling company. The attribution of controlled foreign company income shall be calculated in accordance with the arm's length principle;

(b) the income shall be calculated in proportion to the taxpayer's participation in the entity as defined in paragraph 19(1)(a);

(c) the income shall be included in the tax period of the taxpayer in which the tax year of the entity ends;

(d) where the entity distributes profits to the taxpayer, and those distributed profits are included in the assessable income of the taxpayer, the amounts of income previously included as income of the taxpayer pursuant to paragraphs 19(1) to 19(5) shall be deducted from the income of the taxpayer when calculating the amount of tax due on the distributed profits, in order to ensure there is no double taxation;

(e) where the taxpayer disposes of its participation in the entity or of the business carried out by the permanent establishment, and any part of the proceeds from the disposal previously has been included in the income of the taxpayer pursuant to paragraphs 19(1) to 19(5), that amount shall be deducted from the income of the taxpayer when calculating the amount of tax due on those proceeds, in order to ensure there is no double taxation; and

(f) the Commissioner shall allow a deduction of the tax paid by the entity or permanent establishment in its state of residence or location from the tax liability of the taxpayer in accordance with section 37 of this Act.

PART VII

HYBRID MISMATCH

Hybrid Mismatch

20.(1) For the purposes of this Part "hybrid mismatch" means a situation between a taxpayer in one Member State and an associated enterprise in another Member State or a structured arrangement between parties in Member States where the following outcome is attributable to differences in the legal characterisation of a financial instrument or entity:

(a) a deduction of the same payment, expenses or losses occurs both in the Member State in which the payment has its source, the expenses are

incurred or the losses are suffered and in another Member State ("double deduction"); or

(b) there is a deduction of a payment in the Member State in which the payment has its source without a corresponding inclusion for tax purposes of the same payment in the other Member State ("deduction without inclusion").

(2) For the purposes of this Part, the rate of 25% referred to in the definition of "associated enterprise" contained in schedule 4 part III paragraph 8A, shall be replaced by the rate of 50%.

(3) To the extent that a hybrid mismatch results in a double deduction, a deduction of such payment shall only be given where Gibraltar is the source of the payment.

(4) To the extent that a hybrid mismatch results in a deduction without inclusion, a deduction of such payment shall not be given to the taxpayer.

Dated 20th December, 2018.

F R PICARDO,
for the Government.

EXPLANATORY MEMORANDUM

These Regulations transpose into the law of Gibraltar, Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (the "**Directive**"), save for the rules on exit taxation which are to be transposed by 31 December 2019, pursuant to Article 11 paragraph 5 of the Directive.