

GOVERNMENT NOTICE No. 36

TAXATION ACT

(CAP. 41:01)

TAXATION (TRANSFER PRICING DOCUMENTATION) REGULATIONS, 2017

IN EXERCISE of the powers conferred by section 146 of the Taxation Act, I, GOODALL EDWARD GONDWE, Minister of Finance, Economic Planning and Development, make the following Regulations—

1. These Regulations may be cited as the Taxation (Transfer Pricing Documentation) Regulations, 2017, and shall come into operation on the 1st July, 2017. Citation and commencement

2.—(1) A taxpayer shall have in place contemporaneous documentation that verifies that the conditions in its controlled transactions for the relevant tax year are consistent with the arm's length principle. Required documents

(2) Documentation under these Regulations shall include—

(a) an overview of the taxpayer's business operations (history, recent evolution and general overview of the relevant markets of reference) and organizational chart (details of business units or departments and organizational structure);

(b) a description of the corporate organizational structure of the group that the taxpayer is a member (including details of all group members, their legal form, and their shareholding percentages) and the group's operational structure (including a general description of the role that each of the group members carries out with respect to the group's activities, as relevant to the controlled transaction);

(c) a description of the controlled transaction(s), including analysis of the comparability factors specified in regulation 4 of the Taxation (Transfer Pricing) Regulations, 2017; GN.of 2017

(d) details of the functions undertaken by the connected parties in relation to the controlled transaction, which shall include details of assets in relation to the controlled transaction as well as risk assumed by each party;

(e) an explanation of the selection of most appropriate transfer pricing method, and, where relevant, the selection of the tested party and the financial indicator;

(f) financial statements for the parties to the controlled transaction including where the tested party has been selected as a party outside the country;

(g) comparability analysis, including—

(i) description of the process undertaken to identify comparable uncontrolled transactions;

- (ii) explanation of the basis for the rejection of any potential internal comparable uncontrolled transactions (where applicable);
- (iii) description of the comparable uncontrolled transactions;
- (iv) analysis of comparability of the controlled transaction(s) and the comparable uncontrolled transactions, taking into account regulation 4 of the Taxation (Transfer Pricing) Regulations, 2017; and
- (v) details and explanation of any comparability adjustments made;
- (h) details of any industry analysis, economic analysis, budgets or projections relied on;
- (i) details of any advance pricing agreements or similar arrangements in other countries that are applicable to the controlled transactions;
- (j) a conclusion as to consistency of the conditions of the controlled transactions with the arm's length principle, including details of any adjustment made to ensure compliance; and
- (k) any other documentation or information that is necessary for determination of the taxpayer's compliance with the arm's length principle with respect to the controlled transactions.
- 3. Documentation under these Regulations shall be submitted in the English language.**
- 4. Documentation for a relevant tax year shall be considered to be contemporaneous where it is in place at the statutory tax return's filing date.**
- 5. The documentation required under these Regulations shall be submitted to the Commissioner General within forty five days of the written request being duly issued by the Commissioner General.**
- 6. The obligation of the taxpayer to provide the documentation under these Regulations shall be without prejudice to the power of the Commissioner General to request additional information that in the course of audit procedures he deems necessary to carry out his functions.**
- 7.—(1) Any person who fails to comply with a notice served on him by the Commissioner General under regulation 5 shall be liable to—**
- (a) an initial penalty not exceeding the Malawi Kwacha equivalent of 1,400 United States Dollars at the prevailing exchange rate; and
- (b) further penalties not exceeding the Kwacha amount equivalent of 2,100 United States Dollars at the prevailing exchange rate to for each period of one month where the failure continues.
- (2) Any person who has been subject to an initial penalty for failure to comply with a notice, and subsequent penalties in subregulation (1), and continues to fail to comply with that notice shall be liable to further penalties in an unlimited amount to be determined by the Commissioner General in accordance with criteria set out by the Commissioner General.

GN....of 2017

Language of documentation

Contemporaneous documentation

Time limit for submission of documentation

Power to request additional information

Penalties

Made this 30th day of July, 2017.

GOODALL E. GONDWE
Minister of Finance, Economic
Planning and Development

(FILE NO C/RPD/6/3/3/22)

GOVERNMENT NOTICE No. 37

TAXATION ACT
(CAP. 41:01)

TAXATION (TRANSFER PRICING) REGULATIONS, 2017

IN EXERCISE of the powers conferred by section 146 of the Taxation Act, I, GOODALL EDWARD GONDWE, Minister of Finance, Economic Planning and Development, make the following Regulations—

1. These Regulations may be cited as the Taxation (Transfer Pricing) Regulations, 2017, and shall come into operation on 1st July, 2017. Citation and commencement

2. In these Regulations, unless the context otherwise requires— Interpretation

“arm’s length price” means the price payable in a transaction between independent enterprises;

“comparable transactions” means transactions that are comparable in accordance with regulation 4;

“controlled transaction” means any transaction between related persons;

“financial indicator” means—

(a) in relation to the comparable uncontrolled price method, the price;

(b) in relation to the cost plus method, the mark up on costs;

(c) in relation to the resale price method, the resale margin;

(d) in relation to the transaction net margin method, the net profit margin; or

(e) in relation to the transactional profit split method, the division of the operating profit and loss;

“related persons” shall have the meaning ascribed to that term in section 127A of the Act; and

“uncontrolled transaction” means any transaction between independent persons.

3. The determination of whether the conditions of a controlled transaction are consistent with the arm’s length principle under section 127A of the Act and of the quantum of any adjustment made under section 127A (1), shall be made in accordance with the provisions of regulation 5. Arm’s length principle

Comparability

4.—(1) An uncontrolled transaction is comparable to a controlled transaction within the meaning of section 127A (1) where—

(a) there are no differences between the transactions that could materially affect the financial indicator being examined under the appropriate transfer pricing method; or

(b) such differences exist, if a reasonably accurate comparability adjustment is made to the relevant financial indicator of the uncontrolled transaction in order to eliminate the effects of such differences on the comparison.

(2) For purposes of determining whether two or more transactions are comparable, the following factors shall be considered to the extent that they are economically relevant to the facts and circumstances of the transactions—

(a) the characteristics of the property or services transferred;

(b) the functions undertaken by each person with respect to the transactions, taking into account assets used and risks assumed;

(c) the contractual terms of the transactions;

(d) the economic circumstances in which the transactions take place; and

(e) the business strategies pursued by each of the related persons in relation to the transactions.

(3) For the purposes of determining whether two transactions are comparable, the allocation of risk between related persons shall take into account how economically significant the risk is allocated in contracts between those persons, including which person—

(a) bears the financial risk;

(b) performs the relevant risk control and risk mitigation functions; and

(c) has the financial capacity to assume the risk.

(4) In cases where the contractual allocation of risk diverges from the factors described under this regulation, the risk shall be allocated to the persons that perform the relevant risk control and risk mitigation functions, and have the financial capacity to assume the risk.

(5) Where a person does not in fact control the financial risks associated with its funding activities, for tax purposes, it shall not be allocated the profits associated with those risks and shall be entitled to no more than a risk-free return.

(6) Where a person that performs the relevant risk control and risk mitigation functions does not have the financial capacity to assume the risk, the Commissioner General shall determine what adjustments to the transaction are needed for the transaction to result in an arm's length outcome.

5.—(1) The arm's length remuneration of a controlled transaction shall be determined by applying the most appropriate transfer pricing method to the circumstances of the case.

(2) The most appropriate transfer pricing method shall be selected from among the approved transfer pricing methods set out in regulation 5(3), taking into consideration the following criteria—

(a) the respective strengths and weaknesses of the approved methods;

(b) the appropriateness of an approved method in view of the nature of the controlled transaction, determined in particular, through an analysis of the functions undertaken by each person in the controlled transaction, taking into account assets used and risks assumed;

(c) the availability of reliable information needed to apply the selected transfer pricing method; and

(d) the degree of comparability between the controlled and uncontrolled transactions, including the reliability of comparability adjustments, if any, that may be required to eliminate differences between them.

(3) The following shall be the approved transfer pricing methods for the purposes of regulation 5 (1)—

(a) the comparable uncontrolled price method, which consists of comparing the price charged for property or services transferred in a controlled transaction with the price charged for property or services transferred in a comparable uncontrolled transaction;

(b) the resale price method, which consists of comparing the resale margin that a purchaser of property in a controlled transaction earns from reselling that property in an uncontrolled transaction with the resale margin that is earned in comparable uncontrolled purchase and resale transactions;

(c) the cost plus method, which consists of comparing the mark up on those costs directly and indirectly incurred in the supply of property or services in a controlled transaction with the mark up on those costs directly and indirectly incurred in the supply of property or services in a comparable uncontrolled transaction;

(d) the transactional net margin method, which consists of comparing the net profit margin relative to an appropriate base, such as costs, sales or assets, that a person achieves in a controlled transaction with the net profit margin relative to the same base achieved in comparable uncontrolled transactions; and

(e) the transactional profit split method, which consists of allocating to each associated person participating in a controlled transaction the portion of common operating profit (or loss) derived from such transaction that an independent person would expect to earn from engaging in a comparable uncontrolled transaction. When it is possible to determine an arm's length remuneration for some of the functions performed by the associated persons in connection with the transaction using one of the approved methods described in paragraphs (a) to (d), the transactional profit split method shall be applied based on the common residual profit that results once such functions are so remunerated.

(4) A transfer pricing method other than the approved methods contained in subregulation (3) may be applied where the Commissioner General is satisfied that—

(a) none of the approved methods can be reasonably applied to determine arm's length conditions for the controlled transaction; and

(b) such other method yields a result consistent with that which would be achieved by independent persons engaging in comparable uncontrolled transactions under comparable circumstances.

(5) In cases where other methods are used, their selection shall be supported by an explanation of why methods in regulation 5(3) were regarded as less appropriate or non-workable in the circumstances of the case, and of the reasons why the selected other method was regarded as providing a better arm's length price.

(6) As regards transactions involving the acquisition of new or used assets by taxpayers from related persons not resident in Malawi—

(a) the application of the Comparable Uncontrolled Price method shall require the invoice for the acquisition of the asset and proof of payment when it was purchased from an independent third party and in case of a used asset, the subsequent application of the decline in value already amortised since the asset was purchased, as allowed under accounting principles generally accepted in Malawi; and

(b) this notwithstanding, and only if the asset in question is sold in a different state from the one in which it was purchased, barring ordinary wear and tear, or if there is no third-party invoice, or in the case of an asset built or assembled using a number of components and thus with several invoices, a technical appraisal may be performed by a third-party expert not employed by the company, providing details of the characteristics, scope and other conditions considered in the appraisal, for the purposes of this point and pursuant to this Regulation.

(7) Choice of Tested Party—When applying a cost plus, resale price or transactional net margin method, provided under regulation 5, it shall be necessary to select the party, hereinafter referred to as the "tested party", to the transaction for which a financial indicator, mark-up on costs, gross margin, or net profit indicator, is tested under the most appropriate transfer pricing method in the circumstance.

(8) The selection of the tested party should be consistent with the functional analysis of the transaction.

(9) The tested party is the party to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found, i.e. it will most often be the one that has the less complex functional analysis.

(10) Where the most appropriate transfer pricing method in the circumstances of the case, determined following the guidance at regulation 5, above, is a one-sided method, financial information on the tested party shall be submitted in addition to the information referred to in subregulation (11) irrespective of whether the tested party is a domestic or foreign entity.

(11) Where the most appropriate method is a cost plus, resale price or transactional net margin method and the tested party is the foreign entity, sufficient information shall be submitted to be able to reliably apply the selected method to the foreign tested party and to enable a review by the Commissioner General of the application of the method to the foreign tested party.

6. If a taxpayer carries out, under the same or similar circumstances, two or more controlled transactions that are economically closely linked to one another or that form a continuum such that they cannot reliably be analysed separately, those transactions may be combined to—

Evaluation of taxpayer's combined controlled transactions

(a) perform the comparability analysis set out in regulation 4; and

(b) apply the transfer pricing methods set out in regulation 5.

7.—(1) An arm's length range is a range of relevant financial indicator figures (e.g. prices, margins or profit shares) produced by the application of the most appropriate transfer pricing method as set out in regulation 5 to a number of uncontrolled transactions, that are all comparable, and equally comparable to the controlled transaction based on a comparability analysis conducted in accordance with regulation 4:

Arm's length range

Provided that the highest point in the range is no more than twenty five per cent greater than the lowest point in the range.

(2) Where the application of the most appropriate method results in a number of financial indicators for which the degree of comparability of each to the controlled transactions, and to each other, is uncertain, or the highest point in the range exceeds twenty five per cent of the lowest point in the range, a statistical approach shall be used. Where such an approach is used, the interquartile range shall be considered to be an arm's length range.

(3) A controlled transaction, or a set of controlled transactions that are combined according to regulation 6, shall not be subject to an adjustment under section 127A of the Act where the relevant financial indicator derived from the controlled transaction or set of controlled transactions and being tested under the appropriate transfer pricing method is within the arm's length range.

(4) Where the relevant financial indicator derived from a controlled transaction, or from a set of controlled transactions that are combined according to regulation 6, falls outside the arm's length range, the taxable profit of the taxpayer shall be computed on the basis that the relevant financial indicator is the median of the arm's length range.

(5) For the purposes of regulation 7(4), the median of the arm's length range shall be the fiftieth percentile of the financial indicator figures derived from the comparable uncontrolled transactions forming the arm's length range. For this purpose, the fiftieth percentile is the lowest financial indicator figure such that at least fifty per cent of the financial indicator figures are at or below the value of that figure. However, if exactly fifty per cent of the results are at or below a financial indicator figure, then the fiftieth percentile is equal to the arithmetic mean of that figure and the next highest figure.

Sources of information on comparable uncontrolled transactions

8.—(1) Sources of information on comparable uncontrolled transactions include—

(a) internal uncontrolled transactions, which are uncontrolled transactions where one of the parties to the controlled transaction is also a party to the uncontrolled transaction; and

(b) external uncontrolled transactions, which are uncontrolled transactions to which neither of the parties to the controlled transaction is a party.

(2) Information concerning a comparable external uncontrolled transaction shall not be relied upon by the Commissioner General for the purposes of making an adjustment under section 127A of the Act if the information concerning the transaction is not available to the taxpayer.

(3) Information concerning a comparable uncontrolled transaction shall not be relied upon by a taxpayer for the purposes of demonstrating the consistency of a transaction with section 127A of the Act if the information on the transaction is not made available to the Commissioner General.

(4) In the absence of information on uncontrolled transactions from the same geographic market as the controlled transaction, comparable uncontrolled transactions from other geographic markets may be used by the Commissioner General.

(5) A determination of whether comparables from other geographic markets are reliable shall be made on a case-by-case basis, and by reference to the extent to which they satisfy regulation 4.

(6) For the avoidance of doubt, use of these comparables is subject to adjustment under regulation 4(1).

Services between related persons

9.—(1) A service charge between a taxpayer and a related person shall be considered consistent with the arm's length principle where—

(a) it is charged for a service that is actually rendered;

(b) the service provides, or when rendered was expected to provide, the recipient with economic or commercial value to enhance its commercial position;

(c) it is charged for a service that an independent person in comparable circumstances would have been willing to pay for, if performed for it by an independent person, or would have performed in-house for itself; and

(d) its amount corresponds to that which would have been agreed between independent persons for comparable services in comparable circumstances.

(2) A service charge made to a person shall not be consistent with the arm's length principle where it is made by a related person solely because of the shareholder's ownership interest in one or more other group members, including for any of the following costs incurred or activities undertaken by such related person—

(a) costs or activities relating to the juridical structure of the parent company of the first-mentioned person, such as meetings of shareholders of the parent, issuing of shares in the parent company, and costs of the parent company's supervisory board;

(b) costs or activities relating to reporting requirements of the parent company of the first-mentioned person, including the consolidation of reports; and

(c) costs or activities related to raising funds for the acquisition of participations, unless those participations are directly or indirectly acquired by the first-mentioned person and the acquisition benefits or is expected to benefit that first-mentioned person.

(3) Where it is possible to identify specific services provided by a taxpayer to a related person, the determination whether the service charge is consistent with the arm's length principle shall be made for each specific service, subject to the provisions of regulation 9(4).

(4) Where services are rendered by a taxpayer jointly to various related persons and it is not possible to identify specific services provided to each of them, the total service charge shall be allocated among the related persons that benefit or expect to benefit from the services according to reasonable allocation criteria.

(5) For the purpose of subregulation (4), allocation criteria shall be viewed as reasonable where they are based on a variable or variables that—

(a) take into account the nature of the services, the circumstances under which they are provided, and the benefits obtained or that were expected to be obtained by the persons for which the services are intended;

(b) relate exclusively to uncontrolled, rather than controlled, transactions; and

(c) are capable of being measured in a reasonably reliable manner.

10.—(1) The determination of arm's length conditions, for controlled transactions involving the exploitation of an intangible property by a person shall take into account the contractual arrangements and the following factors with regard to the development, enhancement, maintenance, protection and exploitation of the intangible property—

Transactions involving intangible property

(a) the functions performed by the person;

(b) the management and control of those functions;

(c) the contribution by the person of assets, including financial assets;

(d) the management and control regarding the contribution of assets, including financial assets;

(e) the risks assumed by that person; and

(f) the management and control of those risks.

(2) In cases where the contractual arrangements diverge from the factors listed above, regard shall be taken of those factors in determining the arm's length reward from the exploitation of the intangible.

(3) The determination of arm's length conditions for controlled transactions involving licenses, sales or other transfers of intangible property between related persons shall take into account both the perspective of the transferor of the property and the perspective of the transferee, including in particular the pricing at which a comparable independent person would be willing to transfer the property and the value and usefulness of the intangible property to the transferee in its business.

(4) In applying the provisions of regulation 4 to a transaction involving the license, sale or other transfer of intangible property, consideration shall be given to any special factors relevant to the comparability of the controlled and uncontrolled transactions, including—

(a) the expected benefits from the intangible property;

(b) the commercial alternatives otherwise available to the acquirer or licensee derived from the intangible property;

(c) any geographic limitations on the exercise of rights to the intangible property;

(d) the exclusive or non-exclusive character of the rights transferred; and

(e) whether the transferee has the right to participate in further developments of the intangible property by the transferor.

Disregarding
a controlled
transaction for
tax purposes

11. Where the arrangements made in relation to a transaction between related persons, viewed in their totality, differ from those which would have been adopted by independent persons behaving in a commercially rational manner in comparable circumstances, thereby preventing determination of a price that would be acceptable to both of the parties taking into account their respective perspectives and the options realistically available to each of them at the time of entering into the transaction, the actual transaction as structured by the taxpayer may be disregarded for the purposes of these Regulations, in which case the arm's length position would be as if the transaction had not occurred. In other cases, if appropriate, the transaction shall be replaced by an alternative transaction.

Corresponding
adjustments
for domestic
transactions

12.—(1) Where an adjustment is made by the Commissioner General under section 127A to the taxable income of a taxpayer in relation to a domestic transaction, then the Commissioner General shall allow an appropriate adjustment to the taxable income of the other party to the transaction, unless otherwise provided by the Act.

(2) For the purposes of this regulation, a domestic transaction is one between parties that are liable to tax in Malawi.

Corresponding
adjustments for
international
transactions

13.—(1) Where—

(a) an adjustment to the conditions of transactions between a person liable to tax in Malawi and a related person is made or proposed by a tax administration in a country other than Malawi;

(b) this adjustment results in the taxation in that other country of an amount of income on which the person liable to tax in Malawi has already been charged to tax in Malawi; or

(c) the country making or proposing the adjustment has a treaty with Malawi that reflects an intention to provide for the relief of economic double taxation,

the Commissioner General shall, after a request is made by the person liable to tax in Malawi, examine the consistency of that adjustment with the arm's length principle provided for under section 127A, consulting as necessary with the competent authority of the other country.

(2) If the adjustment proposed or made by the other country is consistent with the arm's length principle both in principle and as regards the amount, the Commissioner General shall make a corresponding adjustment to the amount of the tax charged in Malawi to that person on those profits, in order to eliminate the economic double taxation that would result from the inclusion of the same profits in the taxable income of both that person and the related person.

(3) A request under this regulation shall include the information necessary for the Commissioner General to examine the consistency of the adjustment made by the tax administration of the other country with the arm's length principle, including—

(a) the name, registered address and, where applicable, trading name(s) of the related person;

(b) evidence of the tax residence of the related person;

(c) the year in which the adjusted controlled transaction(s) took place;

(d) the amount of the requested corresponding adjustment and the amounts of the adjustment made by the tax administration of the other country;

(e) evidence of the adjustment made by the tax administration of the other country and the basis for the adjustment, including details of comparability analysis relied upon and the transfer pricing method applied;

(f) confirmation that the related person party will not, or is unable to, pursue any further recourse under the domestic law of the other country that may result in the adjustment made by the tax administration of the other country being reduced or reversed; and

(g) any other information that may be relevant for examining the consistency of the adjustment with the arm's length principle.

(4) The request under this regulation shall be made within three years of the adjustment decision made by the tax administration of the other country, or within the applicable time period for making a request for the case to be resolved by way of mutual agreement procedure if specified under the applicable tax treaty.

Relevance of
OECD Transfer
Pricing
Guidelines

14.—(1) These Regulations shall be interpreted in accordance with the Organization for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines for Multinational Persons and Tax Administrations (in these regulations otherwise referred to as the “OECD Guidelines”).

(2) Where there is any inconsistency between the Act and these Regulations, on the one hand, and the OECD Guidelines, on the other hand, the Act and the Regulations shall prevail.

Beneficial tax
regimes

15. For the purposes of section 127A (5), a tax jurisdiction provides a beneficial tax regime to a person where the amount of tax due on that person's income is fifty per cent or less of the amount of income tax that would be due if the person's income were liable to tax in Malawi.

Threshold for
application of
section 127A
of the Act to
domestic
transactions

16. For the purposes of section 127A (8), the threshold shall be the Malawi Kwacha equivalent of 135,000 United States Dollars at the prevailing exchange rate.

Revocation of
the Cap. 41:01
Sub. leg. p.129

17. The Taxation (Transfer Pricing) Regulations are hereby revoked.

Made this 30th day of July, 2017.

GOODALL E. GONDWE
*Minister of Finance, Economic
Planning and Development*

(FILE NO C/RPD/6/3/3/22)