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Overview

Tricor Taxand, Taxand Malaysia

Taxand Malaysia focuses on providing an extensive range of transfer pricing ("TP") compliance and advisory services, which encompasses the following areas:

- Planning and structuring (conceptualisation and implementation of TP policies, review of TP structures, tax-efficient supply chain structuring of transactions, review and advice on intra-group services and agreements, risk assessment and mitigation, tax planning benchmarks, cost sharing, licensing and intangibles)
- Compliance (global benchmarking solutions, functional and industry analysis, economic analysis, documentation compliance, Local File and Master File documentation, Country-by-Country Reporting)
- Controversy management (audit assistance/ representation before tax authorities, alternate dispute resolution and mutual agreement procedures)

General : Transfer Pricing Framework

The TP legislation and regulations in Malaysia, as well as the 2012 Malaysian Transfer Pricing Guidelines [which have been updated from time-to-time since its issuance] ("TP Guidelines"), are based on the governing standard for TP (i.e. the arm's length principle), as set out under the Organization for Economic Co-operation and Development Transfer Pricing Guidelines ("OECD Guidelines").

Even though certain parts of the TP Guidelines have been adopted directly from the OECD Guidelines, there may be areas which differ to ensure adherence to the Income Tax Act, 1967 ("ITA") and Inland Revenue Board of Malaysia ("IRB") procedures as well as domestic circumstances. "Domestic circumstances" are cited in the TP Guidelines. However, examples of "domestic circumstances" are not provided within the TP Guidelines themselves. Nonetheless, in practice, a potential example is the Malaysian tax authorities' stance on the determination of the arm's length return for controlled transactions, which differs from the OECD Guidelines as TP adjustments are typically made to the median point. This is notwithstanding the fact that the company's financial results may be within the arm's length range of results (but lower than median point). Please refer to the Local Jurisdiction Benchmarks section for further details.

TP in Malaysia is regulated by the TP provisions under Section 140A of the ITA, and the Income Tax (Transfer Pricing) Rules 2023 ("TP Rules 2023"). As for the TP Guidelines, the guidelines provide taxpayers with detailed guidance on the application of the arm's length principle, and the extent of documentation required to be maintained by taxpayers which engage in controlled transactions.

Under Section 140A(5A) of the ITA, "control" is defined as a shareholding of 20% or more and one of the following:

i) Providing necessary proprietary rights (e.g. patents, non-patented technological know-how, trademarks or copyrights) for the business operations;

ii) Having influence over business activities e.g. purchases, sales, receipt or provision of services, pricing and other conditions relating to the supply; OR

iii) Having powers to appoint one or more directors/members of the board of directors.

Accepted Transfer Pricing Methodologies

In line with the OECD Guidelines, the TP Rules 2023 and TP Guidelines make reference to the selection of the appropriate TP method in order to determine the arm's length price for a controlled transaction.

Taxpayers are therefore allowed to apply any of the 5 prescribed TP methods or any other method allowed by the Director-General of IRB which provides the highest degree of comparability between the transactions. Hence, there is no explicit hierarchy for the selection of TP methods. However, taxpayers are required to provide explanations and reasons that the method selected (and profit level indicator) are appropriate.

The most frequently used methods are the TNMM and CUP method. However, it is often difficult to apply the CUP method in practice, as taxpayers are expected to ensure the application of the CUP method on all controlled transactions entered into (instead of a sampling basis).

In addition, for the CUP method to be reliably applied to commodity transactions, the economically relevant characteristics of the controlled and uncontrolled transactions or the uncontrolled arrangements represented by the quoted price need to be comparable. Among others, economically relevant characteristics encompass the physical features and quality of the commodity, contractual terms of the controlled transaction, such as volumes traded, period of the arrangements, credit terms, timing and terms of delivery, transportation, insurance and foreign currency terms. A particularly relevant factor for commodity transactions determined by reference to the quoted price is the pricing date, i.e. specific time and date selected by the parties to determine the price for commodity transactions.

TP Documentation Requirements

In Malaysia, taxpayers which engage in controlled transactions are required to prepare contemporaneous transfer pricing documentation ("TPD") on an annual basis. The deadline for the completion of contemporaneous TPD is defined under the TP Rules 2023 i.e. prior to the due date for furnishing a return in the basis period for a year of assessment ("YA") in which a controlled transaction is entered into.

As such, the TPD needs to be prepared latest by the corporate income tax filing deadline for the relevant YA (which is typically 7 months after the financial year end), or by the extended tax filing due date granted by the

IRB (if applicable). Taxpayers are not required to file the TPD along with the tax return, but are required to submit the same within 14 days upon request by the IRB.

In line with the OECD Guidelines, taxpayers are required to comply with the three-tiered standardised approach to TPD i.e. Local File, Master File and country-by-country report ("CbCR").

MNE Groups are required to prepare and file CbCR if the following conditions are met:

1) Its constituent entities have cross-border transactions with other constituent entities;
2) Total consolidated group revenue in the financial year preceding the first reporting financial year is at least RM3 billion; and
3) Ultimate holding company of the Group/surrogate holding entity/permanent establishment/any of its constituent entities are companies incorporated in Malaysia.

The requirement for taxpayers to prepare the Master File depends on whether the taxpayer is required to prepare the CbCR.

Under the TP Rules 2023, "Multinational Enterprise Group" (or "MNE Group") refers to a collection of enterprises related through ownership or control which is required to prepare consolidated financial statements for financial reporting purposes under the applicable accounting principles or would be so required if equity interest in any of its enterprises were traded on public securities exchange.

Local Jurisdiction Benchmarks

When the TNMM is selected as the appropriate TP method for the purpose of ascertaining the arm's length nature of controlled transactions, a benchmarking study is typically prepared in order to demonstrate that controlled transactions meet the arm's length standard. The application of the TNMM is generally accepted by the IRB. However, the IRB typically closely scrutinizes the selection of comparables in the set.

In addition, the IRB explicitly states its preference for Malaysian comparables when evaluating a tested party which is incorporated in the country. As stated in the TP Guidelines, the IRB gives priority to the availability of sufficient and verifiable information on both the tested party and comparables. As such, in practice, foreign (i.e. regional/global) comparables should only be considered if it can be demonstrated that the search performed yielded either no local comparables or an insufficient number of local comparables.

Financial data and suitability of the existing comparable set are required to be reviewed and updated annually in order to reliably apply the arm's length principle. As for the update of the benchmarking searches in the databases, taxpayers are allowed to update the search every 3 years, rather than annually, as long as the entity's operational conditions remain unchanged.

The arm's length range has been defined within the TP Rules 2023 as "a range of figures or a single figure falling between the value of the 37.5 percentile to 62.5 percentile", whereby:

i) Where the price of a controlled transaction falls within the arm's length range, the price may be regarded as an arm's length price.
ii) Where the price of a controlled transaction is outside the arm's length range, the arm's length price shall be taken to the median.

Where the price of a controlled transaction falls within the arm's length range, the IRB may adjust the price of the controlled transaction to the median or any other point above median (within the arm's length range i.e. up to the 62.5 percentile) if they are of the view that there are comparability defects which cannot be quantified, identified or adjusted, or that comparable companies have a lesser degree of comparability.

There are currently no clear guidelines on how this assessment of comparability will be carried out by the IRB.

Advance Pricing Agreement "APA"/Bilateral Advance Pricing Agreement "BAPA" Overview

The Income Tax (Advance Pricing Arrangement) Rules 2023 ("APA Rules 2023") and Advance Pricing Arrangement Guidelines 2012 ("APA Guidelines") provide detailed guidance to taxpayers in relation to the APA application process and the documentation required for such applications.

The IRB accepts unilateral, bilateral and multilateral APAs, with a proposed covered period of between 3 to 5 YAs. Typically, the entire process of applying for a unilateral APA takes 6 to 12 months to conclude, while an application for a bilateral/multilateral APA may take 1 to 2 years to conclude.

In addition, the IRB considers requests for rollback of a bilateral or multilateral APA if:

a) the proposed TP methodology is relevant to the resolution of the TP issues in the prior years' assessment; and
b) the particular facts and circumstances surrounding the prior years' assessment are substantially the same as that of the covered period, subject to verification on audit.

As stated in the APA Rules 2023, a non-refundable fee is applicable for APA applications depending on the timing of the application i.e. RM5,000 if the application is made within two months after receipt of the IRB notification (on whether the taxpayer may proceed to submit the APA application) OR RM10,000 if the application is made after two months but within six months after receipt of the IRB notification. The APA Rules 2023 also outlines the terms and conditions for the renewal of the APA.

In addition, the APA Guidelines sets out the record keeping requirements in relation to the Annual Compliance Report (which taxpayers are required to submit, upon entering into an APA).

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Transfer Pricing Audits

The frequency of tax audits (which also cover TP issues) carried out by the IRB has increased in recent years. In addition, in the past, tax audits typically took place several years after the submission of the company's tax return. This is no longer the case, as the IRB has been initiating audits shortly after the submission of the company's tax return. In short, tax audits are now more regular and are triggered within a shorter period of time.

Loss-making companies with significant controlled transactions are typically scrutinised by the IRB during audits. As such, it is increasingly important for taxpayers to prepare and maintain robust documentation in order to substantiate the losses incurred and document the detailed commercial and/or operational reasons for such losses.

In addition, there is increased scrutiny on intragroup management services, be it from the perspective of the Malaysian entity as the service provider or service recipient. The IRB often seeks detailed explanations from taxpayers on the allocation basis and charging mechanism for the management service fee charged/paid by the Malaysian entity.

Another common area of challenge faced by taxpayers during tax audits is in terms of demonstrating that intragroup financing arrangements meet the arm's length standard and that the appropriate and reasonable steps have been taken in determining the arm's length interest rate, in order to mitigate risks arising from potential challenges from the IRB.

Transfer Pricing Penalties

Under the TP Guidelines, taxpayers who fail to furnish contemporaneous TPD within the 14-day timeframe are subject to a penalty of RM20,000 to RM100,000 per YA and/or imprisonment for up to 6 months or both. In Malaysia, the statute of limitation to raise additional assessments for TP issues is 7 years.

Prior to 1 January 2021, penalty rates were only applicable if TP adjustments resulted in additional tax payable. Hence, in the past, for companies which are not in a tax payable position (e.g. loss-making companies, companies which are granted tax incentives and not required to pay income tax), there was less priority placed on the preparation of TPD, given that TP adjustments proposed by the IRB would not give rise to additional tax payable.

However, the TP surcharge (of up to 5% of TP adjustments), which came into effect from 1 January 2021 onwards, is computed based on the value of the TP adjustment. The IRB recently clarified that the general rate to be applied in imposing the surcharge under Section 140A of the ITA is 5% on the TP adjustment made and that there will be no scale available (as reference). Hence, a lower surcharge rate will only be offered for voluntary disclosure cases, with further details on the surcharge to be addressed in the amended Transfer Pricing Audit Framework ("TPAF"), which has not been issued to-date. Hence, it is imperative for taxpayers to ensure full compliance to TP provisions in Malaysia, notwithstanding that there may not be an additional tax payable.

Local Hot Topics and Recent Updates

With the introduction of the TP Rules 2023, which was gazetted on 29 May 2023 and comes into effect from YA 2023 onwards, there were several significant changes in terms of compliance requirements for taxpayers.

Apart from the narrower arm's length range of results (as mentioned earlier), the main changes in the TP Rules 2023 are summarized below:

- Re-definition of "contemporaneous" TP documentation – From YA 2023 onwards, the TPD prepared at the point of developing or implementing controlled transactions will no longer be regarded as contemporaneous. In addition, taxpayers are required to date the TPD to indicate the date of completion of the documentation.
- More prescriptive and onerous requirements set out under the TP Rules 2023, including the detailed information relating to the following:
  a) The MNE Group (similar to information required to be covered in a Master File)
  b) Taxpayer's business (including functional analysis of all associated persons and pricing policy for each controlled transaction)
  c) Documents which became the foundation for, support or refer to development of TP analysis
  d) Indication of non-applicability of information/ documents
  e) Information, data or other related documents used to determine an arm's length price
- Use of single year financial data only, and where only financial data for the preceding financial year is available, taxpayers are expected to update the benchmarking set upon availability of data for that financial year.

Given the level of additional details, information and documents which need to be prepared by taxpayers from YA 2023 onwards, this will certainly increase the amount of costs, time and internal resources required to prepare the TPD.

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Documentation threshold

Master file	No specific threshold for preparation of Master File, but Master File is required for taxpayers that are obliged to prepare the CbCR (i.e. companies which are part of a multinational group where total consolidated group revenue is RM3 billion or more, amongst other conditions as mentioned earlier).
Local file	**Full TPD** For a taxpayer carrying on a business, the TP Guidelines apply wholly to a business with gross income exceeding RM25 million, and total amount of controlled transactions exceeding RM15 million. For a taxpayer providing financial assistance, the guidelines on financial assistance are only applicable if that financial assistance exceeds RM50 million. The TP Guidelines do not apply to transactions involving financial institutions. **Minimum TPD** For a taxpayer which do not meet the prescribed thresholds for full TPD above, the taxpayer may opt to either fully apply all relevant guidance as well as fulfil all TPD requirements in the TP Guidelines OR may opt to comply with TPD requirements under Paragraphs 25.4(a), (d) and (e) of the TP Guidelines only.
CbCR	Consolidated group revenue of RM3 billion or more

Submission deadline

Master file	Within 14 days upon request by the IRB.
Local file	Within 14 days upon request by the IRB.
CbCR	No later than twelve months after the last day of the reporting financial year.

Penalty Provisions

Documentation – late filing provision	RM20,000 to RM100,000 per YA / imprisonment for for a term not exceeding 6 months / both
Tax return disclosure – late/incomplete/no filing	**Failure (without reasonable excuse) to furnish an Income Tax Return Form** - RM200 to RM20,000 / imprisonment for a term not exceeding 6 months / both **Incorrect tax return by omitting or understating any income** - RM1,000 to RM10,000 and 200% of tax undercharged **Incorrect information in matters affecting the tax liability of a taxpayer or any other person** - RM1,000 to RM10,000 and 200% of tax undercharged **Fails (without reasonable excuse) to comply with an order to keep proper records and documentation** - RM300 to RM10,000 / imprisonment for a term not exceeding 1 year / both *Please note that the above penalties are not exhaustive and there are other penalties in place for other instances of non-compliance.
CbCR – late/ incomplete/no filing	Fine of not less than RM20,000 and not more than RM100,000 / imprisonment for a term not exceeding 6 months / both. Fine not exceeding RM1,000,000 / imprisonment for a term not exceeding two years / both [under the Labuan Regulations].

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