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# HARMONIZATION OF THE LEGISLATION OF THE REPUBLIC OF MOLDOVA WITH THE OECD TRANSFER PRICING REGULATIONS

# ARMONIZAREA LEGISLAȚIEI DIN REPUBLICA MOLDOVA CU REGLEMENTĂRILE OECD PRIVIND PREȚURILE DE TRANSFER

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**Abstract.** In the context of the globalisation of national economies and the galloping growth of multi-nationals, transfer pricing regulations have become a key element in avoiding the erosion of the tax base and the shifting of profits to low or zero tax jurisdictions. The Republic of Moldova, in its effort to integrate international tax practices and attract foreign investment, faces significant challenges in aligning national legislation with OECD standards. The purpose of this paper is to explore the complex and critical process of harmonising Moldovan legislation with the Organisation for Economic Co-operation and Development (OECD) transfer pricing regulations. Although the Republic of Moldova has made significant progress towards harmonising its legislation with OECD transfer pricing regulations, there are still many areas of inconsistency that require attention and adaptation. These include the need for clarification and detail in national legislation, and the need to develop better administrative capacity for effective implementation of the regulations.

**Keyword:**. transfer pricing; OECD; Republic of Moldova harmonisation; multinationals.

**JEL Classification:** F23; H25; K34

## Introduction

The transfer pricing file has become a key pillar in ensuring fair and transparent practice between multinational companies and tax jurisdictions. As of 1 January 2024, the Republic of Moldova has marked a significant moment in its tax evolution by adopting the OECD transfer pricing regulations, marking an important step in its alignment with international standards. By Law No 356/2022, Moldovan tax legislation was enriched by the introduction of Chapter 112 in Title V of the Tax Code, dedicated to special rules for determining transfer prices according to the arm's length principle. This legislative initiative fills a significant gap, as until now the terminology of related parties and transfer pricing was absent from the Moldovan Tax Code.

This step reflects the Republic of Moldova's continued efforts to integrate into the global tax and economic framework, improving transparency and efficiency in the financial reporting of companies operating both locally and internationally. The implementation of the transfer pricing file plays a key role in preventing the erosion of the tax base and combating the transfer of profits to low or zero tax jurisdictions. In this context, establishing clear and OECD-compliant rules for transfer pricing between related entities is a significant step towards ensuring fair competition and a fair distribution of the tax burden. Moreover, with an income tax set at only 12%, the Republic of Moldova is positioning itself as a competitive tax jurisdiction, seeking to balance the attraction of foreign

investment with the need to comply with recognised international tax practices. This delicate balance between stimulating economic growth and ensuring tax compliance is a constant challenge for policy makers.

Therefore, the inclusion of OECD transfer pricing regulations in Moldova's tax legislation is more than just a legislative change, it is a sign of the country's commitment to transparency, tax fairness and global economic integration. This paper aims to explore the complex and critical process of harmonising Moldova's legislation with the Organisation for Economic Co-operation and Development (OECD) transfer pricing regulations.

## Literature Review

Transfer pricing, an essential mechanism within multinational corporations, primarily involves pricing transactions between affiliated companies in different tax jurisdictions to ensure proper documentation of income and expenses. This practice serves not only to meet regulatory requirements, but also to optimize tax liabilities by aligning them more favorably within global operating frameworks (Schön, 2012). Transfer pricing plays a key role in managing the financial performance of multinational companies, having a direct impact on profit distribution and tax liabilities. Central to the academic discussion is the alignment of transfer pricing with the Arm's Length Principle. Recent authors have highlighted the challenges in implementing this principle, given the complexity of international transactions and differences in tax regulation across jurisdictions (Choe & Matsushima, 2013; Melega et al., 2022).

The literature also highlights the tension between multinational corporations (MNCs) seeking to minimise tax liabilities and tax authorities striving to enforce fair tax practices. According to Gupta (2009), the essence of transfer pricing revolves around manipulating prices for intra-group transactions to shift profits to jurisdictions with more favourable tax rates, effectively reducing the overall tax burden of multinational entities. This practice not only impacts tax revenues, but also engages with broader economic, regulatory and ethical issues (Awodiran, 2014; Zhyhlei et al. 2022). The authors examine how multinationals exploit global tax disparities, a tactic that complicates international tax compliance and equity efforts.

The operational implications of transfer pricing are vast, affecting various aspects of corporate functionality. Tisdell (1989) discusses how transfer pricing can unintentionally stifle innovation within firms by distorting the signals that guide resource allocation across divisions. This distortion of the internal market can lead to inefficient investment decisions and misaligned incentives for division managers. Concurrently, the work of Tono et al. (2018) adds to this by highlighting the role of performance measurement tools in resolving conflicts arising from transfer pricing policies within corporations. These tools are essential to ensure that internal pricing mechanisms reflect fair value and support corporate and fiscal governance.

On the legislative side, countries have developed sound legal frameworks to mitigate transfer pricing risks. For example, Zhyhlei et al. (2022) report the use of specific regulations requiring compliance with controlled transactions rules to protect domestic tax bases. Similarly, McKinley et al.'s (2013) examination of the ramifications of transfer pricing financial reporting reveals the complexity and risks faced by multinational corporations, particularly in aligning their accounting practices with domestic and international tax regulations.

Transfer pricing is a double-edged sword in international business, serving both as a tax optimisation strategy and as a potential source of tax and regulatory dilemmas. They are influenced by a variety of factors, including firm size, leverage and tax pressure. Researchers have paid particular attention to analysing these factors that drive multinationals to transfer pricing. For example, Waworuntu and Hadisaputra (2016) provide a comprehensive analysis of the determinants influencing transfer pricing aggressiveness in Indonesian multinationals listed on the IDX during 2010-2012. This research highlights how certain factors, such as firm size and leverage, are positively associated with transfer

pricing aggressiveness, suggesting that larger, more leveraged firms may engage more in transfer pricing practices to optimize tax liabilities. In contrast, intangible assets and multinationality show a negative association, indicating a more complex interaction between these factors and transfer pricing behaviour, possibly due to strict regulations or operational structures that discourage aggressive tax strategies. Interestingly, the study finds that profitability and the use of tax havens do not significantly influence aggressive transfer pricing, which contrasts with the common perception that more profitable companies or those with subsidiaries in tax havens are more likely to engage in aggressive transfer pricing practices. This result may reflect the unique regulatory and business environments in Indonesia, where local factors and enforcement mechanisms may neutralize the expected impact of these variables. In the same vein, Nguyen, Nguyen and Doan (2018) also identify firm size and the presence of foreign affiliates as significant determinants, but additionally highlight the role of corporate headquarters in tax havens. The researchers stress the importance of considering local economic, regulatory and corporate governance conditions when analysing the determinants of transfer pricing aggressiveness. It suggests a tailored approach to policy formulation and implementation to effectively manage and monitor transfer pricing practices, ensuring fair taxation while supporting international business operations.

National economies have made important progress in minimising the effects of the transfer pricing file on tax revenue collection to the state budget. They have aligned national legislation with international requirements by adopting OECD transfer pricing regulations. The Organisation for Economic Co-operation and Development (OECD) transfer pricing regulations are designed to ensure that transactions between multinational enterprises are conducted on an arm's length basis. However, the adoption and implementation of these regulations faces significant obstacles in different economies. A significant challenge in the adoption of OECD transfer pricing regulations is the need for comprehensive legislative and regulatory frameworks. Many countries lack the legal infrastructure to implement these complex rules. For example, emerging economies often have underdeveloped tax laws that do not align with OECD guidelines, making it difficult to integrate new regulations without substantial legislative reform. In addition, the complexity of transfer pricing regulations can overwhelm local tax administrations, which may not have the capacity to understand or enforce these laws effectively. The adoption of OECD transfer pricing rules imposes significant administrative burdens on both tax authorities and multinational enterprises. The training and documentation requirements for transfer pricing compliance are extensive and can be particularly challenging for smaller economies with limited administrative resources. This complexity often leads to increased compliance costs for businesses and increased risks of disputes and litigation due to misinterpretations or errors in the application of regulations. Economic and political factors significantly influence the adoption of OECD transfer pricing guidelines. Developing countries may prioritise attracting foreign investment and therefore may be reluctant to implement strict transfer pricing regulations that could discourage multinational enterprises (Melega, et al., 2022). In addition, political instability and corruption can undermine the enforcement of transfer pricing rules as governments may lack the political will or institutional integrity to impose strict compliance requirements (McLure Jr, 2006). Another significant obstacle is the lack of capacity and expertise within tax authorities. Effective implementation of transfer pricing rules requires qualified personnel with knowledge of international tax principles and transfer pricing methodologies. Many developing countries face a shortage of qualified tax professionals, which hampers their ability to administer and enforce these regulations. In addition, the continuing evolution of transfer pricing regulations requires continuous training and capacity building, which can be resource intensive. Cultural and institutional differences are also significant barriers. OECD transfer pricing guidelines are based on principles that may not align with local business practices or cultural norms. This non-alignment can lead to resistance from local businesses and tax professionals who may prefer familiar and traditional

methods of valuation and pricing. Institutional differences, such as different legal systems and administrative procedures, further complicate the adoption process.
Adoption of OECD transfer pricing rules is therefore fraught with challenges related to legislative infrastructure, administrative burden, economic priorities, capacity constraints and cultural differences. Addressing these obstacles requires tailored strategies that take into account the specific contexts of individual economies to enhance compliance and effectiveness.

**Results and discussions**

Harmonisation of national legislation with OECD transfer pricing rules is a significant challenge, especially for emerging and underdeveloped economies. The process of adopting these regulations needs to be done gradually, with careful consideration of each step to minimise dissonance and ensure compatibility with the local context. The OECD transfer pricing rules, developed by consensus among member countries, require adaptation to the specificities of each country, such as Moldova. As these regulations are the result of an international agreement, there is a possibility of differences in interpretation and application within the national framework, generating challenges in effective implementation. The adoption of the OECD transfer pricing regulations in the Republic of Moldova reflects a hasty decision with many negative implications. The implementation process was marked by an almost literal transposition of international regulations, without properly adapting the legislation to the economic and contextual realities of the country. This fast-track approach has created a number of challenges in practical implementation and compliance with international standards. Firstly, the direct transposition of OECD legislation without proper adjustment has led to mismatches between the imposed legal framework and local economic realities. The Republic of Moldova, having a distinctive economy and a business sector largely unaligned with global practices, requires a tailor-made approach that better reflects local dynamics and particularities. The word-for-word transposition of OECD regulations has therefore ignored the need for detailed analysis to identify and specifically tailor key aspects of transfer pricing, resulting in rules that may be difficult to implement or that may generate ambiguities and uneven interpretations. A more gradual and better planned approach would have allowed a more careful assessment of the potential impact of these regulations on the business environment in the Republic of Moldova. Rapid adoption, without sufficient consultation with the business community and accounting/tax professionals, has contributed to the implementation of a legal framework that is largely incompatible with the structure and functioning of companies in the Republic of Moldova. This has been observed through difficulties in enforcement and compliance of companies, which are faced with new requirements that are either difficult to understand or inadequate in their operational context.
Another point of discussion is the lack of adaptation of the legislation to the realities of the tax and administrative infrastructure in the country. In the Republic of Moldova, tax authorities lack the expertise and resources to effectively manage and enforce complex transfer pricing regulations. This leads to increased risks of non-compliance and possible tax disputes as companies struggle to adapt to the new requirements and tax authorities encounter difficulties in interpreting and applying the new rules. The problem is compounded by a lack of adequate support infrastructure to implement these rules. Although OECD regulations are intended to ensure transparency and fairness in cross-border transactions, the lack of a robust national framework to support these objectives has created an uncertain and complicated business environment. Companies, especially local ones without international experience, are hampered by the new requirements, which are perceived as excessively bureaucratic and costly relative to the expected benefits.
A longer period of consultation and adjustment, including active dialogues with the business community and tax experts, would have been necessary to address these shortcomings. This would have allowed the adaptation of international regulations to local conditions, the development of support mechanisms and the implementation of training sessions for authorities and taxpayers. Such

an approach would have ensured a smoother transition and more effective compliance with the new standards, reducing the risk of non-compliance and litigation and promoting a fair and efficient application of transfer pricing rules in the Republic of Moldova.

In the Republic of Moldova, economic and political particularities, including political complexity and instability, as well as high levels of corruption, constitute barriers to full alignment with the scenarios set out in the OECD regulations. These issues require specific adjustments to effectively integrate international standards into local legislation. The country's unique economic structure, characterised by reluctance to change, amplifies the need for tailor-made implementation strategies.

In practice, although the new regulations are in force from 1 January 2024, the secondary legislative framework needed to support them was finalised and approved late (February 2024), leading to uncertainties and difficulties for companies. In this context, price adjustments in transactions with affiliates are allowed, but are accompanied by restrictions that run counter to international practice and may render the transfer pricing mechanism unworkable. The restriction that prevents adjustments that would lead to tax relief is particularly problematic. To simplify the process, transactions between resident companies operating under the same tax regime should not require transfer pricing documentation. At the same time, the Tax Code needs to be clarified and harmonised, as certain aspects, such as the non-deduction of losses on transactions with affiliates, are contrary to international principles.

Concerns expressed by business suggest that there is a need for additional time for both companies and tax authorities to understand and adapt to the complex new provisions. According to Mihai Burunciuc, policy manager at AmCham Moldova, "both companies and State Tax Service employees need time to adjust and understand the complex principles of the new provisions. Burunciuc suggests that it would have been better to initially apply these regulations only to cross-border transactions, where there are already sources of information and practices on transfer pricing, and then extend the analysis to the national level (Business Class, 2024). At the same time Ana Groza, executive director at the Foreign Investors Association, stresses the need for close cooperation with the authorities to eliminate the documentation requirement for transactions between residents in the same tax regime, which would reduce the administrative burden for companies and facilitate compliance with the new rules (Business Class, 2024). Sandra Dolghii, tax policy manager at the European Business Association (EBA), points out that although the EBA has been actively involved in discussions with the authorities, the implementation of the new rules in 2024 is problematic due to the lack of an approved secondary framework, which can considerably disrupt the work of companies (Business Class, 2024).

These views reflect the fundamental concerns of the Moldovan business environment towards the new transfer pricing regulations, highlighting the need for specific adjustments and a longer transitional period to facilitate compliance and ensure efficient and fair implementation of these rules.

**Conclusions**

The rapid adoption of OECD regulations by Moldova, without detailed analysis and adaptation to the national specificities, has led to significant problems in the effective implementation of the legislation. The literal transposition of international regulations without appropriate adjustments has resulted in a legal framework that is not fully compatible with the economic and contextual realities of the country. This approach has led to difficulties in understanding and applying the rules, both by the business community and by the tax authorities, highlighting the need for further clarification and adjustment. The implementation of transfer pricing rules requires a robust tax and administrative infrastructure, which Moldova does not yet fully possess. The limited expertise and resources of the tax authorities are a major obstacle in managing and enforcing complex regulations, increasing the risk of non-compliance and tax disputes. This underlines the need for training sessions and capacity building to ensure effective and correct enforcement. In addition, Moldova's distinctive economic and

political context, characterised by complexity and instability as well as high levels of corruption, further complicates the implementation of OECD regulations. These conditions require specific adjustments to integrate international standards into local legislation in a way that is compatible with the local economic structure and business practices.

The adoption of the new transfer pricing regulations has also been affected by the delay in finalising the secondary legislative framework needed to support them. This delay has created additional uncertainties and difficulties for companies, jeopardising compliance with the new requirements and creating risks for the effective functioning of the transfer pricing mechanism. Restrictions imposed, such as those related to voluntary price adjustments that do not reduce tax liabilities, are contrary to international practice and may render the mechanism inoperable.

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