Practical implications of introducing transfer pricing regulation on the international tax landscape in Malta.

By

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Abstract

Title: Practical Implications of Introducing Transfer Pricing Regulation on the International Tax Landscape in Malta.

Purpose: This study analyses the practical implications that are expected to arise in light of the introduction of specific transfer pricing regulations in Malta. Therefore, the research assesses the interaction of these rules with other tax laws and any administrative and compliance considerations that should be taken into account in practice.

Design: Due to the nature of the field of research, the objectives of this study have been achieved by means of semi-structured interviews conducted with twelve local practitioners and a high-ranking official from the ICTU. The participants' perceptions regarding the introduction of TPRs were compared to the interpretation of foreign academics and local dissertations discussed in the literature review.

Findings: This study highlights the importance of buttressing the reference to the OECD TPGs with the specific characteristics of the local scenario since Malta is a small island state. The results also show that although the lack of local comparables is one of the main anticipated complexities, the inclusion of applicable adjustments, EU databases should generally be acetated by the tax authority. Furthermore, tax certainty is provided through the APAs, but these may prove to be prohibitive due to their cost and impractical as they take significant time to be concluded.

Conclusions: The "knowledge gap" has to be addressed via capacity building programs for the OCfR and continued education for tax practitioners. Until such gap is narrowed, firms should consider recruiting practitioners from abroad or outsourcing the TP function. The OCfR ought to undertake regular consultation with practitioners for the purpose of the balanced application of the Arm's Length Principle. The research calls for the provision of public databases and sufficient examples being included in the local guidelines to support the comparability analysis. The study also highlights the need for an approach which makes APAs more accessible to smaller taxpayers and the issuance of practical guidelines for taxpayers for the negotiation and implementation of Rulings.

Value: This study is the first to examine the impact of the TPRs on the international tax landscape in Malta. This was accomplished by considering the scope of the rules, the relevant carve-outs, the arm's length amount and the processes for dispute resolution. This study is a valuable springboard for tax practitioners, taxpayers, and the OCfR for further cooperation and to ensure effective implementation and adherence to these rules.

Keywords: Associated Enterprises, OECD, Taxation, Transfer Pricing

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List of Abbreviations

APA	Advanced Pricing Arrangement
ARR	Advance Revenue Ruling
ATP	Aggressive Tax Planning
ATAD	Anti-Tax Avoidance Directive
AL	Arm's Length
AE	Associated Enterprise
BEPS	Base Erosion and Profit Shifting
BEFIT	Business in Europe: Framework for Income Taxation
CUP	Comparable Uncontrolled Price
CbCR	Country-by-Country Report
CPM	Cost-Plus Method
CBA	Cross-Border Arrangement
DAC	Directive on Administrative Cooperation
DTT	Double Tax Treaty
ECOFIN	Economic and Financial Affairs Council
EC	European Commission
EU	European Union
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FAR	Functions, Assets and Risks
GAAR	General Anti-Avoidance Rule
GDP	Gross Domestic Product
ITA	Income Tax Act
IBFD	International Bureau of Fiscal Documentation
ICTU	International and Corporate Tax Unit
L.N.	Legal Notice
MTC	Model Tax Convention
MNE	Multinational Enterprise
MAP	Mutual Agreement Procedure
NID	Notional Interest Deduction
OCfR	Office of The Commissioner for Revenue of Malta
OECD	Organisation for Economic Co-Operation and Development
PE	Permanent Establishment
RRP	Recovery and Resilience Plan
RPM	Resale Price Method
SAAR	Special Anti-Avoidance Rule
SPV	Special Purpose Vehicle
TNMM	Transactional Net Margin Method
TPSM	Transactional Profit Split Method
TP	Transfer Pricing
TPG	Transfer Pricing Guidelines
TPR	Transfer Pricing Rules
UN	United Nations
UoM	University of Malta

Chapter 1: Introduction

1.1 Background

Globalisation has amplified and facilitated trade, and as a result, it has increased Foreign Direct Investment (FDI) in numerous countries (OECD 2022b). This, in turn, has benefitted domestic economies as it fosters innovation, creates job opportunities, and sustains economic growth (Wrappe 2022). Since economies have become more globally integrated, corporations have also shifted from country-specific business models to global models and integrated supply chains (Wu, Lu 2018). Globalisation has created a corporate climate in which Multinational Enterprises (MNEs) can benefit from the ability of conducting operations in multiple jurisdictions, and in fact, MNEs constitute a substantial proportion of overall trade (Chugan, Panchal 2022).

Moreover, intra-firm trade represents an ever-increasing percentage of world trade. As a matter of fact, large enterprises set up subsidiary companies in multiple countries, some of which transact with other related entities within the same MNE (Keuschnigg, Devereux 2013). These set-ups are established for a multitude of reasons, including growth, marketing strategies and tax efficiencies (Ishikawa 2015). Intra-firm trade carried out between related parties must nonetheless be priced, the pricing process is referred to as transfer pricing (TP), whereby the transfer price can be defined as “the price established in a transaction between related persons” (Arnold 2019).

TP holds vital roles in both managerial accounting and tax reporting (Hiemann, Reichelstein 2012). From the point of view of management accounting, TP is useful for several control issues namely, the performance measurement of responsibility centres and their respective managers (Rossing, Cools et al. 2017). From the taxation perspective, TP is required for the purpose of income allocation to different entities in a MNE, and consequently to different jurisdictions (Nielsen, Raimondos-Møller 2012).

The current international tax regime necessitates the Separate Entity Approach, which views the different entities in a MNE independently from each other, rendering this allocation of income a necessary prerequisite (Faccio, Picciotto et al. 2017). Since these entities are under common control, this approach is patently susceptible to being manipulated, leading to profits being shifted from one jurisdiction to another through transfer mispricing (Devereux, Auerbach et al. 2021).

In the absence of Transfer Pricing Rules (TPRs), both tax authorities and MNEs lack the guidance required when determining TP in related-party transactions (Cottani

2018). Thus, in an attempt to achieve a degree of uniformity, both the Organisation for Economic Co-Operation and Development (OECD) and the United Nations (UN), issued Model Tax Conventions to serve as templates for countries in the negotiation of double taxation treaties (Musselli 2019). In these same models, these organisations provide, that transactions between associated enterprises (AE) must be at arm's length (AL) (Musselli 2019). They further contend that AL price should be determined by reflecting market values that unrelated parties would have charged for similar transactions (Arnold 2019). Reference to the application of the AL Principle can be found in Article 9(1)[1] of the OECD Model Tax Convention on Income and Capital (MTC) and the 2022 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (TPGs) (Navarro 2018).

Developments such as TP have been exacerbated by the increasing degree of sophistication of tax planners in identifying and subsequently exploiting legal arbitrage opportunities and exceeding boundaries of acceptable tax planning (Cristea, Nguyen 2016). This provides MNEs with more confidence in taking aggressive tax positions with the aim of minimising their tax burden (OECD 2013). Due to information gaps with the tax administration, MNEs might charge arbitrarily low or high prices for sales between linked parties in high- and low-tax jurisdictions, shifting earnings and lowering overall tax liabilities (de Mooij, Liu 2020).

[1] Vide Appendix A

1.2 Current Situation in Malta

Malta's economy has been experiencing sustained employment creation and rapid growth for several years (European Commission 2022c). Nonetheless, a number of long-term structural challenges remain (European Commission 2022c). These include the high share of corporate income taxes and a degree of reliance placed on such taxes, which could weigh heavily on the sustainability of government finance in the long-term and which implies a greater level of vulnerability to future economic shocks. As of 2020, Malta's share of corporate income tax in total tax revenue is still one of the highest in the European Union (EU) (European Commission 2022b). This can be partly attributed to Malta's tax-payment-and-refund system, which attracts foreign businesses by enabling the reduction of the effective tax rate from 35% (nominal tax rate) to between 0% and 10% through tax credits and refunds (Attard 2019).

Furthermore, although Malta has implemented European and internationally agreed initiatives to address some aggressive tax planning (ATP) concerns, such as the first and second EU Anti-Tax Avoidance Directives (ATAD), and the sixth amendment of the Directive on Administrative Cooperation (DAC 6), economic evidence suggests that Malta's corporate tax rules are used for and may facilitate ATP. This can be substantiated by data regarding the high degree of dividend and royalty payments as a percentage of Gross Domestic Product (GDP), together with the consistently high levels of both inbound and outbound FDI stock, which are nearly entirely controlled by Special Purpose Vehicles (SPVs) (European Commission 2022a).

Consequently, Malta has been pressured to close off specific features of the tax system in order to curb the room for ATP. In October 2021, Malta agreed to the OECD's global minimum corporate tax pact, which sets the minimum tax for MNEs at 15%. By being under the watchful eyes of the European Commission (EC) and following the inclusion in the Financial Action Task Force's (FATF) list of Jurisdictions under Increased Monitoring untill the 17th of June 2022 (FATF 2021), Malta has been encouraged to implement, together with other measures, TPRs in order to avoid being used as a base for ATP.

Following Malta's Recovery and Resilience Plan (RRP) that was agreed with the EC in September 2021 and approved by the Economic and Financial Affairs Council

(ECOFIN) in October 2021, in which Malta is expected to receive approximately €316 million in grants, the Government of Malta committed to the implementation of specific TPRs in line with the current global standards regarding the AL Principle (European Commission 2021).

The implementation of TPRs was anticipated by the introduction of the enabling provision in Article 51A of the Income Tax Act (ITA), Chapter 123 of the Laws of Malta, as part of the enactment in the Budget Measures Implementation Act 2021 (Act No. XVII 2021). This paved the way for the introduction of TPRs in Malta by providing authorisation to the Minister of Finance to enact rules in relation with TP in general and, in particular, to provide for the application and therefore, the determination of AL pricing of a transaction or series of transactions, advanced pricing arrangements (APAs) and any adjustments thereto.

Following the introduction of this enabling provision, the Office of the Commissioner for Revenue of Malta (OCfR) published a public Consultation Document on the 22nd of December 2021 with respect to TPRs, which was followed by the introduction of such rules through Legal Notice (L.N.) 284 of 2022 on the 18th of November 2022. The provisions of L.N. 284 of 2022 will come into effect as from the 1st of January 2024.

1.3 Need for the Study

A substantial amount of literature can be found regarding TP within both the international and local contexts. Past studies in Malta were conducted on the premise that Malta lacked specific TPRs. In fact, the majority of these studies recommended that Malta should introduce TPRs as the benefits of such rules outweigh their drawbacks (Aquilina 2016). However, as per above, this has changed since TPRs were published in Malta on the 18th of November 2022.

It could be argued that the prior reluctance to enact TPR was associated with Malta's taxation policies, which were intended to attract FDI via a number of tax incentives (Pace 2015). However, the formal introduction of TPRs will improve Malta's international reputation as a stable and transparent jurisdiction, which in turn will safeguard and attract FDI (Rapa-Manche' 2002). Nevertheless, the TPRs should not give rise to excessive and disproportionate burdens on tax practitioners, taxpayers, and tax authorities (Ellul Sullivan 2007).

With this in mind, it should be ensured that the TPRs do not impede the flexibility which the Maltese tax system offers (Gatt 2018). Therefore, it is essential to determine and take into consideration the implications that the formal introduction of TPRs could have on the manner in which international tax practice is currently being conducted locally (Ellul Sullivan 2007). Furthermore, this study seeks to provide an indication of the way by which the prospective TPRs will fit within the broader context of Malta's taxation policy.

1.4 Objectives of the Study

The researcher aims to study the implications on the Maltese international tax landscape in light of the formal introduction of TPRs. In that regard, the main objectives of this study are:

1) To identify the implications of the practical compliance considerations emanating from the TPRs on the local tax practitioners and taxpayers.

This study will assess the anticipated related compliance costs and administrative burdens imposed on taxpayers and the impact concerning FDI in response to the introduction of TPRs

2) To assess the local TPRs recently published by the OCfR.

This dissertation will examine the interaction of TPRs with other tax laws, and investigate whether there should be a re-think of certain aspects of international tax. Additionally, whether it would be necessary to amend existing tax regulations due to the introduction of TPRs.

3) To investigate the administrative implications associated with the introduction of TPRs on the OCfR.

This research will ascertain what administrative and procedural matters are critical for the practical implementation of TP, such as entering into Unilateral TP Rulings (Rulings) and APAs. Furthermore, this study will determine the degree of legislative power that the OCfR will possess.

1.5 Scope and Limitations

The scope of this study shall focus on the practical implications associated with the introduction of the TPRs into domestic legislation.

Primarily, a limitation that can be found in this study arises from the subject area itself since TP is a vast topic, associated with several related areas such as profit attribution and TP adjustments.

Secondly, this study will be undertaken in a period in which the TPRs have only been recently enacted into Maltese law. Thus, the level of experience and specialisation of the interviewees concerning the practical implications of TPRs may emerge as a limitation of scope. Furthermore, no official guidance on the application of the TPRs have, at time of writing, been published by the OCfR

Thirdly, since the TPRs deal with transactions of MNEs, the focus of this study was limited to the Big Four and mid-tier firms and the OCfR, since these parties were considered the most likely to possess sufficient knowledge regarding the subject area. Nonetheless, small boutique investment firms were also interviewed in order to obtain an understanding of the practical implications facing such firms as a consequence of the introduction of TP rules.

Moreover, this study is limited to the Income Tax implications of TP and hence, indirect tax implications and management accounting implications of TP shall be considered outside the scope of this study. Finally, another limitation emanates from the fact that continuous developments may come to light as a result of the contemporary nature of the subject matter.

1.6 Overview of the Study

Figure 1.1. illustrates the general outline of the dissertation and should serve as a guide to the reader.

Chapter 1 Introduction

- An Introduction on Globalisation
- An explanation of the current situation in Malta
- The need for the study as a result of the introduction of TPRs in Malta
- A discussion of the objective to help the reader understand the research rationale

Chapter 2 Literature Review

- A critique of the available literature on the subject matter.
- A report on the TRPs set out by the relevant Maltese Legislation.

Chapter 3 Research and Methodology

- An exposition on the rational behind the research.
- An explanation of the preliminary research undertaken.
- The selection of individuals for primary reseach, the formulation of the interview questions and their analysis.
- A discussion of limitations and ethical considerations.

Chapter 4 Findings and Discussion

- A comparison of the responses emerging from the interviews carried out as stated in Chapter 3 with the literature in Chapter 2.
- A discussion of the responses for the objectives originally designed and outlined in Chapter 1.

Chapter 5 Conclusion and Recommendations

- A summary of all findings and results obtained, together with recommendations and other venues of further study.

Figure 1: Overview of the Study

Chapter 2: Literature Review

2.1 Overview

This chapter commences with the concept of the ATP by MNEs which builds up and culminates with the introduction of TPRs in Malta. Figure 2.1 below provides an overview of this chapter.

Section 2.1 Introduction

- ATP practices through BEPS from higher to lower tax jurisdictions by MNEs will be discussed, particullarly via intra-firm transactions with foreign-related parties. The effect of corporate tax reforms on ATP will also be mentioned.

Section 2.2 Addressing ATP

- Detailed discussion on the OECD TPGs, especially focusing on the AL Principle, TP methods, comparability analysis, TP documentation and dispute resolution.

Section 2.3 TP and the OECD/G20 BEPS Project

- TP will be considered in light of the OECD/G20 BEPS Project. the importance of TPRs will be highlighted.

Section 2.4 TP in Malta

- The senario prior to the introduction of the local TPRs will be assessed. The impact of recently introduced TPRs will be analysed in terms of the compliance and administrative burdens created.

Figure 2: Section structure of Chapter 2

2.1.1 Aggressive Tax Planning

Corporate tax avoidance, through base erosion and/or shifting profit from higher to lower tax jurisdictions, has become an economic activity in its own right (Barrios, Andria et al. 2020). The practice of ATP is defined as "acting within the law, sometimes at the edge of legality, to minimise or eliminate tax that would otherwise be legally owed" (European Commission 2012).

Highly profitable MNEs such as Apple, Google, and Starbucks have been able to significantly reduce their tax burden on their worldwide income by shifting profits from high-tax to low-tax jurisdictions, hence eroding the tax base of their group companies located in higher tax jurisdictions (Buettner, Overesch et al. 2017). This has led to increased awareness that substantial corporate tax revenue is being lost by governments, in response to the ATP practices undertaken by MNEs (Tørsløv, Wier et al. 2022).

Since jurisdictions face the pressure of generating tax revenue as a result of high debt levels, predominantly emanating from the Covid-19 pandemic and the Russia-Ukraine conflict (Piedrahita 2021), the taxation of MNEs is at the forefront of the international policy agenda (Fuest, Spengel et al. 2013). Therefore, MNEs continue to face unprecedented public scrutiny from policymakers, tax authorities, and civil society organisations across the world (Cooper, J., Fox et al. 2016).

Global corporations take advantage of cross-border differences in corporate income tax rules through schemes such as TP, the strategic allocation of intangible assets across tax jurisdictions[2] and debt shifting (Barrios, Andria et al. 2020). However, MNEs maintain that they have fully abided by the income tax legislation and stress that it is the legislator who should seek to close existing loopholes for ATP activities (Riedel 2018).

2.1.2 Transfer Pricing as an Aggressive Tax Planning Technique

Among various tax avoidance practices, intra-firm transactions with foreign-related parties may be entered into so as to shift taxable profits from high-tax to low-tax jurisdictions (Clausing 2003). It is attested that TP is manipulated for the purpose of

[2] Through schemes, which have now been phased, out such as the "Double Irish Dutch Sandwich" and "Single Malt"

MNE tax-minimisation strategies (Clausing 2016). This manipulation can produce results that do not reflect the value created through the underlying economic activity carried out by the members of a MNE (OECD 2015).

The key incentive behind the movement of taxable profits lies in the tax differentials between countries (Heckemeyer, Overesch 2013). This refers to MNEs' ability to maximise their aggregate net income if the majority of their profits are allocated to jurisdictions in which such profits are taxed at a low tax rate (Rathke, Rezende et al. 2021).

The mispricing of intra-firm transactions is identified as one of the dominant mechanisms used in MNE corporate tax planning (Cooper, Nguyen 2020). Robust and significant empirical evidence indicates that base erosion and profit shifting (BEPS) do occur by confirming a negative correlation between reported parent or subsidiary profits and local tax levels (Hines 1999, Devereux 2007, Heckemeyer, Overesch 2013).

Furthermore, MNEs that trade with both controlled and uncontrolled entities have an incentive to distort their AL prices in the direction and magnitude of the TP, depending on tax differentials (Cristea, Nguyen 2016). MNEs obscure the degree of mispricing between AEs by manipulating the prices between third-parties, thus enabling such MNEs to follow the AL Principle while undertaking BEPS (Cristea, Nguyen 2016).

Studies also show that less developed economies may be more susceptible to BEPS than developed economies (Crivelli, Keen et al. 2016). Additionally, developing economies report that significant levels of tax revenues are lost through the mispricing of intra-firm trade (Collier, Riedel 2018).

TP is predominantly found within large MNEs, and that despite significant revenue losses results from TP, such losses are attributable to a small number of entities (Davies, Martin et al. 2018). Additionally, TPRs normally exert greater influence on smaller MNE, than larger MNEs (Yoo 2022). In this regard, tax authorities should dedicate more resources to monitor and regulate large MNEs and should also request more detailed reporting obligations from such entities (Yoo 2022).

2.1.3 Effect of Corporate Tax Reforms on ATP

The attention being paid to the issue of tax-motivated profit shifting within MNEs (Dharmapala 2014) and the exploitation of loopholes resulting from gaps and frictions in existing tax rules, which facilitate MNEs' ability to reduce their tax liability, (Fuest, Spengel et al. 2013) opened the opportunity for reform in the international tax system (Alexander, De Vito et al. 2020). As a consequence, countries have augmented their corporate tax systems by introducing the core principles of the OECD TPGs into domestic rules and subsequently implementing specific adjustments to conform to their regulatory backgrounds and established tax practices (Knoll, Riedel 2014).

A lower magnitude of ATP by MNEs has been reported over time, which can be explained by the spread of TPRs and TP documentation requirements (Dharmapala, Riedel 2013). Furthermore, evidence from developed economies indicate that such regulations are effective in restricting income-shifting to low-tax jurisdictions (Beer, Mooij et al. 2020).

2.2 Addressing Aggressive Tax Planning

2.2.1 The OECD Transfer Pricing Guidelines

Since the late 1970s, jurisdictions have sought to establish an international standard for taxpayers and tax authorities to address TP matters (Devereux, Vella 2014). In this regard, the OECD TPGs is undoubtedly the most important source of information. These guidelines support the interpretation and enforcement of TPRs by providing recommendations to tax practitioners, tax authorities and courts (Navarro 2023). The OECD TPGs mainly deal with the application of the AL Principle, the process of selecting and utilising the different TP methods and the procedure for performing a comparability analysis (Pepper, Coleman et al. 2022).

Both OECD Member States (MS) and non-members have adopted these recommendations to incorporate binding TPRs into their respective national tax laws (Marques, Pinho 2016). There are also jurisdictions that make reference to, and advocate for the use of, the OECD standards without actually adopting them into domestic law (Marques, Pinho 2016).

The OECD TPGs, which are non-binding, merely provide suggestions for establishing a framework for countries to follow and do not provide a set of rules or laws that MNEs are obliged to follow (Aquilina 2016). The guidelines state that its main purpose is to protect counties' tax authorities, and to avoid double taxation and double non-taxation to occur (OECD 2022b).

Additionally, the UN has also published the UN Practical Manual on Transfer Pricing for Developing Countries (UN TP Manual), which is based on the framework of the OECD TPGs and expressly endorses the AL Principle (Cottani 2018). Nonetheless, as the title suggests, the UN TP Manual focuses in particular on providing guidance regarding issues expressed by developing countries (UN 2017).

2.2.2 The Arm's Length Principle

For decades, governments across the world have set up systems to limit the degree of BEPS and to enforce the AL Principle (Schreiber, Simons et al. 2020). This includes delineating the methods to be used to determine AL prices, prescribing documentation requirements, imposing penalties for of non-compliance, and determining the probability of a TP adjustment (de Mooij, Liu 2020).

The conditions of the commercial and financial relations of transactions conducted between unrelated parties should be in accordance with the market conditions and should be considered to be in line with the AL Principle (Schreiber, Simons et al. 2020). The authoritative statement on this Principle, which is established in Article 9(1)[3] of the OECD MTC, fundamentally considers the AEs of a MNE as separate entities, rather than members of a whole (Muyaa 2014). It is important to note that numerous TPRs are designed on the basis of this article, but not all definitions of AEs are the same and the OECD TPGs does not present a threshold which establishes control (Lohse, Riedel et al. 2014). For instance, in Ireland, under Part 35A Taxes Consolidation Act, AEs includes entities that are not only controlled by the person/s but also "relatives" of that person, including parents, spouses, legal descendants and brother/sister.

Moreover, the need for "an approach that is balanced in terms of, on the one hand, its reliability and, on the other, the burden it creates for taxpayers and tax administrations"

[3] Vide Appendix A

is accentuated (OECD 2022b). One of the main complexities that arises when establishing AL, is referred to, in the OECD TPGs, as delineating the transaction (OECD 2022b). To address the concern of an over-reliance on taxpayer contracts, which may be inconsistent with the nature of the actual conduct of parties in practice, the required approach highlights the importance of "getting behind the contracts to the real conduct of the parties" and subsequently establishing the TP analysis on such conduct and thereby adopting a substance over form approach to analysing related party transactions (Collier 2018). This requires a more materially detailed analysis of the conduct of the parties, which makes the application TPRs notably onerous in practice (Collier 2018).

The complexities that arise when establishing precisely what the AL price should be, presents MNEs that have AEs located across a number of jurisdictions with an opportunity to shift profits to low-tax countries (Saunders-Scott 2013).

2.2.3 Transfer Pricing Methods

The OECD TPGs allow for five methods to ascertain whether the TP for intra-firm transactions adhere to the AL Principle (Marques, Pinho 2016). It is essential to select the most appropriate TP method for a specific case (OECD 2022b). To achieve this, the selection process should evaluate the relative strengths and limitations of the OECD recognised methods, the method's appropriateness in light of the nature of the controlled transaction, the availability of reliable information required to apply the selected method, and the extent of comparability between controlled and uncontrolled transactions (Navarro 2023). It should be noted that no single approach is appropriate in every scenario, nor is it necessary to demonstrate that a specific method is inappropriate in a given context (OECD 2022b).

Primarily, the guidelines refer to three traditional transaction methods, specifically the Cost-Plus Method (CPM), the Comparable Uncontrolled Price (CUP) method, and the Resale Price Method (RPM), which compare intra-firm transactions with prices or gross margins agreed by independent entities (Knoll, Riedel 2014). Additionally, the OECD TPGs make reference to two transactional profit methods, namely the Transactional Net Margin Method (TNMM) and the Transactional Profit Split Method (TPSM), which compare the profit of related parties to the profit earned by comparable uncontrolled parties (Knoll, Riedel 2014).

The degree of discretion involved when choosing between the 5 TP methods makes it difficult to implement in practice (Hofmann, Riedel 2018). Moreover, the successful application of the 5 TP methods tends to be arduous, especially for tax authorities of developing economies that normally lack experience and technical capacity (Brugger, Engebretsen 2022).

2.2.4 Comparability Analysis

The comparability analysis is the crux behind the application of the AL Principle (Turina 2018). Thus, the comparability between related and independent parties to a transaction serves as the foundation for applying the AL Principle (Schoueri 2015).

Following the OECD TPGs, it is important to ensure that the comparability against which a specific related party transaction will be compared is pertinent to the situation being evaluated (OECD 2022b). This implies that the features of the transaction, the parties involved, the circumstances, and the industries should be sufficiently comparable (OECD 2022b).

Additionally, the guidelines indicate that any discrepancies between the comparable and the situation being evaluated (the tested transaction) could potentially impair the comparability analysis, hence adjustments would need to be made to the comparable in question to remove any disruptive difference (OECD 2022b). Thus, in a comparable uncontrolled transaction based on market conditions, companies would typically undertake a fact-intensive process (Brugger, Engebretsen 2022). This entails an assessment of the conditions, terms, and prices being put forward to them before entering into a transaction, and an alternative is chosen if such conditions are deemed to be unsatisfactory (Muyaa 2014).

Complexity is inherent to comparability analysis, since finding comparables is in itself a challenging task (Turina 2018). To further complicate matters, information collected on comparables may not even be available or may be available in insufficient detail or in a way not suitable for effective comparability analysis (Muyaa 2014).

Furthermore, developing economies also face the challenge of scarce data for comparables, which impedes the comparability analysis (Navarro 2021). To counter this issue, tax authorities may permit the AL prices to be determined from indirect comparables (Hofmann, Riedel 2018).

2.2.5 Transfer Pricing Documentation

Policymakers implement TP documentation requirements in national tax laws to limit the scope for distorting TP and to induce transparency in price setting (Lagarden 2016). Detailed documentation, which is essential because in most countries the burden of proof rests on the tax authorities, is required to enable tax authorities to monitor the TP policy of MNEs (OECD 2022b). It is evidenced that documentation requirements were introduced on a large scale in numerous countries and are one of the key elements of TPRs (Abdallah 2016). TP documentation requirements are noted to substantially decrease BEPS among subsidiaries of a MNE (Beer, Loeprick 2014).

The OECD TPGs includes a chapter on recommended documentation to assist both taxpayers when compiling documentation regarding related-party transactions and tax authorities when establishing documentation inquiries (Lohse, Riedel et al. 2014). To analyse TP policies, it is necessary to have “information about the AEs involved in the controlled transactions, the transactions at issue, the functions performed, and information derived from independent enterprises engaged in similar transactions or businesses” (OECD 2022b).

Introducing TPRs or initiating changes in the enforcement of such regulations impacts three components of a subsidiary’s reported profit, namely: the amount shifted out to other subsidiaries of the MNE, the amount shifted in from other subsidiaries of the MNE and the subsidiary’s cost of doing business (Saunders-Scott 2013). TPRs are intended to reduce profit-shifting outflows, but simultaneously, they may also reduce profit-shifting inflows and increase compliance costs for all MNEs that engage in related-party transactions (Beer Loeprick et al. 2022). Although the reduction of outflows should increase reported profits, the other two effects, the reduction of inflows and the increase in compliance costs, reduce reported profits (Saunders-Scott 2013). Therefore, there is a possibility and likelihood that TPRs reduce the level of tax collections in most countries (Beer, Loeprick et al. 2022).

The OECD TPGs identifies three objectives of TP documentation rules. Firstly, to verify that an appropriate level of consideration is given to TP requirements by taxpayers, particularly determining prices and other conditions for intra-firm transactions and reporting the profits derived from these transactions in their tax returns (OECD 2022b). Secondly, TP documentation provides tax authorities with

essential information to apply when conducting a thorough audit of MNEs' TP practices (OECD 2022b). Thirdly, these rules equip tax authorities with the necessary information to undertake a comprehensive TP risk assessment (OECD 2022b).

Moreover, the OECD TPGs suggests a standardised three-tiered approach to transfer pricing documentation (Abdallah 2016). This consists of a master file, a local file, and a Country-by-Country Report (CbCR) (OECD 2022b).

The master file should contain standard information relevant to all related parties in a MNE to provide an overview of the nature of the MNEs' global business operations, its overall TP policies, and its global allocation of income and economic activity to help tax authorities to assess any possibility of significant TP risk (Brennan 2015). The local file, which supplements the master file, presents information with greater detail regarding specific material intercompany transactions of the local taxpayer (Brennan 2015).

Lastly, the CbCR, which was adopted in Malta through the Directive 2016/881/EU on automatic exchange of country-by-country reports (DAC4), and transposed into Maltese Law through L.N. 400 of 2016, assists tax authorities in conducting high-level TP risk assessments amongst the largest group of MNEs (Evers, Meier et al. 2017). This obliges undertakings that in the previous two financial years reported a total consolidated revenue greater than €750 million to publicly disclose income tax information (Evers, Meier et al. 2017). This should contain details regarding the global allocation of the MNE income, taxes paid, and indicators relating to the location of economic activity among tax jurisdictions in which the MNE conducts business (OECD 2022b).

2.2.6 Dispute Resolution

2.2.6.1 APAs

Disputes between taxpayers and tax authorities may arise in the course of applying TPRs since a jurisdiction may not agree with a TP adjustment by another jurisdiction (Lohse, Riedel et al. 2014). APAs are defined as "an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (ex: method, comparables, and appropriate adjustments thereto, critical assumptions as to future

events) for the determination of the TP for those transactions over a fixed period of time" (OECD 2022b).

There are three forms of APA, depending on the number of tax authorities included in the negotiation (Kuropka 2020). These are Unilateral TP Rulings, Bilateral APAs and Multilateral APAs (Kuropka 2020). It is emphasised that "wherever possible, an APA should be concluded on a bilateral or multilateral basis", due to the greater efficiency of Bilateral and Multilateral APAs and the number of limitations associated with Rulings (OECD 2022b). The OECD provides guidance that can be linked to jurisdictions' domestic guidance or the Mutual Agreement Procedure (MAP) and APA processes for the provision of certainty (OECD 2023).

APAs create a win-win situation for the stakeholders involved because it provides a number of benefits to both taxpayers and tax authorities (Beebeejaun 2019). Primarily, the risk of a TP or tax audit is kept to a minimum if the terms of the agreement are followed properly by the concerned parties (Siewe, Kephe 2022). Secondly, APAs provide certainty on the tax liability for the taxpayer and tax revenue for the tax authority as a result of the agreement entered into in advance with respect to the AL pricing or pricing methodology (Rathke, Rezende et al. 2022). Thirdly, an APA is likely to free scarce resources for tax authorities and in turn, reduce administration costs (Becker 2017). Furthermore, entities may benefit from a rollback period which enables the application of APA prices to a number of years before the completion of such agreement (Rathke, Rezende et al. 2022).

Nonetheless, there are concerns that certain MNEs may not be interested in entering in APAs since some entities may be too small in scale to request an APA (Becker 2017). Finally, the process of initiating and negotiating an APA may strain the limited resources of a tax authority since drafting and finalising an APA may detract from resources earmarked for other purposes (Becker 2017).

It is argued that Rulings may lead to unintended consequences for both parties involved because of their spill-over effects on competition policy and thus such rulings, may be deemed to constitute state aid (Eden, Byrnes 2018). Furthermore, they may be seen as too discretionary and vulnerable to misuse (Eden, Byrnes 2018). With the intention of increasing transparency, Council Directive 2015/2376/EU (DAC 3) was introduced, amending Directive 2011/16/EU concerning mandatory automatic

exchange of information in taxation (Zavatta, Stecchi et al. 2019). This was established due to rulings regarding tax-driven structures which have resulted in artificially high levels of income being taxed at a low level in the jurisdiction issuing, amending or renewing the ruling and leaving artificially low levels of income to be taxed by other jurisdictions involved.

2.2.6.2 Penalties and TP Audits

According to the OECD, penalties encourage compliance with the TPRs, and it is evidenced that taxpayers are motivated by narrowly defined and individually based financial considerations such as audits and penalties (Alm 2019).

The OECD TPGs emphasise that care should be taken to ensure that the implementation of a penalty system is fair and not unduly onerous for taxpayers (OECD 2022b). In addition, it is found that specific TP penalties discourage BEPS (Lohse, Riedel 2013).

2.3 Transfer Pricing and the OECD/G20 BEPS Project

2.3.1 OECD/G20 BEPS Project

Following a mandate by the G20 finance ministers, the OECD published the 15 Action Plans of the BEPS Project to tackle ATP (OECD 2013). This unparalleled effort to address the weaknesses within the international tax system has been made through the development of the OECD/G20 BEPS Project (Gupta 2018). These 15 Actions are included within the BEPS Package to equip governments with the required domestic and international legislative instruments to ATP and ensure profits are taxed where economic activity and value creation occur (OECD 2013).

The OECD acknowledges that the agenda of developed and developing economies may not necessarily align (OECD 2014). Firstly, developing economies may encounter constraints regarding their “capacity” to implement and enforce such measures (Collier, Riedel 2018). Secondly, there is the issue relating to the opportunity cost of focusing limited resources on the OECD/G20 Initiative (Collier, Riedel 2018). Thirdly, developing economies could experience a conflict between attracting FDI and protecting their tax base (Hofmann, Riedel 2018).

2.3.2 Impact of OECD/G20 BEPS Project on the OECD TPGs

Following the publication of the OECD/G20 BEPS Project, the OECD TPGs were amended, on the 23rd of May 2016, as a result of the BEPS Action points related to TP namely; Actions 8-10 “Aligning Transfer Pricing Outcomes with Value Creation” and Action 13 “Transfer Pricing Documentation and Country-by-Country Reporting” (Schon 2015).

These action plans are particularly relevant to developing countries due to aggressive TP practices, including: the mis-pricing relating to the use of intangible assets and management and technical services (Collier, Riedel 2018). Furthermore, the measures from Action 13 should support developing countries to focus the resources of the tax authority on high-risk taxpayers (Muscat 2018).

Nonetheless, this initiative has led to “an explosion of complexity” with respect to TP, especially due to the increase in the detail included in the guidance (Collier, Andrus 2017). Moreover, such TP measures within the BEPS Action Plans are extremely complex and onerous to apply (Collier, Riedel 2018).

Finally, on the 20th of January 2022 the OECD TPGs were amended once again, with the inclusion of the revised guidance on the TPSM, the application of the approach to hard-to-value intangibles and the new guidance regarding TP on financial transactions (OECD 2022b).

2.3.3 The Importance of TPRs

A jurisdiction’s TPRs are defined as “the set of rules and practices, as well as enforcement instruments, established to regulate price setting between related companies and ensure compliance with the regulations in force” (Marques, Pinho 2016). It is claimed that specific TPRs are the most effective way of inhibiting the profit-shifting practices of taxpayers (Rathke, Rezende et al. 2021). In fact, MNE profit-shifting activities substantially decrease when TPRs are introduced or tightened by countries, with stricter rules inducing stronger declines in such activities (Lohse, Riedel 2013). Thus, even though TPRs impose a significant administrative burden on firms and tax authorities, it is suggested they exert positive welfare effects (UN 2017). Additionally, TPRs provide guidance to what is acceptable by the respective tax

authorities and hence, aiding willing taxpayers to obtain a better understanding on the pricing requirements of tax authorities (Schön, Konrad 2012).

On this account, it should be noted that similar TPRs in different tax jurisdictions may lead to different implications (Rathke, Rezende at al. 2020). Internationally, a desirability exists for homogeneity of TPRs across jurisdictions, which is justified by the inconsistencies that are created through the interaction of distinct TPRs (Rathke, Rezende 2016).

However, although generally accepted, the AL Principle and TPRs are interpreted and applied differently in different jurisdictions (Marques, Pinho 2016). Generally, this is the case due to differences in the economic and political realities, historical context and tax characteristics of a jurisdiction (Rathke, Rezende 2016). The main differences that arise from such modifications include: the nature and quantum of TP penalisation, the extent of TP disclosure, related-party status, the priority of TP methods, the availability of APA and similar procedures (Rathke, Rezende et al. 2020).

2.4 Transfer Pricing in Malta

Malta has been relatively late in introducing specific TPRs. But being late should not be necessarily viewed as negative, since this presents Malta with the possibility of basing the local TPRs on the experience of other jurisdictions (Bilaney, Tomaselli 2022).

2.4.1 Transfer Pricing Prior to the Introduction of Specific TPRs

Prior to the introduction of specific TPRs in Malta, domestic legislation made sporadic reference to TP and AL Principle (OECD 2022a), as follows:

- Although not specifically related to TP, Article 5(6) of the ITMA aims at the prevention of tax abuse locally. This provision outlines that when a non-resident person, carrying out business with a resident person, produces for the latter, either ‘no profits or less than ordinary profits’ expected to arise, then the non-resident person shall be assessable and chargeable to tax, in the name of the resident person.
- Article 51(2)(a) of the ITA, delineates the Commissioner’s power to ‘determine the liability to tax’ for any year of assessment in the manner and amount

necessary of any person who either as a direct or indirect result of any scheme, with the purpose of taking an advantage in order to avoid, reduce or postpone tax liability, has obtained such, or is to obtain such advantage.

- Article 12(1)(u)(2) of the ITA, outlines that any income or gain derived from a company registered in Malta, but attributable to a permanent establishment outside Malta, and wherein the taxpayer has not shown such revenue as part of its 'chargeable income', shall be calculated, as if the permanent establishment is an 'Independent enterprise operating in similar conditions and at AL'.
- Article 52 of the ITA enables taxpayers to seek Advance Revenue Rulings (ARR), including APAs, from the OCfR. In terms of this article, the OCfR provides such ruling for a period of 5 years.

2.4.2 Consultation Period

The OCfR issued a Consultation Document on draft TPRs on the 2nd of June 2021, with the public consultation lasting until the 28th of February 2022, during which stakeholders were invited to provide observations on the tax policy route relating to TP, to recommend alternatives and to put forward suggestions on pertinent matters that have not been addressed or sufficiently addressed in the proposals (OCfR 2021).

2.4.2.1 OECD TPGs as a Source of Reference

The Consultation Document published by the OCfR states that "it is envisaged that the OECD TPGs will constitute an important source of reference in the application of the rules" (OCfR 2021).

Accordingly, the chargeable income of companies falling in scope of the TPRs shall be ascertained with reference to the AL amounts of incomes and expenditures.

2.4.2.2 Computational Rule

The Consultation Document specified that "the requirement for the application of the ALP is a computational rule for the purposes of the ITA and does not propose to impact the actual commercial arrangements between the parties" (OCfR 2021).

It is acknowledged that the original intent of TPRs was as a mechanism against anti-avoidance (Schoueri 2015). However, TPRs constructed on the AL Principle have

been enacted as a profit allocation parameter essentially in all jurisdictions (Navarro 2023).

It is essential to distinguish TP from anti-avoidance legislation, “the consideration of transfer pricing should not be confused with the consideration of problems of tax fraud or tax avoidance, even though transfer pricing policies may be used for such purposes” (OECD 2022b). Furthermore, TP is a “routine aspect of how MNEs operate” (UN 2017).

Hence, TP has moved from the tax avoidance perspective towards the allocation of tax revenues among states and consequently has created debate on how TPRs will interact with General Anti-Avoidance Rules (GAARs) and Special Anti-Avoidance Rules (SAARs) (Schoueri 2015).

2.4.2.3 Local Rules

Rule 1

This rule indicates the applicability of the TPRs and also sets forth a grandfathering provision which prescribes that the TPRs will only have an effect on arrangements entered into before the 1st of January 2024 where such arrangements are “materially altered” on or after that date.

Rule 2

This rule provides a number of definitions, namely the definition of “company” which carves out SMEs, the definition of “cross-border arrangement” (CBA) and the definition of “AE” which specifies the thresholds for control.

Rule 3

This is the core provision of the TPRs which stipulates that entities are required to ensure that any CBA entered into by an AE is at AL, given that the amount receivable or payable is relevant in ascertaining total income.

Rules 4 and 5

Rule 4 stipulates the definition of the AL amount, while Rule 5 notifies that this amount shall be determined based on the TP methods prescribed in the guidelines issued in terms of article 96(2) of the ITA.

Rule 6

This rule specifies that records shall be prepared “on a timely basis” and retained “as may reasonably be required” in order to determine whether, the total income of the company has been ascertained in accordance with the TPRs.

Rules 7 and 8

Rule 7 provides for the use of the AL amount, while Rule 8 indicates that any adjustments made in terms of the TPRs shall be relevant only for the purposes of the ITA.

Rule 9

This rule provides for exceptions where the TPRs do not apply. This puts forwards a de minimis threshold which states that the aggregate AL value of all items forming part of cross-border arrangement in a year does not exceed €6 million (of a revenue nature) & €20 million (of a capital nature).

Rule 10

This provision sets the rule for ascertaining the total income of a permanent establishment (PE).

Rules 11 and 12

Rules in connection to Rulings and APAs are provided in Rules 11 and 12 respectively.

2.4.3 Impact of TPRs on local practitioners and tax officials

TP, which has become a subspeciality in itself within tax practice, necessitates specialist knowledge pertaining to different jurisdictions, making TP occupy transnational spaces in addition to being local practitioners (Rogers, Oats 2022). These specialists should possess the required level of practical experience that equips them to implement the appropriate TPRs and procedures to ascertain and establish whether or not there has been compliance with such regulations and with the ALP, in the allocation of profits between jurisdictions (Rogers, Oats 2022).

A number of studies conducted before the introduction of TPRs in Malta show that due to the absence of TP practice, Maltese audit firms and practitioners lack local expertise in TP (Pace 2015, Aquilina 2016). Such expertise can be acquired by audit firms in

Malta through coordination with their international network firms (Aquilina 2016). In addition, the same was reported regarding the level of expertise within the OCfR (Spiteri 2021). Capacity-building programs involve the training of tax officials by TP specialists could be implemented to overcome the “knowledge gap” in countries which adopted TPRs without sufficient training (Navarro 2021, OECD 2022c).

2.4.4 Impact of TPRs on Foreign Direct Investment

The result of introducing or strengthening TPRs has important tax policy implications. For instance, MNE’s investment response to TPRs varies depending on the strictness of such regulations (Marques, Pinho 2016).

Therefore, although to a certain extent, stricter TPRs are capable of dissuading MNEs from carrying out profit-shifting activities, unintended consequences such as a fall in MNE investment may occur (Choi, Furusawa et al. 2020). This would outweigh the benefits of TPRs, particularly in the case that MNE investment yields positive spill-over effects on local businesses (de Mooij, Liu 2020).

Thus, governments may be reluctant to introduce TPRs unilaterally or to introduce strict regulations to mitigate their negative and sizable implications on MNE investment. It is essential to note that TPRs have become stricter over time (Lohse, Riedel et al. 2014). Nonetheless, studies have concluded that TPRs do not have significant adverse effects on FDI (Buettner, Overesch et al. 2017).

2.5 Conclusion

This chapter has provided a structured and comprehensive examination of the pertinent literature, in order to provide a better apprehension of the subject area. A more holistic perspective will be realised when this chapter is viewed in combination with Chapter 4 – Findings and Discussion.

Chapter 3: Research Methodology

3.1 Introduction

This chapter portrays the process conducted by the researcher from the outset in order to achieve the objectives of the study. This comprises the preliminary enquiries in the field of research introduced in Chapter 1 and the primary literature analysis undertaken in Chapter 2.

Subsequently, the chapter puts forward the necessary information related to the formulation of the research questions. This includes, an account of how the researcher proceeded with the research methodology adopted, and the reasoning why such approach was chosen over others, any limitations presented and ethical issues encountered.

3.2 Preliminary Research

At the initial stage of this study, the researcher consulted with a local international tax practitioner to acquire a deep understanding of the current taxation issues practitioners face in Malta.

Once an area of interest was established, a substantial amount of both local and international literature on TP was collated and assimilated. This provided a foundation for developing knowledge and served as a basis for engendering new thoughts on TP specific to Malta (Snyder 2019).

Reference was frequently made to conferences held and publications issued by the OECD. Specifically, foreign literature was of paramount importance, both in establishing the findings and as a benchmark in relation to Malta's current situation.

Furthermore, the researcher attended a number of webinars hosted by one of the Big Four firms focusing on TP, as well as the MIT Annual Tax Conference 2022 which addressed a range of topical issues, particularly the subject area of this particular study. This enabled the researcher to establish the title and objectives of this dissertation, and to ensure the feasibility of the study.

3.3 Research Design

3.3.1 Research Philosophy

The starting point of a study is for the researcher to determine the research philosophy to be adopted because each philosophy is undergirded by specific elements that will guide the researcher towards a particular methodology (Saunders, Lewis et al. 2019).

This relationship is essential because “the methodological implications of paradigm choice permeate, the research question/s, participants’ selection, data collection instruments and collection procedures, as well as data analysis” (Kivunja, Kuyini 2017).

A pragmatist approach was undertaken due to the fact that the researcher will be seeking to focus on problems, practices and relevance of the selected study area, with the aim of contributing practical solutions that inform future practice (Kelemen, Rumens 2008). Therefore, this complements the study since its main objective is to ascertain the practical implications of TPRs on the international tax practice within the local scenario.

3.3.2 Research Approach

Based on the research objectives, the abductive approach was considered the most effective in facilitating the modification of existing theory or generation of new theory, due to the wealth of information on TP in an international context but far less in the Maltese context (Saunders, Lewis et al. 2019). This process involves repeated oscillations between theory and data, to enable one to illuminate and contribute to the other (Given 2008).

The abductive approach was used in this study to continuously ameliorate the knowledge of TP in Malta in terms of the application and practicality of the TPRs. This was done by highlighting their implications, with the intention of providing recommendations to improve the current situation.

3.3.3 Research Method

The pragmatic approach suggests that the most appropriate research methodologies include mixed or multiple method designs, quantitative and qualitative designs

(Saunders, Lewis et al., 2019). A quantitative study would be inadequate for the research objectives, since the author wants to obtain comprehensive facts, opinions and personal experiences.

When taking into consideration the complexity and technical expertise required with respect to TP, it has been concluded that the most suitable research method would be a mono-qualitative approach. This facilitates the use of semi-structured interviews “so that questions, procedures and focus may alter or emerge during a research process that is both naturalistic and interactive” (Saunders, Lewis et al. 2019).

Furthermore, an abductive approach employs both induction and deduction in research, by applying theoretically-deduced themes in the semi-structured interviews to be able to test the application of theory emanating from such interviews (Saunders, Lewis et al. 2019).

3.4 Data Collection

For the purpose of this study, the researcher collected data from both primary and secondary sources (Shepherd, Suddaby 2017).

3.4.1 Secondary Data Collection

The secondary data collection process was essential for interpreting the objectives set out and analysing the field of research. Moreover, this desk research helped the researcher to acquire the necessary knowledge on the subject matter and to obtain a thorough understanding to assist analysis and conclusion (Zikmund 2013).

This research provided the researcher a basis for the study through the collection of data from the University of Malta (UoM) Library and the International Bureau of Fiscal Documentation (IBFD) Tax Portal. An extensive review of the relevant literature; which includes numerous peer-reviewed academic articles, reports, legislation and UoM dissertations was conducted in order to obtain a better knowledge and competence on the subject of TP.

3.4.2 Primary Data Collection

The semi-structured interviews would provide structure to the research but would not restrict the respondents. In contrast, they would give them the freedom to express their

experiences, reviews and assessment on the themes and questions posed to them (Saunders, Lewis et al. 2019).

Furthermore, this allows the interviewer to probe further for a deeper and more elaborate explanation (Zikmund 2013), and to ask additional follow-up questions if perceived necessary, in order to explore further important insights on aspects that might have not surfaced during the process of formulating of the interview questions (Given 2008).

Moreover, this approach opens up the opportunity for a detailed analysis of the research objectives and a complete assessment of the contentious issues that are being presented in this study (Saunders, Lewis et al. 2019).

3.4.3 Developing and Administering the Research Instrument

3.4.3.1 Developing the research instrument

The main themes and questions to be presented were identified following the analysis of Maltese legislation, together with academic reports, and foreign and EU legislative instruments, including case law. Additionally, specific reference was made to the Consultation Document for TPRs published by the OCfR. In order to set the scene for the relevant questions, each theme was preceded by basic principles from domestic legislation, OECD TPRs and Council Directives.

Two interview schedules were drawn up, one for the local tax practitioners and one for the office of the OCfR. Nonetheless, the main themes were deemed to be pertinent for both parties, which helped elicit similarities and differences between the responses given to the two schedules

The final interview schedules, which were modified following the recommendations for improvement by the dissertation tutor, can be found in Appendices B and C, and the themes of the questions put forward are outlined in the table below.

Question Number	Theme
1-2	General Questions
3-8	Interaction of TPRs with current Maltese Law
9	TP Professionals
10a, b, c	Scope of TPRs and Definitions
11-13	Comparability Analysis
14-16	Impact on Taxpayers- Client Contracts
17-18	APAs
19	TP Adjustments
20-21	Penalties
22	Safe Harbour Rules
23	Circumvention of TPRs

Table 1: Outline of interview schedules

3.4.3.2 Identifying and getting access to the interviewees

Given the level of expertise and specialisation associated with the subject matter, the researcher opted for purposive sampling in the process of shortlisting potential interviewees, which is "virtually synonymous with qualitative research" (Given 2008). This technique enables the researcher to target interviewees depending on their capacity to contribute to achieving the primary objectives. In fact, the researcher selected interviewees based on their knowledge in the area of TP.

3.4.3.3 Carrying out the interviews

The researcher decided to pilot the interviews with a tax practitioner, in order to test the questions, gain some valuable practice in interviewing, and become more comfortable with the interview questions (Majid, Othman et al. 2017, Crabtree, Miller 2022).

Specifically, the researcher avoided leading questions that could be seen as indicating a preferred response (Given 2008).

3.5 Ethical Considerations

The researcher is responsible to those that s/he studies by ensuring that there will generally be no adverse effects resulting from their participation (Denzin, Lincoln 2018).

As part of an ethical formal procedure, the researcher was permitted to commence the study by presenting participants with a letter from the Supervisor introducing the researcher as a UoM student and inviting them to participate in the field of research. This was followed by the approval of the research proposal by the Dissertation Board, and the interview questions were processed by the FREC for the purpose of ethical clearance checks.

Moreover, participants were provided a 'Research Interview Participation Consent Form'. This informed them that they are entitled to withdraw at any stage, that the data shared would be bound by confidentiality, their identity would be kept anonymous, and that the information provided will be utilised only for the purposes of this dissertation (Hammersley, Traianou 2012).

Finally, the researcher requested the participants' explicit consent to audio-record the interview prior to its commencement.

3.6 Data Analysis

Data analysis is crucial to the success of a research study; it is "always the name of the game" (Silverman 2013).

The interview recordings were transcribed on a word-by-word basis in text format as soon as possible, to extract the maximum value from the interviews, since "accuracy, timeliness, and efficiency are critical" (Crabtree, Miller 2022). Moreover, they were compiled in such a way as to capture not just what was said but also how it was said, such as hesitation, repetition, overlap and pauses, with the aim of providing the researcher with a greater degree of interpretation and understanding when analysing the data (Hammersley 2013). Subsequently, the transcriptions of the audio recordings were inspected for transcription errors (Denzin, Lincoln 2018).

Data was explored through a thematic analysis, whereby the researcher allows categories to emerge from the data, and assigns codes for the similar or differing

themes identified (Saldaña 2021). The coding process revealed themes embedded in the transcriptions which lead the thematic directionality of the analysis (Gibbs 2018 Williams, Moser 2019).

3.7 Limitations

One of the main limitations of this study was that the TPRs had not been introduced in Malta by the time the primary data collection process had been initiated.

In a few circumstances, internet-mediated interviews had to be conducted. Such mode may place a limitation on personal contact and on the dependence on verbal and paralinguistic signals (Vogl 2013). However, internet-mediated interviews proved to be more convenient since this mode allowed participants to choose a suitable time of day and/or period of the year to be interviewed that otherwise would not have been so easy to take part in a face-to-face interview (Trier-Bieniek 2012).

3.8 Conclusion

This chapter explained the rationale behind the methodology utilised in this study to achieve the research objectives. The following chapter will evaluate the findings from the primary data gathered.

Chapter 4: Findings and Discussion

4.1 Introduction

This chapter exhibits and examines the main themes that arose from the interviews conducted with the high-ranking official within the International and Corporate Tax Unit (ICTU) and with the local tax practitioners.

Section 4.1 Introduction

Section 4.2 Impact on Stakeholders

- To analyse the impact of TPRs on tax practitioners, tax officials, taxpayers and on FDI.

Section 4.3 The Local Transfer Pricing Rules

- To assess the local TPRs, by evaluating the basis of these rules and the main definitions and carve-outs.

Section 4.4 Interaction of TPRs with aspects of Maltese Law

- To investigate the interaction of the TPRs with certain aspects of Maltese tax law.

Section 4.5 The Arm's Length Principle

- To review the comparability analysis and the assocaited complexities when determining the AL amount.

Section 4.6 Tax Adminsitration and Dispute Resolution

- Assessing complexities associated with tax administration and dispute resolution.

Section 4.7 Concluding Remarks

Figure 3: Section structure of Chapter 4

4.2 Impact on Stakeholders

In fulfilling the first part of the first research question, the point of departure shall be to analyse the impact that the TPRs are expected to have on local tax practitioners, tax officials and taxpayers.

4.2.1 Tax Practitioners and Tax Officials

There is a general consensus between all the tax practitioners (12/12) interviewed that there is a "knowledge gap" and both officials within OCfR and tax practitioners need to upskill due to the introduction of the TPRs. However, several respondents (9/12) acknowledged that the level of theoretical knowledge on TP is improving, as a result of an increase in the "quality and quantity" of courses offered concerning TP. Nonetheless, according to an interviewee (1/12), it is "common that there is such a gap prior to the introduction of TPRs". A senior manager at a Big Four firm opined that upskilling "comes naturally" at a Big Four firm due to the international network, while in contrast, at a smaller firm, practitioners may find it more challenging to upskill.

Moreover, as pointed out by a number of interviewees (7/12), TP "goes beyond knowledge of the TPR and Guidelines" and requires "hands-on experience". Some respondents (5/12) also remarked that abroad, audit firms have departments dedicated to TP, with practitioners specialising in TP. Few practitioners (3/12) also mentioned that the lack of expertise in the local market makes it more challenging for smaller firms. These respondents also added that such service providers may also struggle to allocate resources for setting up a TP department, and may have to outsource the TP function.

These issues were referred to by Rogers and Oats (2022) and Navarro (2021).[4] In light of these findings, the researcher recommends that TP becomes mandated within the CPE requirements for tax practitioners to ensure a basic understanding of the fundamentals of TP. Meanwhile the researcher recommends that the "knowledge gap" among tax officials can be addressed through capacity-building programs (Navarro 2021).[5] The researcher recommends that until the tax authority and local practitioners

[4] Vide Section 2.4.3
[5] Vide Section 2.4.3

acquire a sufficient level of knowledge and expertise, firms should recruit practitioners from abroad or subcontract their TP function.

4.2.2 Taxpayers

4.2.2.1 Importance of contracts

In accordance with the OECD TPGs, contracts are the starting point that should ideally define in detail the functions, assets and risks (FAR) undertaken by the parties and the expected outcomes at the time of entering into a transaction. Therefore, the researcher asked the interviewees to explain what such an exercise consists of, and how challenging it is in practice.

Some respondents (5/12), four senior managers at a Big Four firm and a tax partner at a mid-tier firm indicated that MNEs have "have strong internal legal practices around contracts and intercompany transactions".

In fact, a tax practitioner (1/12) with first-hand experience in TP expounded that "proactive clients already take into consideration transactional structures in a MNE scenario". This tax practitioner continued to state that intra-group agreements are typically already in place, such that, for this category of clients, TP is not going to be challenging and is not something new. Conversely, in his experience, he claimed that "this exercise will be challenging for those clients that had the impression that they would not be in scope of the TPRs". He discussed that TP will not only be arduous because of its novelty to such clients, but also because they have not been educated and made aware of the complexities that may arise.

Many interviewees (7/12) also highlighted that the exercise of analysing intra-firm contracts does not only comprise of looking at a contract by itself, but also necessitates an analysis of the whole group.[6] One of the tax practitioners (1/12) emphasised the importance of understanding that this is "not simply a contract situation", but a group analysis through a value chain analysis, and the analysis of the FAR. Another practitioner (1/12) added that pricing applied on the basis of analysis ensures that profits are taxed where economic activities take place and value is created. A few respondents (2/12) also commented on the importance of conducting interviews and meetings with clients, to understand and obtain information on the client for the

[6] Vide Section 2.2.2

purpose of such analyses. The importance of the "fact-finding exercise" was highlighted by Brugger and Engebretsen (2022).[7]

Finally, four practitioners (4/12) also provided their views on the grandfathering provision in Rule 1.[8] Although three of the respondents remarked that the grandfathering provision is "extremely accommodating and helpful in practice", they opined that they will still seek to review and update arrangements which have been entered into before the 1st of January 2024. The researcher agrees with this remark, in order to apply best practice. The ICTU representative and one tax practitioner (1/12) identified that complexities may arise with respect to those contractual agreements that were entered into before the 1st of January 2024 that have been "materially altered" on or after that date.

The researcher contends that further clarification should be provided regarding the definition of "materially altered."[9] Additionally, should the intention be to eventually remove the grandfathering provision, then there should be a notification in advance identifying the date by which agreements entered into before the 1st of January 2024 would no longer be excluded from the local TPRs. This should be done in order to give taxpayers the opportunity to "get their houses in order" once such agreements are not grandfathered.

4.2.2.2 Regularly updating contracts

Respondents were divided on their opinions concerning whether the TPRs will induce MNEs to regularly update their intra-group company arrangements.

The majority of the practitioners (8/12) stated that it will be a necessity to have structures in place that reflect such arrangements, in order to avoid TP adjustments. Four respondents (4/12) claimed that contracts which provide contradicting information from the financial statements and are not reflecting substance, should be terminated.

A practitioner (1/12) highlighted that tax audits are based on what is actually going on in practice. That is, tax investigations in tax adjusting jurisdictions do not stop at an

[7] Vide Section 2.2.4
[8] Vide Section 2.4.2.3
[9] Vide Section 2.4.2.3

analysis of the intra-group agreements but also carry out an analysis of actual fact finding.

A couple of interviewees (2/12) highlighted that having a contract in place between AEs is the “bare minimum” that taxpayers are advised to prepare. This resonated with the two practitioners (2/12) who stated that in practice, they do not think that MNEs will start to regularly update intra-group contracts due to the introduction of the TPRs. Their reason was that, from their expertise working abroad on TP, “tax authorities do not make the final judgement from the terms of the contract”.

Therefore, the researcher suggests that MNEs having a presence in Malta should proactively start analysing their intercompany arrangements. This ensures that contracts between AEs that will be entered into, on or after the 1st of January 2024 apply best practice, by regularly updating their intra-group company arrangements.

4.2.2.3 Conduct conforming to the terms of the written contract

The OECD TPGs emphasise the importance of considering the commercial or financial relations between AEs to examine whether the arrangements reflected in the actual conduct of the parties substantially conform to the terms of any written contract.

All tax practitioners (12/12) emphasised the vital importance that contracts reflect, and actual conduct follows the actual arrangements between parties. One particular practitioner (1/12) made reference to Canada v. General Electric Capital Canada Inc., 2010 and Chevron Australia Holdings Pty Ltd v. Commissioner of Taxation, 2017 to illustrate that tax auditors are enhancing their level of education and elaboration when finding out what is happening in reality against what is written in the contract.

Several practitioners (8/12) said that every year, taxpayers have to test that the conduct of the parties is in line with the contracts. If not, parties will be exposing themselves to the risk that the OCfR will challenge the TP of the taxpayer. Nonetheless, a few interviewees (4/12) noted that it is common, in practice, that the terms of the contract and the actual conduct are not aligned.

4.2.2.4 The balance created for taxpayers and OCfR

The OECD TPGs emphasise the importance of an approach that is balanced in terms of reliability and the burden created for taxpayers and tax administrations in

determining the ALP (OECD 2022b). Hence, the researcher sought to assess how such balance is to be upheld by the TPRs introduced in Malta.

One practitioner (1/12) pointed out that achieving such balance is a constant challenge and claimed that no country has got this balance right. Thus, the researcher recommends that the ICTU should continuously conduct consultations to revisit what kind of requirements are needed for the balanced application of the ALP.

A substantial portion of the practitioners (7/12) interviewed stated that this balance could be upheld through the SME carve out which will be discussed in further detail in Section 4.3.4. To substantiate this argument, one of these respondents mentioned that in cases "where the tax paid is lower than the cost to conduct the economic analysis of a TP study, the risk involved does not find this balance, since the risk is so low that it is not worth having to engage the services of a professional to conduct this study". Some respondents (4/12) said that by excluding SMEs, the TPRs will be applied to material transactions by large MNEs. They argued that it is understandable that such entities require some additional compliance burden through TP documentation. In this respect, the ICTU representative remarked that although it would be "ideal that taxpayers would be able to provide supporting documentation evidencing the AL price of related party transactions", only those entities in scope of the TPRs are required to prepare TP documentation under Rule 6.[10] Furthermore, the official explained the importance of accounting for all aspects of the tax system to achieve such balance, especially the "allocation of the burden of proof".

Drawing from these remarks, in order to achieve the balance emphasised in the OECD TPGs from the administrative perspective, the limited resources of tax authorities should generally be dedicated towards large MNEs, as outlined by Yoo (2022).[11] From the compliance perspective, the balance is achieved by limiting the burden on smaller MNEs since as discussed by Davies, Martin et al. (2018),[12] TPRs tend to impact smaller MNEs more than larger MNEs.

[10] Vide Section 2.4.2.3
[11] Vide Section 2.1.2
[12] Vide Section 2.1.2

4.2.3 Foreign Direct Investment

After the analysis of the effect of the TPRs on taxpayers, and tax practitioners' and officials' knowledge and experience in TP, this sub-section shall review the impact of the TPRs on FDI.

On the one hand, a sizeable proportion of respondents (10/12) believe that the introduction of the TPRs will not detract as much FDI as feared. All in all, these findings show that practitioners' expectations regarding the effect of introducing TPRs on FDI are in line with Buettner, Overesch et al. (2017),[13] who concluded that TPRs do not have significant adverse effects on FDI. Various arguments were put forward as to why the TPRs should have a limited impact on FDI. One of the main reasons given by these respondents (6/12) is that Malta was the last jurisdiction in the EU to apply specific TPRs. One of these practitioners (1/12) claimed that, had Malta been at the forefront of introducing TPRs, then his opinion would have been the obverse.

Furthermore, a number of respondents (7/12) commented that the absence of TPRs "carried a negative connotation", which tarnished the reputation and the perception that foreign investors have of Malta. A few (4/12) added that the introduction of TPRs will indicate that Malta wants to "move forward and evolve". Two practitioners (2/12) claimed that such rules should eliminate FDI that "was attracted to Malta for undesirable purposes, and which we should not be concerned about losing". Touching upon this, some other respondents (4/12) mentioned that as a jurisdiction, especially due to the current international environment,[14] we should seek to attract quality investment into Malta which "is not solely tax driven."

On the other hand, the other tax practitioners (2/12) emphasised that they think that the TPRs will negatively affect Malta's attractiveness for FDI as a "tax-friendly jurisdiction". This reflects the discussion by de Mooij, Liu (2020).[15] Another reason provided is that the introduction of TPRs will require MNE to conduct TP studies and have TP documentation in place. One respondent (1/12) believes that companies' attempt to find ways to minimise their tax, and has reservations that entities will incorporate a

[13] Vide Section 2.4.4
[14] Pillar 2 – Aims to limit tax competition
[15] Vide Section 2.4.4

company in Malta if the tax saving would be minimal, due to the introduction of the TPRs.

To counter the argument that TPRs may be an added compliance burden, the ICTU representative discussed that MNEs are still likely to be required to prepare documentation for other jurisdictions, therefore, pointing out that probably most, if not all, of the MNEs would already have such documentation prepared. In addition, it was highlighted that Maltese parented companies are already required to file a CbCR under DAC 4, in accordance with BEPS Action 13.[16]

Several respondents (4/12), although acknowledging that the TPRs will be seen as an additional compliance expense and an increase in the complexity in filing the tax return, were in agreement with the argument brought forward by the ICTU official. This is mainly attributable to the practice that several clients have already been transacting at AL, since other jurisdictions have TPRs in place, and since reference to AL in domestic legislation has been present prior to the introduction of the TPRs.[17]

Therefore, to avoid deterring FDI as a result of TP documentation costs, the researcher accentuates the importance of limiting the level of excessiveness associated with TP documentation requirements, as per the discussion by Saunders-Scott (2013).[18] In addition, these findings support the motion that TPRs should safeguard Malta in terms of reputational purposes as argued by Rapa-Manche' (2002).[19]

[16] Vide Section 2.2.5
[17] Vide Section 2.4.1
[18] Vide Section 2.2.5
[19] Vide Section 1.3

4.3 The Local TPRs

4.3.1 The Basis of the Local TPRs

The second objective of this dissertation is to assess the local TPRs recently published by the OCfR.

The Consultation Document published by the OCfR states that "it is envisaged that the OECD TPGs will constitute an important source of reference in the application of the rules."[20]

In order to understand the views of the key stakeholders, all interviewees were asked to what extent the OCfR should focus and depend on the OECD TPGs as a basis for the local TPRs and guidelines (which will be issued in due course), and how viable it is to rely on them.

The high-ranking official from the ICTU strengthened the position taken by the OCfR during the consultation stage by reiterating that it is envisaged that Malta will refer to OECD TPGs as an important source of reference in determining the ALP. This is especially relevant since Malta currently follows the OECD TPGs for Advanced Revenue Rulings and bilateral and multilateral MAPs.

In support of this argument, three practitioners pointed out that the majority of double tax treaties (DTT) are based on the OECD MTC, and that the OECD TPGs are used to interpret Article 7 and Article 9 in a DTT. Furthermore, some tax practitioners (4/12) highlighted that the ITA and ITMA already provide that transactions between foreign non-residents should be at AL.

Echoing the response by the representative from the ICTU, all of the tax practitioners (12/12) argued that the OECD TPGs are the standard that is accepted and referred to by most jurisdictions. In fact, as pointed out by three interviewees (3/12), Brazil which was one of the few major economies with a TP regime not fully in line with international standards passed Provisional Measure No. 1,152, via which OECD-aligned TPGs were introduced by shifting from formula-based TP to an AL standard.

[20] Vide Section 2.4.2.1

In this respect, interviewees (6/12) declared that it would not make sense that Malta would have guidelines which are different from the OECD. This is due to the importance of basing our TPRs on the OECD TPGs, to enable tax practitioners and the OCfR to use such guidelines as a second reference following the publication of the local guidelines. Moreover, two senior managers (2/12) from the Big Four addressed the fact that Malta does not have the resources and expertise to build its own set of guidelines. As stated by a tax partner of a mid-tier audit firm (1/12), the OECD TPGs "should be the starting point and they will probably be even more than just a starting point".

Furthermore, two tax partners at a mid-tier audit firm and a senior manager of a Big Four firm (3/12) called for "simplicity and consistency", so that "investors would know what to expect" from the Maltese TPRs. One of these respondents (1/12) remarked that "Malta has always thrived in facilitating business and making the fiscal aspect not as burdensome as other jurisdictions".

In this regard, a sizeable proportion of interview participants (9/12) emphasised the importance of the approach taken by the OCfR that took into consideration the particularities of the local scenario, namely that Malta is a small island state. The researcher is of the opinion that such a practical approach has been taken by buttressing the reference to the OECD TPGs with something more specific to Malta. This has been accomplished by establishing our own carve-outs, thresholds and having the ability to choose which updates of the OECD TPGs to adopt, for the purpose of applying the TPRs in a way that best fits the Maltese international tax landscape. This is in line with the discussion by Knoll and Riedel (2014)[21] who found that countries augment their corporate tax regime through the introduction of the core principles of the OECD TPGs into domestic law and subsequently implementing specific adjustments to conform to their regulatory backgrounds and established tax practices.

The ICTU representative clarified that "practitioners will be encouraged to follow the OECD TPGs for the general principles". Meanwhile, the local guidelines which will be issued in the coming months will guide the interpretation of the TPRs. The guidelines of such rules will make specific reference to the OECD TPGs, where it will be

[21] Vide Section 2.1.3

recommended that practitioners will follow such guidance to determine the AL price. However, it was made clear by the ICTU official that the OECD TPGs are not binding, as per Aquilina (2016).[22]

In fact, a few participants (3/12) commented that, even though the consultation document and the TPRs make it clear that the OECD TPGs will be an important source, the OCfR gives the impression that the OECD TPGs will not be the only set of guidelines which may be applicable in Malta. These participants, two senior managers in Big Four firms and a director of a boutique accounting firm opined that, although the OECD TPGs are an important source and Malta as a jurisdiction should focus on them, the OCfR should "let the window open" for taxpayers to refer to guidelines other than the OECD TPGs and enable practitioners to deviate from them if relevant and based on judgement.

Therefore, the researcher could argue that on the one hand, it would make sense to have the OECD TPGs applied in Malta as discussed by Navarro (2023),[23] especially since they are the most widely used guidelines. But on the other hand, since the Maltese tax practice is internationally focused, leaving room for flexibility would make Malta more attractive than other jurisdictions. The downside to this arises from both the administrative and compliance perspective. The OCfR might not be able to comprehensively scrutinise the TP documentation submitted by certain taxpayers that follow other TPGs other than the OECD TPGs. Meanwhile, the researcher acknowledges that Maltese tax practitioners may encounter issues due to resource limitations, feasibility and expertise.

4.3.2 Computational Rule

The Consultation Document specified that the requirement that emanates from the TPRs for the application of the ALP is a computational rule for income tax purposes and should not impact commercial arrangements between the parties involved.[24]

When asked to elaborate further on this, the ICTU representative explained that the main objective of TPRs is to ensure that transactions are correctly priced, consequently, ensuring that profits are located where value is being created. Hence

[22] Vide Section 2.2.1
[23] Vide Section 2.2.1
[24] Vide Section 2.4.2.2

tax authorities, including the OCfR must ensure that there is a balanced allocation of taxing rights between MS where entities are located. Several respondents (7/12) acknowledged that this requirement seeks to make sure that profits are taxed where there is substance and where value is created.

The interviewee from the ICTU continued by elucidating that an imbalanced allocation of taxing rights may result in TP adjustments, as mandated by Article 9(2)[25] of the OECD Model Tax Convention, whereby tax authorities will jointly determine whether they will agree on an adjustment or otherwise. Furthermore, artificial schemes which create circumstances under which no tax or minimal tax is levied may be disregarded if they have no commercial justification.

From these findings, the researcher can conclude that the TPRs put forward a computational requirement for the purposes of the ITA and not for any other purpose, as provided by Rule 8,[26] and does not propose to impact the commercial arrangement between the parties. However, if following a functional analysis by the OCfR it transpires that the actual conduct of the parties differs from what is outlined in the contractual agreements, the TP adjustment of the entity must be reported in the Income Tax return. The amount of the adjustment will reflect the conduct of the Maltese entity or entities, to ensure that profit is allocated where value is being created.

One particular interviewee (1/12) articulated that it is intriguing that the OCfR specifically stated this in the Consultation Document; remarking that it effectively means that the OCfR will allow AEs to transact not at AL, and subsequently adjust for income tax purposes.

As such, the researcher deduces that, although this requirement will increase complexity, it will be perceived as less draconian, because the impact of the TPRs will be felt solely for income tax purposes.

Opinions were more divided when respondents were asked whether the local TPRs should be considered as an anti-avoidance rule rather than a computational rule.

Only one practitioner (1/12) did not agree that the TPRs are a computational rule because he said that their ultimate aim is to curb aggressive tax planning. Meanwhile,

[25] Vide Appendix A
[26] Vide Section 2.4.2.3

half of the respondents (6/12) remarked that, although it is clear that there is a computational aspect, since the TPRs require taxpayers to ascertain their taxable income by adhering to the ALP, there are "traces of the original intent" emanating from the BEPS Project. Thus, these practitioners asserted that although the practical point of view is computational, "one should not exclude the anti-avoidance aspect", particularly due to the fact that specific TPRs have been implemented by the Maltese government as part of Malta's RRP, as approved by ECOFIN, following international pressure. The literature confirms this, since it is stated that the original intention of TPRs was an anti-avoidance mechanism, which has now shifted to determining the best way to allocate profits to entities within the group in different countries (Schoueri 2015).[27]

However, some participants (5/12) asserted that TPRs are "part of the computational element of the tax system", and definitely not an anti-avoidance rule. This is because, as explained by a practitioner, if it were an anti-avoidance rule, the OCfR would accuse the taxpayer of tax avoidance, specific penalties would be imposed and submission of TP documentation would be required. In support of this rationale, the interviewee added that TP in Malta should comprise a negotiation through discussion between the OCfR and the taxpayer, with the aim of agreeing on the correct pricing, by following the appropriate TP method. In reply to this, another tax practitioner (1/12) opined that the introduction of TPRs is a way of instilling certainty in a scenario, rather than as an anti-avoidance measure.

4.3.3 Definition of Associated Enterprises

The researcher appraised the stakeholders' opinions on the definition of AE[28] given in the local TPRs.

Primarily, a few respondents (3/12) underlined that different jurisdictions have different thresholds that define AE. They noted that although 50% is the most common threshold, some countries go even lower.

The ICTU representative indicated that during the consultation period, several practitioners and bodies argued that the TPRs will increase the burden on MNEs and

[27] Vide Section 2.4.2.2
[28] Vide Section 2.4.2.3

entities registered in Malta. Therefore, it was decided by the OCfR that unless the global revenue of the MNEs is more than €750m, the threshold will rise from 50% to 75%.

Unexpectedly, only four tax practitioners (4/12) were in favour of the threshold being as high as 75%. These respondents suggested that the 50% threshold indicated in the Consultation Document "would have shocked the system" because it was too low and hence, too aggressive. These respondents claimed that some stakeholders were in favour of a low threshold only due to reputational purposes, and "did not look at the bigger picture".

Those against the threshold being as high as 75% (9/12) accepted that the intention behind such a figure is to avoid having a significant impact in the initial years of implementing the TPRs locally. In fact, a couple of respondents (3/12) qualified their opinion by stating that they agree with the 75% threshold solely as an introductory measure, and on the basis that it is decreased in the future, in order to make the definition of AEs more comprehensive. Others (5/12) argued that the initial proposed threshold of 50% would have worked in practice and that the revised 75% threshold "dilutes the effect of TPRs".

Therefore, the researcher suggests that the definition of AEs should be decreased in phases over a period of time. Simultaneously, this would provide stakeholders with an opportunity to acquire a broader knowledge and expertise on TP.

Nonetheless, a practitioner (1/12) claimed that in his opinion, the threshold should have been even less than the 50% proposed in the Consultation Document. He acknowledged that the majority of stakeholders will not agree with this opinion, namely because such definition would be more onerous for stakeholders. He added that anti-avoidance rules in line with EU countries, and therefore the wider definition of AE, should also be introduced within the TPRs. This respondent concluded by saying that any threshold above 50% is futile because the taxpayer will have control from a TP perspective. Another respondent (1/12) also hinted at the lack of effectiveness that may emanate from this definition especially since the vast majority of domestic businesses are owner-managed or family businesses.

In light of these findings, the researcher recommends that as an anti-avoidance measure, the definition of AEs should also have included a body/body of persons

controlled by a "relative" thereof, similar to the definition of AEs in Ireland.[29] This should restrict the abuse of the AEs definition, without making it more burdensome for taxpayers and the OCfR.

4.3.4 SME Carve-out

The researcher attempted to gauge the interviewees' opinions on whether they agree with the carve-out that arises due to the SME definition[30] in the local TPRs.

The ICTU representative argued that the rationale behind this carve-out is to "find a balance between the interest of the taxpayer and the tax authority", which will be sought on various aspects.

Three respondents (3/12) pointed out that the carve-out will indirectly scope-out the majority of domestic businesses from the TPRs. Out of the tax practitioners interviewed, the majority (10/12) agreed with the SME carve out, since the TPRs would be "a huge administrative expense for SMEs". A number of respondents (4/12) added that SMEs cannot be expected to take on the same compliance obligations as a large MNE.

Furthermore, a number of interviewees (5/12) observed that from a transitioning perspective, it was "the most practical move" since the "resources of the tax department are not infinite" and it would be "pointless" to apply TPRs to all companies and subsequently not being able to monitor and enforce. To support their argument, a few respondents (4/12) commented that tax practitioners would have also been overwhelmed without such provision in the local TPRs.

Nonetheless, the researcher opines that, if it is anticipated that the SME carve out is removed in the future, a provision should have been included, stipulating when SMEs will fall in scope of the TPRs. This would enable a ramp-up to the level of preparedness in terms of training and awareness for SMEs.

One of the two respondents (2/12) who argued against the SME carve-out, qualified her position by stating that although she does not agree with the principle behind the provision, she understands that there needs to be a balance between the risk of losing tax revenues with the complexity and administrative burden of TP documentation on

[29] Vide Section 2.2.2
[30] Vide Section 2.4.2.3

SMEs. The other respondent questioned the real premise behind the introduction of the TPRs, which is that of satisfying the parameters required by RRP that enables an MS to access EU funding under such instrument.

4.4 Interaction of TPRs with certain aspects of Maltese Tax Law

The researcher asked about the anticipated interaction of the TPRs with certain aspects of the Maltese tax law. A few respondents (4/12) immediately expressed their doubts on whether the interaction of the TPRs with our Income Tax laws has been studied in sufficient detail, and as such, they called for further studies to be conducted.

The main responses put forward considered the GAAR, the Notional Interest Deduction (NID), Fiscal Unity and Capital Gains Rules.

4.4.1 GAAR

In terms of GAAR, a number of tax practitioners (5/12) stated that the "TPRs go way beyond the GAAR". One of the tax practitioners (1/12) expressed that this is the case because the aim of GAAR is that the tax base in Malta is not eroded, thereby, meaning that the income is not understated and the expenses are not overstated. Nonetheless, the GAAR is not concerned with the income being overstated and the expenses being understated, because by having income which is overstated and expenses being understated would increase the Malta tax base, potentially at the expense of another jurisdiction.

This interviewee concluded by stating that the TPRs will not only ensure that the income is not understated and the expenses are not overstated but also ensure that the income is not overstated and the expenses are not understated. Thus, it could be the case that the application of the TPRs in Malta leads to the lowering of the tax base in Malta.

Furthermore, these tax practitioners argued that, since the OCfR was too dependent on Article 51, the TPRs should relieve the pressure off of the GAAR, meaning that "the TPRs and GAAR go hand in hand". In line with this, the ICTU official and a lawyer from a Big Four firm highlighted the relationship between the non-genuine arrangement under GAAR and the economic reality that must be reflected under the TPRs, in order arrive at the correct pricing of the transaction.

4.4.2 NID

With respect to the NID, there was a general agreement between participants (4/12) that the TPRs will not greatly impact the NID.

Having said that, these respondents identified a “chicken and egg situation” of whether to start by applying the TP principles or by calculating the NID. There was a consensus in favour of the former. The ICTU representative clarified that the guidelines which will be published on the TPRs will likely specify that the application of the TPRs shall precede the application of the NID. Thus, an entity within scope of this rule shall first determine the nature of the funding in terms of the TPRs before determining whether any such funds fall within the definition of risk capital in terms of the NID rules.

However, two of the participants (2/12) probed deeper and added that issues could arise in cases where debt payable is recharacterized as equity due to TPRs. This is especially relevant on the basis that in Malta, there is the possibility of claiming NID on interest-free loans. This led these participants to question whether this would mean that an instrument may only be partially applicable to NID, if at all.

4.4.3 Fiscal Unity Regime

Few practitioners (3/12) maintained that they envisage that there will be a certain level of interaction between the TPRs and the fiscal unity regime when arriving at the chargeable income of the company. The respondent from the ICTU explicated that the TPRs adopted a separate entity approach, which contrasts with the consolidated group income tax rules, which state that all entities within a fiscal entity are treated as one unit.

Hence, the researcher acknowledges that this area needs to be studied in further detail.

4.4.4 Capital Gains Rules

Surprisingly, only one (1/12) tax practitioner called for the need to assess the juxtaposition of the TPRs and certain rules of valuation such as the capital gains rules. The ICTU representative also acknowledged that there may be an issue with how the capital gains rules will interact with the TPRs.

The researcher contends that that this needs to be discussed in further detail especially due to the "market value" and "related persons" definitions in S.L. 123.27 which apply to the transfer or receipt of capital assets. Thus, further clarification is called for in order to avoid the uncertainty which may arise.

4.5 The AL Principle

4.5.1 Comparability Analysis

In accordance with the OECD TPGs "comparability analysis is at the heart of the application of the ALP."[31] The comparability factors are to be identified in the commercial or financial relations between the AEs in order to accurately delineate the actual transaction.

4.5.2 Complexities that may arise

The researcher discussed the practical challenges in determining the economically relevant characteristics of the accurately delineated transaction with the respondents.

The majority of tax practitioners (8/12) stated that the main challenge that will emanate from the comparability analysis, in order to accurately delineate the actual transaction, is identifying true comparables. The main reason for this, as recognised by interviewees (5/7) is the lack of domestic information in finding local comparables. Another respondent (1/12) even added that it is problematic that there is no availability of Maltese data in the financial databases currently available, or data through providers such as Amadeus or Sirius. Especially since, as remarked by a few practitioners (5/12), when comparing with other EU islands, such jurisdictions have several different characteristics from Malta, such as the country's economy and the level of political stability. This was discussed by Hofmann and Riedel (2018).[32]

Nonetheless, three interviewees (3/12) with experience of working on TP abroad claimed that, although it will be difficult to find local comparables, this is an issue that exists in other EU countries. As such, tax authorities in different EU countries are likely to accept comparables from other EU countries due to the same currency, similar legislation and other similarities. Hence, these practitioners argued that data could be

[31] Vide Section 2.2.4
[32] Vide Section 2.2.4

extracted from EU, central EU-wide sets, eastern/western EU or Island EU data sets, and subsequently include the applicable adjustments. In connection with this, an interviewee (1/12) added that it is essential to apply "intelligence and deductive reasoning to filter out data which is incomparable".

With regard to this, some of the respondents (4/12) also emphasised the importance of adjustments within the benchmarking study in order to tackle the issue of comparability. A practitioner (1/12) suggested that initially, one should start each and every situation by identifying the economic variables and then subsequently move on to identify the comparables, including jurisdictional comparables, industry comparables and size comparables. One of these respondents (1/12) explained that country-specific factors can be factored in, making the data comparable through an adjustment in various forms, such as a multiplier or a percentage. He added that the country-specific factors are additional variables, that will only marginally alter the data. Thus, he concluded that using an EU database will provide robust data.

This ties in with the recommendations by Muyaa (2014),[33] as it is suggested that practitioners apply multiple-year data in order to balance out differences in comparables. Moreover, the researcher recommends utilising an option that is being applied by most tax authorities; identifying and using a specific point within the AL range.

A few of the interviewees (3/12) specifically mentioned issues in searching for economically relevant characteristics delineating financial transactions. They accentuated that the OECD TPGs present a number of examples illustrating such transactions, which only take place within a MNE scenario because there is no market for them or no requirement for them in the open market. This includes captive insurance, insurance, re-insurance, cash pooling and other synergetic activities such as exploiting the name of a trademark or just being part of a group. The difficulty arises when the advisor has to utilise the examples provided to extrapolate your own analysis. Three interviewees (3/12) referred to company financing as another complexity that will arise due to intercompany loans, which are issued at a nominal rate or interest-free, and thus not necessarily at AL.

[33] Vide Section 2.2.4

In light of these findings, the researcher calls for the inclusion of a number of specific examples, especially with respect to complex transactions, in the guidelines that are to be published by the OCfR that may be helpful in supporting the comparability analysis.

Surprisingly, only a single respondent (1/12) alluded to the selection of the most pertinent TP method to apply as a complexity that should be considered by tax practitioners and the tax authority. As emphasised in the OECD TPGs, this is one of the most important stages in a thorough comparability analysis[34], and is identified as a source of complexity in TP.

Half of the practitioners (6/12) mentioned that another challenge arises from the application of the de minimis threshold articulated in Rule 9[35]. One of these practitioners (1/12) explained that lack of clarity arises since in order to determine whether an entity falls within or out of the threshold, the calculation of the aggregate AL value may have to be conducted.

4.5.3 The Accurately Delineated Transaction

The ICTU official, upon further probing, stated that so far, the OCfR does not have any database software, but the official assumes that in the future, the tax authority will have to acquire at least two separate databases. With respect to the choice of software to be used, the official ensured that the OCfR will not impose any database on taxpayers, but a recommendation could be made once the OCfR decides which database to use. Furthermore, the official said that, based on recommendations by other jurisdictions, there are two separate forms of databases being; EU-based databases and worldwide databases. Moreover, the official also pointed out that other jurisdictions deploy various databases, namely a database for financial transactions and for commodities, amongst others. In fact, interviewees (8/12) mentioned that appropriate databases have to be found depending on the type of transactions. Additionally, a number of respondents (5/12) indicated that the tax authorities of other jurisdictions provide taxpayers with information to find comparables through databases, a list of comparables and case law.

[34] Vide Section 2.2.3
[35] Vide Section 2.4.2.3

Thus, the researcher recommends that the OCfR should provide suggestions on which databases could be used, datasets and/or publish their own comparables. The creation of public databases, providing reliable information on comparability data could help both the OCfR and taxpayers to apply the ALP as discussed by Navarro (2021).[36]

4.6 Tax Administration and Dispute resolution

The third objective of this dissertation seeks to investigate what the introduction of the local TPRs will mean to the OCfR in terms of administration and dispute resolution. Not only will the taxpayer and tax practitioners have to deal with the implications of the TPRs, but the OCfR will also be affected in terms of their complexity in the context of enforcement.

4.6.1 Unilateral TP Rulings and APAs

The researcher wanted to know where the respondents stand with respect to Rulings being included in the local TPRs. Unsurprisingly, all the tax practitioners (12/12) agree with such rulings being requested by taxpayers.

It was brought forward by some practitioners (3/12) that this provision has created a "formal Unilateral TP Ruling Regime" which is "in line with the general rulings in the ITA". One interviewee stated that Rulings are "important as a starting point because specific situations would warrant a Ruling, thus TPRs have to cater for that option as well", as discussed based on the argument by Beebeejaun (2020).[37] However, in a situation where more than one jurisdiction is contesting the TP, it will not be that helpful to have a Ruling.

This is due to the comments brought up by the majority of respondents (7/12), who acknowledged that Rulings may not provide tax certainty in a MNE set-up because this procedure does not guarantee that double taxation will be eliminated. Therefore, as pointed out by the ICTU official, Rulings provide tax certainty for covered transactions in Malta, and may be more helpful in instances when there is no double tax treaty between Malta and the other jurisdiction. As remarked by a tax practitioner (1/12), multilateral and bilateral APAs are the complement of Rulings because they provide the taxpayer with certainty in more than one jurisdiction. This results from a

[36] Vide Section 2.2.4
[37] Vide Section 2.2.6.1

reasonable agreed approach between two competent authorities, since the taxpayer is not included in the negotiation in any way.

This confirms Kuropka's (2020)[38] argument that Bilateral and Multilateral APAs should be recognised as a tool which can effectively impact tax risk management through limiting the negative tax consequences which may arise.

All the interviewees (12/12) recognised the role of Multilateral and Bilateral APAs in providing tax certainty to taxpayers on specific transactions for a period of time. Its importance was highlighted by a respondent who stated that "one of the main issues with TP is that there is a lot of uncertainty, so anything to improve the level of certainty is a plus". The ICTU official explained that APAs provide tax certainty on the TP policy being applied, including the TP methodology, and the pricing of the transactions, conditional on the facts and circumstances remaining the same. Several practitioners (8/12) claimed that through an APA, they expect to be "informed of the consequences of a transaction from a taxation point of view". This argument is in line with Rathke, Rezende et al. (2022).[39]

From the findings, the researcher can infer that one of the main purposes of TPRs is to provide taxpayers certainty through rulings and APAs. Furthermore, the TPRs allow taxpayers to request a Ruling or multilateral and bilateral APAs.

The ICTU representative also highlighted that the local APAs allow a rollback period. Unexpectedly, only one practitioner, a senior manager at a Big Four firm, accentuated the importance of such a rollback period in practice, especially since most issues with respect to APAs arise due to timing. This finding suggests that practitioners should be aware of the prospective incentives of APAs mentioned by Tamburnan, Rosdiana et al. (2020).[40]

A couple of respondents (2/12) also commented on the practicality of requesting a Ruling. They explained that taxpayers who require an issue to be resolved in a timely manner should opt for a Ruling because the other types of APAs take too much time. In fact, a sizeable portion of the respondents (7/12) and the ICTU official pointed out that "APAs take months if not years to complete". Furthermore, a practitioner (1/12) asserted

[38] Vide Section 2.2.6.1
[39] Vide Section 2.2.6.1
[40] Vide Section 2.2.6.1

that Unilateral TP Rulings are “the only realistic option”, due to the substantial amount of resources that it would require from the tax authorities to enter into a multilateral or bilateral APA.

These arguments contrast with the findings from the study by Becker, Davies et al. (2017)[41] which shows that a hold-up problem from a time-inconsistent tax authority is solved through the implementation of an APA.

Half of the respondents (6/12) also pointed out that requesting an APA is a costly exercise, especially due to the internal and external resources required from the taxpayers’ perspective. In addition, an interviewee (1/12) also brought up the argument that when entering into an APA, the taxpayer has to disclose a lot of information upfront. Notably though, only a couple of respondents (2/12) maintained the importance of having sufficient evidence and a robust argument for the pricing to be proposed in the APA since the tax authority may not agree with the position brought forward by the taxpayer.

Three interviewees (3/12) specified that APAs are arduous to conclude because they involve the revenues of jurisdictions, and each jurisdiction will be reluctant to give up revenue. Thus, the complexity of getting the jurisdictions involved to agree makes it more practical to enter into a Unliteral TP Ruling. In fact, another two practitioners (2/12) made reference to the 2021 MAP statistics, in which TP accounted for a substantial percentage of MAP procedures. These comments echo Ignat’s (2017)[42] study which discussed the main advantages and disadvantages of APAs.

A number of practitioners (7/12) commented that requesting an APA depends on a number of factors. This includes: the level of substance of the transaction, the risk related to the transaction’s materiality, the complexity of the transaction and the aggressiveness of the tax authorities involved. Based on these arguments, a few practitioners (4/12) agreed that the OCfR did not only focus on Multilateral and Bilateral APAs.

The researcher asked whether the OCfR has the intention of issuing practical guidelines for taxpayers to negotiate and implement Rulings. The ICTU representative

[41] Vide Section 2.2.6.1
[42] Vide Section 2.2.6.1

replied that although it is not envisaged that further guidance will be issued, if various requests are received in the future, and further clarification would be required, further guidance may be issued eventually. This is in line with the recommendation by Kuropka (2020).[43]

Also, a few practitioners (3/12) conveyed their fears that the EC may conclude that a Ruling may be considered to constitute State Aid if it is proven that a MS has given a particular MNE a tax advantage not available to their rivals, which harms fair competition in the EU. Consequently, the ICTU representative stated that in line with DAC 3,[44] any Rulings issued are exchanged between MS so that jurisdictions are aware of what other jurisdictions are providing certainly on. One of the tax practitioners (1/12) added that taxpayers should reconsider requesting a Ruling the moment that such APAs start being attacked by media, claiming that an agreement was reached with the tax authority in order to deprive society of its rightful tax revenue.

In light of the unintended consequences of APAs, the recommendation discussed by Eden and Byrnes (2018)[45] resonates with the researcher, as such, the OCfR could make information on individual APAs more publicly available.

4.6.2 Penalties

The OECD TPGs emphasise that penalties would encourage compliance with the TPRs. Therefore, the researcher felt compelled to ask the ICTU representative to provide justification as to why specific penalties have not been introduced in the TPRs. The reasoning given for this was that since TP is new to the Maltese tax landscape, both the tax practitioners and the OCfR will require time to get to grips with TP, and also in order to initially gauge the impact of the TPRs on the economy as a whole. The Official clarified that the omissions tax and other penalties as regulated by the ITA will be applicable, but there are no specific penalties for non-compliance with the TPRs.

A number of the respondents (8/12) agreed with the fact that penalties have not been introduced from the outset, but they also acknowledged that penalties should be introduced in the future, once the “grace period” is over. Meanwhile, a few interviewees

[43] Vide Section 2.2.6.1
[44] Vide Section 2.2.6.1
[45] Vide Section 2.2.6.1

(3/12) stated that penalties should not be introduced to avoid attaching "negative connotations" to TP.

One practitioner (1/12) argued that "penalties should have been included in the TPRs, because companies will have no incentive to conduct a TP analysis if there are no penalties". In reply to this, the official from the ICTU said that it is in the taxpayers' interest to ensure that the required documentation is in place, in order to defend their position by establishing the evidence and justification for the pricing of a transaction or a series of transactions and ensuring that the correct pricing is applied. This is because if there is no audit on the Maltese entity by the Maltese tax authority, the other jurisdiction may still audit the MNE.

Hence, the researcher suggests that if introduced, penalties should be relatively low and gradually increased, in order to protect practitioners by enabling them to get used to the requirements of the TPRs and give them appropriate time to learn, with small penalties in place. With reference to this, a few interviewees (5/12) commented that if introduced, specific TP penalties should be "fair and proportionate to the offence."[46]

Furthermore, those that agreed that TP penalties should be introduced in the future (8/12) were asked whether the current penalty regime should be extended to TP, or whether specific penalties should be applied.

Two respondents (2/12) argued that penalties should be introduced by extending the current regime because "penalties should be consistent across the board, not to complicate matters." Conversely, half the practitioners (6/12) remarked that the current penalty regime should not be extended to TP, since such system is "controversial and not fit for purpose, especially for TP which is highly technical".

One practitioner explained that a mere disagreement between OCfR and taxpayer may become quite expensive for a taxpayer acting in good faith. As such, these interviewees added that the tax authority should distinguish between penalties relating to cases where there is a clear sign of negligence or an actual intent to avoid tax, and penalties relating to an error in good faith. Moreover, another respondent pointed out that it would not be fair to impose a TP penalty on taxpayers who made "reasonable

[46] Vide Section 2.2.6.2

effort to set the terms of their transactions with AEs at AL", or for "failing to consider data to which was not accessible or available to the taxpayer".

Resulting from these findings, the researcher recommends that there should be a standalone ad hoc penalty regime which takes into account the high degree of complexity of TP.

4.6.3 Tax Audits and TP Documentation

A few respondents (4/12) attested to the lack of clarity in Rule 6 of the TPRs, mainly due to the lack of detail provided regarding what is "actually required to be kept on file."

Hence, the ICTU representative explained the various levels of scope and intensity to which tax audits are conducted, depending on whether it is an inquiry audit or a full audit.

Moreover, the official mentioned the main reasons for a TP audit to be conducted. Primarily, a TP audit can be undertaken to verify whether a TP adjustment that emanates from a tax audit of another jurisdiction is correct or otherwise. Secondly, local TP auditors may ask some questions to shed light on the functions performed and the risks assumed by the Maltese entity, through functional interviews and functional questionnaires. Thirdly, taxpayers may also be asked for documentation outlining accurate explanations and justification for related party policies and arrangements, and the rationale behind the pricing of intragroup transactions. Finally, the ICTU official indicated that tax auditors may also ask for trial balances, invoices and other relevant information.

From these findings, the researcher calls for further clarity on behalf of the OCfR when it comes to the records which taxpayers are required to prepare and retain.

4.7 Concluding Thoughts

Due to the subjectivity associated with TP, this chapter adopted a discussion approach which took into consideration the added complexity and burdens associated with TP. The implications on Malta's reputation were also acknowledged by respondents.

In addition, practitioners (7/12) reiterated the importance of continued communication between stakeholders for the purpose of revisiting what kind of requirements are needed for the purpose of a applying the ALP, together with an effective and efficient

dispute resolution mechanism. This was reciprocated by the ICTU official by highlighting the importance of a healthy relationship between practitioners and the tax authority.

Chapter 5: Conclusion and Recommendations

5.1 Overview

This research project was concerned with analysing the practical implications of the recent introduction of TPRs on the Maltese international tax landscape. In this vein, the researcher set out to determine the complexities that arise in terms of tax compliance and tax administration and to investigate the interaction of these rules with certain aspects of the local tax law.

The three research objectives were achieved through semi-structured interviews which the researcher conducted with twelve tax practitioners and an official within the ICTU. The findings emanating from these interviews were subsequently discussed in the previous chapter and are summarised in this chapter. The data collected led to a number of recommendations, and identified areas for further research.

5.2 Summary of the Study

5.2.1 The Impact on Tax practitioners, Taxpayers and FDI

From the research performed, it appears that there is a knowledge gap within the Maltese landscape when it comes to TP, which necessitates upskilling. Nonetheless, knowledge on the subject is improving and more importance is being given to the subject within the local fora. In the absence of TP practice, there is also a lack of expertise in the local market. Furthermore, smaller audit firms may experience greater challenges because of the lack of expertise on TP in general and due to the added resources required.

The research revealed that TP should not be a challenge to proactive MNEs, since such groups would already have intra-group agreements in place which adhere to the AL Principle. However, TP could potentially be quite arduous on entities that were under the incorrect impression that they would be out of scope from the TPRs. Additionally, the importance of a fact-finding exercise was emphasised when analysing intra-firm contracts. The importance of the grandfathering provision in limiting the impact of the TPRs was highlighted, but arrangements entered before the 1st of January 2024 should still be reviewed and updated to apply best practice. The importance of contracts reflecting substance could not be overstated to avoid the risk of TP adjustments and it was determined that it is essential that such contracts are

tested to ascertain whether conduct of parties is in line with the written arrangements. Finally, the SME carve-out was welcomed by practitioners due to the high compliance burden associated with TP documentation, the complexities of TP and as such, the extension of the TPRs to such entities is not proportional to the risk of mis-pricing occurring.

The TPRs should not detract as much FDI as feared, mostly due to the fact that Malta was late in introducing TPRs. Rather, the TPRs may enhance Malta's reputation since the lack of TPRs carried a negative connotation.

5.2.2 On the Introduction of TPRs in Malta

The importance of the approach taken by the OCfR of buttressing the reference to the OECD TPGs with the specific characteristics of the local scenario was accentuated, especially since Malta is a small island state. The expectation is that it will be recommended that practitioners follow the OECD TPGs to determine the AL price, implying that practitioners may also refer to alternative TPGs.

The research finds that although the TPRs do not propose to impact the commercial arrangement between the parties, a TP adjustment of the entity must be reported in the Income Tax return if it is determined that the actual conduct of the parties defers from what is outlined in the contractual agreements.

5.2.3 On the Interaction with Aspects of Maltese Tax Law

This study finds that there is a dearth of research regarding the interaction of the TPRs with specific Maltese tax law.

Primarily, this research brings to light that the TPRs should relieve the pressure off the GAAR, since the OCfR was too dependent on Article 51 ITA. Secondly, it is anticipated that the application of the TPRs shall precede the application of the NID. Thirdly, it is expected that when arriving at the chargeable income of an entity, there could possibly be a degree of inconsistency between the Fiscal Unity Regime and the TPRs. Fourthly, greater awareness should be made with respect to any implications that TPRs may have on the Capital Gains Rules.

5.2.4 Administering the Arm's Length Principle

It is probable that the application of the ALP in practice will probably be supported through recommendations by the OCfR, indicating databases that may be used for comparability analysis. One of the main complexities mentioned by practitioners is the lack of local comparables, but this is a common issue in a number of jurisdictions. As such, by including the applicable adjustments and filtering out incomparable data, EU databases should normally be acceptable by the tax authority.

5.2.5 Tax Administration and Dispute Resolution

This study confirmed that although Rulings are practical in their application, since only the Maltese tax authority is involved, tax certainty is not guaranteed. Certainty is provided through the APAs, but these may prove to be prohibitive due to their cost, as well as impractical, since APAs take significant time to be concluded. Hence, a number of factors should be considered before requesting an APA.

5.3 Recommendations

5.3.1 Capacity Building Programs and Continued Education

To address the "knowledge gap" among tax officials, capacity-building programs involving training by TP specialists could be implemented. Furthermore, it is recommended that TP becomes mandated within the CPE requirements for tax practitioners.

5.3.2 Recruiting Practitioners from Abroad or Outsourcing the TP Function

Chapter 4 depicted that the practitioners themselves consider that they have a lack of practical experience in the field of TP. Hence, firms should consider recruiting TP specialists from abroad or opt to outsource the TP function. Additionally, it is recommended that local practitioners seek to acquire practical expertise on the subject through coordination with network firms via secondments.

5.3.3 Continuous Consultation Process

As seen with the adoption of TPRs in Malta, when introducing regulations that could bring about considerable changes to domestic legislation that could potentially have a

broad impact on stakeholders, the importance of consultation cannot be understated. The researcher recommends that the OCfR conduct regular consultations regarding TP, to revisit what kind of requirements are needed for the purpose of a balanced application of the ALP. This could include future consultation regarding the definition of AE, namely whether the threshold should be gradually decreased. It is important to have feedback on whether the grandfathering provision and the SME carve out should be retained or not; and also, whether anti-avoidance provisions such as anti-TP mismatch rules should be introduced within the TPRs and if Malta should adopt a practice of applying secondary adjustments.

5.3.4 Databases and Inclusion of Specific Examples

The researcher recommends that the OCfR provides public databases for comparability analysis to enable adequate enforcement of the ALP. In this regard, it is also suggested that the tax authority issues non-restrictive suggestions on which databases should be used by taxpayers.

In addition, the researcher calls for a sufficient number of the examples being included in the guidelines that are to be published by the OCfR that may be helpful in supporting the comparability analysis, particularly when it comes to complex TP areas.

5.3.5 Accessibility of Bilateral and Multilateral APAs for All Taxpayers

The study reveals that APAs may prove to be prohibitive to certain taxpayers due to the high costs involved. The adoption of a streamlined approach should be considered to make such APAs more accessible to smaller taxpayers that are in scope of the TPRs. This could be achieved by determining the level of inquiry during APA evaluation, depending on the size of the transaction involved.

5.3.6 Practical Guidelines issued for Unilateral TP Rulings

The ICTU should consider issuing practical guidelines for taxpayers for the negotiation and implementation of Rulings, similar to the guidelines issued for the MAP.

5.4 Areas for Further Research

5.4.1 Follow-up Research

Another study can be undertaken a few years from now to assess whether certain provisions of the TPRs should be updated. This could involve revisiting the threshold in the definition of AE, the SME-carve out and the retention of the grandfathering provision.

5.4.2 Comparative Study

This study has analysed the implications arising from the introduction of TPRs in the Maltese landscape. A comparative analysis between the impact of TPRs on other jurisdictions could be conducted to compare the outcome with the implications established in this study.

5.4.3 Prospective adoption of Business in Europe: Framework for Income Taxation (BEFIT)

BEFIT seeks to introduce a single tax rulebook for the EU which aggregates consolidated profits of MNEs in the EU and subsequently, utilising a formulary approach for profit allocation to the respective MS. This formulary approach is suggested as an alternative to the AL Principle, which is the basis of the local TPRs. Hence, a study can be held specifically with how such an initiative could impact the application of local TPRs.

5.5 Concluding Remarks

This research has provided an insight on the practical implications of the local TPRs on the international tax landscape in Malta. This was achieved by assessing these rules and subsequently investigating their compliance and administrative considerations.

In addition to enhancing the local literature on TP, this study should serve as a springboard for tax practitioners, taxpayers, and the OCfR in encouraging further cooperation in order to ensure effective implementation and adherence to these rules.

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Budget Measures Implementation Act, 2021*,* Malta

Income Tax Act, 1994, Laws of Malta Cap. 123

Income Tax Management Act, 1994, Laws of Malta Cap. 372

Subsidiary Legislation 123.207 *Transfer Pricing Rules*, 2022, Malta

Subsidiary Legislation 123.127 *Cooperation with Other Jurisdictions on Tax Matters (Amendment) Regulations*, 2016, Malta

Appendices

Appendix A - Article 9 OECD MTC

ARTICLE 9

ASSOCIATED ENTERPRISES

1. Where

a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State - and taxes accordingly - profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

Appendix B - Interview Questions: Practitioners

Introduction

Question 1

The Consultation Document stated that "it is envisaged that the OECD Transfer Pricing Guidelines will constitute an important source of reference in the application of the rules."

1. In your opinion, to what extent should we focus/depend on OECD TPGs as a basis for the local TPRs and how viable is to rely on them?

Question 2

The Consultation Document specifies that the requirement for the application of the arm's length principle is a computational rule for the purposes of the Income Tax Acts, rather than an anti-avoidance rule.

2. Do you agree with this considering the fact that some may argue that TPRs are generally introduced in order to curb aggressive tax planning?

Interaction of TPRs with current Maltese Law

Question 3

3. In your opinion, how will the introduction of TPRs impact Malta's attractive tax regime and how do you think that the TPRs will interact with certain aspects of Maltese tax law including:

- GAAR,
- NID,
- Fiscal unity regime and
- Anti-hybrid rules

Question 4

Malta's tax regime is viewed as the one of most attractive features for foreign investors.

4. How do you think that TPRs will impact FDI?

Question 5

5. What are the main complexities that may arise as a result of the introduction of TPRs?

Question 6

6. What has been the level of interest in the TPRs from clients, any quires received?

Question 7

7. Rule 8 of the TPRs states that any adjustments made in furtherance of such rules shall be relevant only for the purposes of the ITA.

How important is this article for the purpose of limiting the implications of the TPRs on other laws namely the VAT and the Duty on Documents and Transfers Acts?

Question 8

7. Could you compare and contrast the impact of TPRs on locally parented companies with foreign subsidiaries outside of Malta and foreign parented companies with a subsidiary in Malta?

TP Professionals

Question 9

TP is an area that requires a high level of expertise.

9. What implications could arise with respect to practitioners' knowledge as a result of the introduction of TPRs and will tax practitioners have to upskill?

Scope of TPRs Definitions

Question 10

10. Do you agree with:

a) the carve out that arises due to the SME definition in the TPRs?

b) the 75% threshold that is indicated for voting rights or ordinary shares within the definition of Associated Enterprises provided in the TPRs?

c) The exemptions that arise in Rule 9 of the TPRs?

Comparability Analysis

In accordance to the OECD TPGs "comparability analysis is at the heart of the application of the arm's length principle."

Question 11

The economically relevant characteristics (comparability factors) are to be identified in the commercial or financial relations between the associated enterprises in order to accurately delineate the actual transaction.

11. What are the associated challenges in practice of determining the economically relevant characteristics of the accurately delineated transaction?

Question 12

12. The OECD TPGs emphasizes the importance for the need for an approach that is balanced in terms of reliability and the burden created for taxpayers and tax administrations. How is such balance upheld by the TPRs introduced in Malta?

Question 13

When it comes to the application of the 5 TP methods, TP practitioners refer to benchmarking databases. After choosing one of the methods, a benchmarking exercise is to be undertaken.

13. From a Maltese perspective, what would you suggest to carry out such TP analysis for data be obtained in order to establish the conditions of the commercial and financial relations for the purpose of comparability?

Client Contracts

Question 14

It is being advised that MNEs having a presence in Malta should proactively start analysing their intercompany arrangements to ensure that contracts between related entities that will be entered into on or after 1st January 2024 are regularly updated and kept current in order to apply best practice.

14. What would such exercise consist of and how challenging is it in practice?

Question 15

Contracts are the starting point that should ideally define in detail the functions and risks undertaken by the parties and the expected outcomes at the time of entering into a transaction.

15. Do you think that the TPRs will induce MNEs to regularly update their inter-group company contracts/arrangements?

Question 16

The OECD TPGs emphasizes the importance of considering the commercial or financial relations between associated enterprises to examine whether the arrangements reflected in the actual conduct of the parties substantially conform to the terms of any written contract.

16. How important is it that contracts reflect, and actual conduct follows, the actual commercial arrangements between parties, and how will you advise clients to reflect the principle of substance over form?

Unilateral TP Ruling

Question 17

The OECD TPGs emphasize that "Wherever possible, an APA should be concluded on a bilateral or multilateral basis..." This is due to the number of disadvantages associated with unilateral APAs.

17. Do you agree that unilateral TP Rulings have been included in the local TPRs?

Bilateral and Multilateral APAs

Question 18

18. In your opinion what are the main benefits and drawbacks to consider while advising clients whether to enter into an APA or not?

TP Adjustments

Question 19

19. in your opinion, should Malta adopt a practice of applying/allowing secondary adjustments?

Penalties

Question 20

According to the OECD, penalties would encourage compliance with the TPRs.

20. In your opinion should the current system for penalties be extended to TPRs or do you expect that specific penalties are introduced as a result of the introduction of the TPRs?

Question 21

21. Taking into account Malta's background, in what shape and form (in terms of nature and quantum) would you envisage that specific penalties are introduced?

Safe Harbour Rules

Question 22

Safe harbour rules would simplify compliance, reduce the compliance cost, and provide certainty to eligible taxpayers that the tax administration will accept the price charged or paid on the qualifying intercompany transaction.

However, safe harbour rules may raise fundamental problems that could potentially have perverse effects on the pricing decisions of enterprises engaged in controlled transactions.

22.Do you think that safe harbour rules for certain sectors should be introduced, bearing in mind that safe harbour rules are automatically reportable for taxing purposes in terms of Hallmark E1 under DAC 6?

Appendix C – Interview Questions: ICTU Official

Introduction

Question 1

The Consultation Document states that "it is envisaged that the OECD Transfer Pricing Guidelines will constitute an important source of reference in the application of the rules."

1.To what extent should practitioner expect to focus/depend on OECD TPGs as a basis for the local TPRs and how viable is to rely on them?

Question 2

The Consultation Document specifies that the requirement for the application of the arm's length principle is a computational rule for the purposes of the Income Tax Acts, rather than an anti-avoidance rule.

2. What makes this a computational rule considering the fact that some may argue that TPRs are introduced in order to curb aggressive tax planning?

Question 3

3. In the process of introducing TPRs in Malta, did the OCfR look into other countries such as Ireland to learn from their mistakes and successes?

Question 4

4. What has been the level of interest in the introduction of TPRs from firms and practitioners?

Interaction of TPRs with current Maltese Law

Question 5

5. How does the OCfR envisage that the introduction of TPRs will impact Malta's attractive tax regime and how is it anticipated that the TPRs will interact with certain aspects of Maltese tax law such as:

- GAAR,
- NID,
- fiscal unity regime
- anti-hybrid rules

Question 6

Malta's tax regime is viewed as the most attractive feature for foreign investors.

6. How do you think that TPRs will impact FDI?

Question 7

7. What are the main complexities that may arise as a result of the introduction of TPRs?

Question 8

8. What was the rationale behind:

- the carve out that arises due to the SME definition in the consultation document?
- the threshold of 50% that is indicated for voting rights or ordinary shares within the definition of Associated Enterprises provided in the Draft TPRs?

TP Professionals

TP is an area that requires a high level of expertise.

Question 9

9. How do you envisage that the requirements of TPRs will impact the office of the OCfR with respect to administrative duties and feasibility?

Question 10

10. Are there enough persons with adequate experience who are capable of carrying out transfer pricing audits, and will there be training to OCfR employees?

Question 11

11. Is it planned to have a department within the Office dedicated to TP?

Question 12

12. What implications could arise with respect to practitioners' knowledge as a result of the introduction of TPRs?

Guidance for applying the ALP

Question 13

13. What will practitioners be expected to take into consideration when verifying whether Transfer Prices used by a MNE is indeed at arm's length?

Question 14

Comparability Analysis

In accordance to the OECD TPGs *"comparability analysis is at the heart of the application of the arm's length principle."*

14. The OECD TPGs emphasizes the importance for the need for an approach that is balanced in terms of reliability and the burden created for taxpayers and tax administrations. How is such balance upheld by the TPRs that will be introduced in Malta?

Question 15

When it comes to the application of the 5 TP methods, TP practitioners refer to benchmarking databases. After choosing one of the methods, a benchmarking exercise is to be undertaken.

15. From a Maltese perspective, what is suggest to carry out such TP analysis for data be obtained in order to establish the conditions of the commercial and financial relations for the purpose of comparability?

TP documentation

Question 16

16. What important information should be included in TP documentation for the purpose of TP audits?

Question 17

17. What can taxpayers expect TP audits to include?

Unilateral TP Ruling

Question 18

The OECD TPGs emphasize that "*Wherever possible, an APA should be concluded on a bilateral or multilateral basis...*" This is due to the number of disadvantages associated with unilateral APAs.

18. What was the rationale behind the introduction of unilateral TP Rulings in the local TPRs?

Question 19

19. Does the OCfR have the intention to issue guidelines for Unilateral TP Rulings and APAs similar to the Guidelines for the MAP?

Bilateral and Multilateral APAs

Question 20

20. In your opinion what are the main benefits and drawbacks on entering into an APA with taxpayers and do the benefits outweigh the drawbacks?

Question 21

21. Could you explain whether APAs concluded in terms of Article 52 ITA will have to be reapplied for in terms of the TPRs, or will these ruling have to be reviewed?

TP Adjustments

Question 22

22. is there the possibility that the OCfR will start accepting Secondary adjustments in light of the introduction of TPRs, if not will this create adverse consequences at the entity level?

Question 23

23. Rule 8 of the draft TPRs states that the TPRs will have no consequences on Indirect taxes. However, VAT will be impacted indirectly if actual prices of intra-group transactions are changed due to a TP adjustment. What implications will this create and how could such a situation be dealt with?

Penalties

Question 24

According to the OECD, penalties would encourage compliance with the TPRs.

24. In your opinion should the current system for penalties be extended to TPRs or do you expect that specific penalties are introduced as a result of the introduction of the TPRs?

Question 25

25. Taking into account Malta's background, in what shape and form (in terms of nature and quantum) would you envisage that specific penalties are introduced?

Safe Harbour Rules

Question 26

Did the OCfR consider introducing safe harbour rules for certain sectors?

Anti-avoidance

Question 27

12. Did the OCfR consider introducing provisions or rules relating to situation in which MNE try to circumvent TPRs through certain arrangements between associated enterprises?

Appendix D – Interviewee Schedule

	Date	Time	Duration (in minutes)
Interviewee 1	**01/11/2022**	**10:30**	**55**
Interviewee 2	**03/11/2022**	**8:00**	**35**
Interviewee 3	**04/11/2022**	**16:00**	**70**
Interviewee 4	**10/11/2022**	**15:30**	**40**
Interviewee 5	**16/11/2022**	**10:30**	**90**
Interviewee 6	**16/11/2022**	**17:00**	**90**
Interviewee 7	**17/11/2022**	**16:30**	**110**
Interviewee 8	**18/11/2022**	**13:30**	**60**
Interviewee 9	**28/11/2022**	**11:00**	**55**
Interviewee 10	**2/12/2022**	**10:00**	**75**
Interviewee 11	**2/12/2022**	**15:00**	**90**
Interviewee 12	**27/02/2023**	**17:00**	**105**
Interviewee 13	**2/03/2023**	**14:00**	**50**

Table 2: Interviewee Schedule