

E-COMMERCE IN MALTA

Introduction

Information technology is changing the world. It has broken down all barriers of distance and time in the way dealings are made with retailers, consumers, banks, government, insurance companies and just everybody else. It is affecting everyone, everywhere and has brought people closer together creating unprecedented potential for wealth, employment and growth.

E-Commerce: a booming industry

Electronic commerce is booming. The business of buying and selling goods and services through the internet medium is already worth 17 billion Euro in the EU. It is expected to reach 340 billion Euro by 2003. In the USA, the figure for e-commerce revenues is 3 times higher.

E-Commerce and Malta

Malta's economic policy encourages information technology operations and the territory has invested heavily in state-of-the-art telecommunications. There are, in fact, a good number of Internet Service Providers in Malta.

The Islands' geographical location (European time-zone); good telecommunications links; sophisticated business infrastructure; and the low-cost, English speaking, highly educated work-force are all factors which attract sales, marketing and administrative departments of European retail operations.

The Government of Malta is committed to establishing e-Government services to ensure the transformation of Malta into a highly advanced information economy and information society. e-Government is to result in a virtual service provision in such a way that the particular services related to a transaction are simultaneously triggered once the episode relating to that service is activated by a user thereby attaining a veritable '*no stop service*'.

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Thus, for example, the opening of a business which in the current framework requires the following from various service providers:

Registration of business	Malta Financial Services Centre
Registration of VAT	VAT department
Registration of company or self-employed income tax	Inland Revenue Division
Registration of national insurance	Social Security Department
Registration of business trading license	Trading License Authority

Is, under the e-Government vision and strategy, to be collapsed into an episode which when triggered will virtually and intelligently activate the transactions across the various organizational entities to complete the service request.

Setting up an e-commerce activity in Malta

For optimal tax benefits and incentives, a foreign enterprise or undertaking wishing to operate and set up an e-commerce facility in Malta should incorporate an *International Trading Company* (ITC) under the Laws of Malta and thereby benefit from a preferential tax treatment.

Accordingly, although an ITC is subject to the normal corporate tax of 35% levied on all Maltese companies, the net effective rate of taxation will be reduced to merely **4.17%** upon a distribution of dividends to the ITC's non-resident shareholders.

[For further information on ITCs please refer to our fact sheet entitled 'International Trading Companies']

Taxation and the Internet

The tax issues associated with electronic commerce on the Internet are complex. No geographical boundaries exist in cyberspace and it is also often difficult to identify a user's identity or location if he wishes to conceal this information. The result is that the traditional cornerstones of income

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tax, such as the 'source' of income and the 'residence' of a person or entity become difficult to apply.

The importance of resolving the issues surrounding the taxation of Internet activity can be appreciated when one considers that electronic commerce comprises a wide spectrum of activities including, *inter alia*, online retail sales, online delivery of digital content, electronic fund transfers, electronic share trading, electronic bills of lading, commercial auctions, direct consumer marketing and after-sales service.

Physical sales and distribution

The internet is currently experiencing huge growth of both retail and business purchasing and a substantial part of this is taking place from web-sites (servers) located in high-tax jurisdictions.

However, there is no reason why an e-shop should be confined to an onshore jurisdiction and not move offshore to another jurisdiction such as Malta which offers significant tax advantages through its *international trading companies*. Additional benefits may include lower labour and overhead costs that, in Malta, are significantly lower than in most other European countries. Other attractions include an e-commerce legislation, existing finance center expertise, language skills and an increasingly competitive telecommunications sector.

However, one sure benefit is '*internationalisation*' and it may well be that an offshore vendor is in a more favourable situation to service multiple and diverse countries than one in a high-tax jurisdiction. If a company's procurement is global in scope then a jurisdiction such as Malta will almost certainly offer interesting commercial and fiscal opportunities: Malta even boasts a Freeport thereby allowing for warehousing, processing and marketing of products for onward shipping in a tax-free and customs duty-free environment.

Digital sales and distribution

Products which can be put into digital form and digitally delivered are the ideal candidates for an offshore e-commerce undertaking. These products include:

- ❖ computer software;
- ❖ music, videos and images;
- ❖ booking services (e.g. travel);
- ❖ publications including books, magazines, newspapers etc.;
- ❖ betting and gambling;
- ❖ professional services; and
- ❖ training courses.

It is clearly feasible to supply a customer in a high-tax area with any of the above products through the internet medium and, consequently, without incurring any local import duties, VAT or sales tax when these might apply.

Moreover, as explained above, Malta tax would be a mere **4.17%**.

Offshore banking and Financial Services

In recent years, growing financial awareness has created a strong demand for offshore financial services: this is especially true of offshore collective investment funds. Indeed, the internet opens the way to a far broader market for the providers of offshore financial services by reducing transaction costs and by making information instantly available to anyone who is interested and in an environment which is considerably less regulated than others.

The whole range of retail financial services can be provided from offshore using the internet:

- ❖ electronic banking, including current and deposit account maintenance, paying bills, direct debits etc.;
- ❖ offer and sale of shares, stocks, investment and mutual fund units, equity derivatives etc.;
- ❖ foreign exchange services;

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- ❖ offer, sale and maintenance of savings products including pension schemes; and
- ❖ offer and sale of insurance products.

Offshore corporate functions

Many companies choose to hive off administration and service functions from operational units and outsource them in tax regimes such as Malta which offer a preferential tax treatment to non-residents. Indeed, the rapid development of e-commerce and e-business, hand-in-hand with advanced telecommunication techniques adds new possibilities for companies wishing to place their support functions and services where they can be most efficiently (including tax-efficiently) performed.

An excellent opportunity that exists in Malta is the possibility of setting up *back office management companies* in Malta. Back office services are any activities and services of a routine, administrative and on-going nature such as:

- ❖ book-keeping and accounting services (excluding work which may only be carried out by a person or firm holding a warrant under the Accountancy Profession Act);
- ❖ information and data processing; and
- ❖ computer bureau, database and computer outsourcing.

Such activities may include, for instance, the processing and recording of invoices, sales transactions and accounts management information reporting, form-filling work in support of trust services, shipping and maritime trade, insurance or fund administration business.

As back office management companies must be set up as International Trading Companies their effective Malta tax rate is merely **4.17%**.

New Opportunities, New Laws

In May 2000, the Maltese Government issued a White Paper on the Legislative Framework for Information Practices in which 3 new laws are proposed, namely:

- ❖ An **Electronic Commerce Bill** which attempts to provide a secure legal foundation for the conduct of electronic transactions and communications so as to encourage economic activity. The Bill provides for the protection of both the consumer and the service provider. The Bill has been drafted in such a way as to be sufficiently flexible to embrace new technological developments by, *inter alia*, granting the Minister responsible for communications the power to prescribe regulations on a number of aspects of e-commerce.

The Bill borrows from a variety of sources including the UNCITRAL Model Law on E-Commerce of 1996, the EU directive 1999/93/EC as well as from the legislation of other jurisdictions, primarily Australia (enacted November 1999) and Ireland (draft Bill – January 2000).

- ❖ A **Data Protection Bill** which is intended to safeguard citizens from the potential abuse of their personal data through information systems. The Bill proposes to protect data by making sure that it is processed according to the requirements set out in the Bill.

The Bill is modelled on The Data Protection Directive 95/46/EC as well as on the legislation of other jurisdictions, primarily Sweden's Personal Data Act (1998:204), the Portuguese Protection of Personal Data Act, 1998, and the Italian Data Protection Act, 1997. The introduction of the Data Protection Bill will allow Malta to become a signatory to the 1981 Council of Europe Convention for the protection of individuals on data protection with regard to the automatic processing of personal data (European Treaty Series No. 108).

- ❖ A **Computer Misuse Bill** which protects the rights of the owners of valuable data and information systems. Indeed, all those who depend on information technology in the conduct of their business are vulnerable to crimes committed through their systems. Criminals may steal sensitive information, redirect funds or carry out acts of sabotage

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from a remote location, possibly even their home computer. The Bill proposes a district law as against amending existing provisions of the criminal code. Accordingly, the Bill will only deal with those aspects of criminal acts which are strictly related to the computer, i.e. in cases of computer fraud or forgery, the prosecutor would bring charges under 2 counts: unauthorized access under the Bill and fraud or forgery under existing criminal laws.

The Electronic Commerce Bill was enacted in January, 2001 – the *Electronic Commerce Act* (Act III of 2001).

E-payments

The Malta Financial Services Centre is currently drawing up a strategy and programme to develop Malta into the world's first center for e-payments. E-payments is a new form of facilitating purchasing and selling through the medium of the internet using personal computers, mobile telephones and interactive TV.

Despite the popularity of the internet as a marketplace, traditional payment methods through cheques, credit cards, debit cards and the banking system are expensive, complex, time-consuming and not completely safe. However, a number of leading computer software enterprises have developed and are starting to introduce systems that overcome these problems. In an e-payments system money has no physical presence. It becomes e-money. There is no cash, no cheques, no credit cards and no debit cards. Money exists only as computer code and can only be accessed and used by people with the right access codes or electronic signatures.

Take, for instance, the example of a customer in France placing a bet with an online Maltese bookmaker. Rather than use a credit card or debit card to place the bet, the customer '*tops-up*' his/her mobile phone with money supplied electronically by an e-payments supplier. When the customer places the bet, the bookmaker's system automatically knows the money is there to cover the bet. The e-payments supplier automatically sends the

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customer's money to the bookmaker and the supplier records and reports the transaction to the customer. Apart from the fact that the cost savings are enormous¹, the number of electronic processes is thereby greatly reduced and encryption software makes the whole process very secure.

Malta: a hub of e-commerce activity

As a major financial services center of world repute with many tens of thousands of international trading companies and foreign enterprises already installed, it is only a matter of time before Malta becomes a center of e-commerce activity.

The contents of this article are intended to provide general information only and cannot substitute legal advice for each specific case.

For further information please contact *Emmanuel Mallia & Associates (Advocates)*, Malta

¹ At present, it costs about US\$8 per an airline to process a ticket bought using a credit or debit card. It is estimated that e-payments systems will reduce that cost to around US\$1.