TAX & CUSTOMS ADMINISTRATION MALTA

Guidelines in relation to the Transfer Pricing Rules

These guidelines are issued in terms of Article 96(2) of the Income Tax Act (Chapter 123 of the Laws of Malta) and are to be read in conjunction with the Transfer Pricing Rules (S.L.123.207).

These guidelines will be regularly reviewed and in the case of any changes, the revised version of the guidelines will be published on the Malta Tax and Customs Administration website. It is within the interest of the reader to ensure that the most recent version of the published guidelines is being referred to. It is hereby clarified that:

Rule 1 - Citation and applicability

Rule 1(2) provides for a time limited grandfathering provision for arrangements entered into before 1 January 2024 which are not materially altered on or after the said date.

Determining whether an arrangement has been materially altered requires a case-by-case analysis which must consider whether an alteration to an existing transaction or agreement between parties to an arrangement materially alters the substance of the arrangement by reference to the functions performed, assets used, and risks assumed by each of the parties to the arrangement (not necessarily the form of the arrangement). As per the definition of arrangement, the said change may also be in relation to dealings between the parties, i.e., where notwithstanding there being no change in the transaction or agreement between the parties, the conduct of the parties with respect to one another evidences a change in the actual arrangement between them which would necessitate a repricing of the arrangement.

Where the change in conduct of the parties (which in turn leads to a potential change in the arrangement concerned) is occasioned by external factors, such as, a change in the geopolitical or economic environment of a country, such change in conduct would not "constitute an alteration to an arrangement" to the extent that such parties are contractually bound by the pricing that existed before such change.

Examples of what should not be regarded as material alterations include:

- Adjustments to an arrangement involving minor administrative details such as changes in address, contact details including representatives of the parties, account numbers referring to bank accounts into which payments are to be affected and payments terms;
- Unilateral changes to the internal operation of either party intended to support the performance of the obligations under the arrangement (such as hiring of further employees, changes in assets used for carrying out their part of the transaction), even if this results in a change in profit margins;
- The mere re-domiciliation of a company into/ out of Malta, or transfer of residence of company into Malta; and

- Changes to parties arising merely as a result of a merger whereby a party inherits the same rights and obligations arising out of the arrangement.

Without prejudice to the examples listed above, examples of what would be regarded as material alterations include:

- a change in the consideration (e.g., where the arrangement provides for a fixed consideration, or if the consideration is determined by means of a method, a change in the method) for the performance of the arrangement;
- a change in the rights and/or obligations undertaken by the parties to the arrangement, which change affects the risks undertaken by the respective parties, and in turn may change the remuneration under such arrangement; and
- a change in the duration of the agreement.

Rule 2 - Interpretation

"Series of transactions, agreements and dealings"

It is being clarified that the term "a series of transactions, agreements and dealings" refers to a number of transactions, agreements and dealings entered into by associated enterprises in relation to an arrangement between parties that may include non-associated enterprises.

Transactions, agreements and dealings with a party which is not an associated enterprise will fall outside scope of the definition of a series of transactions, agreements and dealings except where the involvement of the non-associated enterprise is artificial.

Rule 3 - Ascertaining the total income

Arm's Length Price

Paragraphs 3(a) and 3(b) should be interpreted to include transactions that do not contemplate the payment of any consideration.

Expenditure in ascertaining the total income

(i). Notional Interest Deduction

The application of the Transfer Pricing Rules shall precede the application of the Notional Interest Deduction Rules [S.L. 123.176]. An entity within the scope of these rules shall first determine whether the loans or other debt it borrowed or any portion thereof, should bear interest or not for the purposes of the Transfer Pricing Rules before determining whether

such loans or other debt constitute qualifying risk capital in terms of the Notional Interest Deduction Rules.

Example 1:

Company A, which is a company resident in state A, gives an interest free loan to company B, which is a company resident in Malta. In terms of the Transfer Pricing Rules [S.L.123.207], it is determined that the interest-free loan should bear interest at a rate of 3%. In such a scenario, the debt instrument (which is nominally interest-free) shall no longer fall within the definition of "risk capital" and thus the taxpayer may not avail itself of a notional interest deduction in terms of Article 14(1)(o) by reference to that (now non-qualifying) risk capital.

Example 2:

Company A, which is a company resident in state A, grants an interest-bearing loan (interest at 3%), to company B, which is a company resident in Malta. In the given case, by way of example, it is determined that only 40% of the principal would have, under arm's length conditions been lent under the terms established in the debt instrument, with the remaining 60% not being lent as an interest-bearing loan. Accordingly, the remaining 60% of the loan principal (on which no deduction for borrowing costs is allowed following the arm's length assessment), would constitute qualifying risk capital in terms of the Notional Interest Deduction Rules [S.L. 123.176].

(ii) Transactions in scope

Amounts brought forward (e.g. unabsorbed losses, unabsorbed NID) in respect of arrangements that were outside scope are not required to be restated in terms of the Transfer Pricing Rules [S.L. 123.207].

Example 3:

Company A is a company resident in Malta. In the given case, the Transfer Pricing Rules do not apply to Company A for financial years 2024 and 2025. In financial year 2026, the cross-border arrangements entered into by Company A fall within the scope of the Transfer Pricing Rules. It is hereby clarified that a trade loss brought forward to financial year 2026 will be taken "as is" (i.e. not required to be analysed from a transfer pricing perspective) in the company`s tax return for YA 2027.

It is recognised that an arrangement that is entered into by a company which became in scope for the purposes of these Rules may subsequently no longer be such in future periods. The latter could also be the case for a number of intervening periods due to the application of the size thresholds, thresholds of associated enterprises or de-minimis thresholds provided for in the Rules.

In this respect, whilst these Rules would not find application to such future or intervening periods, it is expected the "arms-length amount" so determined under these Rules would, barring relevant changes to economic circumstances to which the arrangement may be subject to, continue to find application to such periods.

Rule 5 –Transfer Pricing methods

(i). Transfer Pricing methods

The preferred methodology to be applied for the purposes of these rules shall be those outlined in Chapter II of the OECD Transfer Pricing Guidelines[1].

Other methods may be accepted in accordance with Paragraph 2.9 of the OECD Transfer Pricing Guidelines.

(ii). The use of more than one method

The use of one method is generally appropriate to give the best approximation of the arm's length price. Nonetheless in more complex cases, where no one approach is conclusive, a flexible approach is acceptable. This will allow the evidence of various methods to be used in conjunction to approximate the arm`s length price.

(iii). Low value adding intra group services

The arm's length charge for low value adding intra-group services may be determined in accordance with the OECD Transfer Pricing Guidelines and EU Joint Transfer Pricing Forum guidelines.

[1] Where applicable throughout these guidelines, reference is being made to the 2022 OECD Transfer Pricing Guidelines. . This also applies to any grandfathered arrangement that is brought within the scope of the Transfer Pricing Rules by virtue of a material alteration post-1 January 2024.

Rule 6 – Records to be retained

The taxpayer would be required to disclose its transfer pricing documentation to the Malta Tax and Customs Administration (MTCA) only upon a specific request by the MTCA. However, the MTCA , in the interest of conducting an informed examination of the taxpayer's transfer pricing practices, retains the right to request further information and documentation on the arrangements under review. The taxpayer would be required to make its transfer pricing documentation available, upon request by the MTCA, within a reasonable timeframe.

The documentation which is required to be held by taxpayers shall be in line with Chapter V of the OECD Transfer Pricing Guidelines, as follows:

Master file:

The Master file shall include the information outlined in Annex I to Chapter V of the OECD Transfer Pricing Guidelines. If the Master file is requested by the MTCA , it shall be made available in English or Maltese.

Local file:

The Local file shall include the information outlined in Annex II to Chapter V of the OECD Transfer Pricing Guidelines. If the Local file is requested by the MTCA , it shall be made available in English or Maltese.

(i) Retention of Records

It is hereby being clarified that the documentation required to be kept in terms of these rules, constitute part of the record keeping obligations in terms of Article 19(1) of the Income Tax Management Act. The time limit referred to in Article 19(5) of the Income Tax Management Act for the retention of such records shall start to run from the end of the period to which the arrangement in question refers to or the date of that arrangement, whichever is the later.

Example 4

Entity R, which is tax resident in Malta, enters into a loan agreement with Entity N, which is tax resident outside Malta. The thresholds in Rule 9 were not exceeded during the first 5 years of the agreement, however in Year 6, the thresholds in Rule 9 are exceeded. In this regard, the company is required to prepare the transfer pricing documentation, including the inter-company agreement, as from Year 6.

(ii) Record keeping for low value adding intra-group services

A taxpayer which opts to adopt the simplified approach of low value adding intra-group services shall prepare the information in terms of Chapter VII of the OECD Transfer Pricing Guidelines. The information shall be made available to the MTCA upon request.

Rule 9 - Exceptions

Transfer pricing rules are intended for all 'cross-border arrangements' as defined in Rule 2 of the Transfer Pricing Rules which are relevant for the purposes of Rule 3.

However, the rules will not apply to transactions entered into a financial period where during the said financial period the aggregate arm's length amount of:

- transactions of a revenue nature do not exceed EUR 6,000,000; and
- transactions of a capital nature do not exceed EUR 20,000,000.

In aggregating the items of income and expenditure of a revenue nature to determine the application of these rules, one should not include any dividends paid to an associated enterprise.

Distribution/s in kind may need to be considered for the purpose of this rule.

Rule 11 – Unilateral Transfer Pricing Rulings

In the absence of a primary adjustment initiated by another jurisdiction, the Commissioner will only consider requests for the issuance of Unilateral Transfer Pricing Rulings performing a downward adjustment only if the following conditions are met:

(a) the downward adjustment is consistent with the arm's length principle both in principle and as regards the amount;

(b) in the absence of a downward adjustment in Malta, the taxpayer will otherwise face issues of double taxation;

(c) the Unilateral Transfer Pricing Ruling is spontaneously exchanged with the tax administration of the relevant jurisdiction who is in turn notified of such Ruling together with all the factual and legal circumstances necessary to evaluate the downward adjustment under the arm's length principle.