

# Transfer Pricing

## The arm's length principle

**BDO Malta's Tax Team analyses the OECD's perspective on the application of the arm's length principle to intercompany transactions. This has long been the guiding principle in the area of transfer pricing among OECD countries, including Malta.**

Transfer pricing refers to the terms and conditions surrounding transactions between associated enterprises forming part of a multinational enterprise (MNE) group. In accordance with international standards, the individual group members of the MNE must be taxed on the basis that they act at arm's length in dealings with each other.

Under the arm's length principle (ALP), MNE groups must apply the same conditions to their transactions as they would apply to independent parties under similar circumstances.

In recent years, intercompany transactions have attracted considerable attention from tax authorities around the world, as evidenced by the increasing volume of transfer pricing case law, and these authorities have become more sensitive to the mispricing of these transactions, which can lead to the shifting of profits from one country to another country.

At the same time, the OECD, through its BEPS (Base Erosion and Profit Shifting) Action Plan, has also put an important focus on these intercompany transactions. In BEPS Action 4,

the OECD addresses the issue of interest deduction used by MNEs to achieve base erosion in high-tax jurisdictions by providing a set of rules to combat this practice.

Years of debate about alternatives to the ALP have led to the ALP being reinforced during the 2015 OECD BEPS Project. OECD countries concluded that the ALP has proven useful as a practical and balancing standard for tax

administrations and taxpayers to evaluate transfer prices and prevent double taxation. However, OECD countries have also recognised that the existing guidelines are vulnerable to manipulation.

Furthermore, in BEPS Actions 8-10, the OECD has done some considerable work to improve the transfer pricing guidelines so that profits are taxed where value is actually created.

Malta currently does not have specific transfer pricing rules. However, in 2021 the Maltese Government amended the Income Tax Act to include a new article relating to transfer pricing. The new article provides that the Minister responsible for Finance may make rules on transfer pricing and may provide for the determination of the arm's length pricing of transactions, any adjustments in relation thereto and advance pricing agreements.

Malta is expected to implement transfer pricing rules in accordance with and based on the OECD Transfer Pricing Guidelines related to the ALP, and the rules will come into force with effect from financial year 2024. Guidelines in this

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respect are expected to be issued during the last quarter of 2022.

The transfer pricing rules are anticipated to apply in relation to any arrangement entered into on or after 1 January 2024 and arrangements entered into prior to 1 January 2024 which are materially altered on or after that date.

Although the Transfer Pricing Guidelines are still to be issued by the

Maltese tax authorities, we expect that certain enterprises (due to a minimum threshold for large entities) would not be captured by the Transfer Pricing Rules. However, such exclusions are yet to be announced.

**BDO Malta** serves clients on an international level as they navigate an increasingly complex tax landscape. Our tax professionals draw on deep experience and industry-specific knowledge to deliver clients the insights and innovation they need to maintain compliance and drive value – wherever they do business. Our transfer pricing professionals help you develop transfer pricing policies that ensure profit allocation based on the functions, assets and risks assumed, while minimising the likelihood that you will be subject to tax adjustments and penalties. Our tax professionals work closely together, so we bring the knowledge from across BDO to all our engagements – whether you’re a multinational, a privately held business or a private individual. **This article was a joint effort of BDO Malta Tax Partner Josef Mercieca, Tax Manager Milena Palikarova and Tax Supervisor Stephanie Bileci.**

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