Transfer Pricing and the Malaysian Tax Corporate Governance Framework

8 March 2023

The Tax Corporate Governance Framework (“TCGF”) in Malaysia

The role of governance in managing tax decisions within companies has become more important in recent years. With the introduction of concepts such as ESG or Environmental, Social and Governance principles, businesses have been placing a greater emphasis on managing risks associated with these factors. A subject that has been largely left untouched by senior management is how tax risks are identified and managed within a particular business. The proper management of tax risks, including those relating to transfer pricing on transactions within the same group of companies, will enable companies to effectively navigate the ever changing tax landscape.

In April 2022, the Inland Revenue Board of Malaysia (“IRBM”) introduced the very first TCGF in Malaysia which intends to provide an overview of the IRBM’s expectations from corporate taxpayers on the tax corporate governance processes. The IRBM’s issuance of the TCGF comes amidst the backdrop of increased expectations by stakeholders for organisations to have a level of governance that ensures accountability, transparency and integrity of the tax system in Malaysia.

Tax Matters within the Scope of the TCGF

The TCGF is a bold step forward in setting out the IRBM’s expectations of how tax decisions should be embedded in the various aspects within the organisation. The scope of the IRBM’s TCGF includes all forms of taxes that are applicable in Malaysia, and the IRBM has listed the following areas that are encouraged to be addressed by tax governance framework developed by a Malaysian organisation:

- Income tax
- Petroleum tax
- Real Property Gains Tax (RPGT)
- Transfer Pricing / Advanced Pricing Arrangement (APA)
- Withholding tax
- Tax payment (CP204, CP 250, CP204A, CP250A, instalments, RPGT and Withholding Tax)
- Monthly tax deduction of employees (CP39, CP39A), additional monthly deduction (CP38)
- Stamp duty
- Taxation on Labuan Business Activities
- Tax incentives and tax strategies
- Public Ruling compliance
- Tax rules and regulations
- Advanced Ruling

Overall, the above tax matters should be addressed by an organisation’s own framework. The IRBM’s TCGF also outlines the following key focus areas that organisations can pay attention to ensure that their tax governance practices are in place and effective:

- Roles and Responsibilities
- Control framework
- Control testing
- Management of tax risks
- Significant or new transactions
- Tax and accounting results

Areas Concerning Transfer Pricing

Despite the TCGF having a broad application to almost all tax matters in Malaysia, there are specific areas where the TCGF focuses on transfer pricing matters that are managed by an organisation. The inclusion of transfer pricing in the TCGF by the IRBM is noteworthy as, in practice, organisations have the tendency of managing transfer pricing issues separately from tax decisions. It is often the case for large scale organisations that transfer pricing matters are dealt with more intermittently as compared to general corporate tax compliance matters that are routinely addressed in yearly financial accounting processes.

This is in part due to the absence of a statutory deadline in Malaysia with regard to the submission of transfer pricing documentations to the IRBM, where documentations are only required to be submitted upon request by the IRBM within a stipulated timeframe. The consequence of such ambiguity would mean that there remains a possibility that transfer pricing matters would be left unattended by the management, until such time when requests are made by the tax authorities or such issues are flagged by other external parties (e.g., external auditors or tax agents).

To address this gap, the TCGF outlines a key area for consideration which relates to “significant or new transactions”. Paragraph 5.5. of the TCGF notes that significant or new transactions are to be identified, documented and subjected to review and a sign-off for tax risk purposes. Examples of evidences that the IRBM may look for could be in the form of:

- Document process to identify and map major categories of transactions to relevant tax classifications (e.g. identification of major related party transactions and their supporting transfer pricing analysis).
- Assess the potential impact due to the change of tax legislations (e.g. announcement of new tax proposals, etc.).
- Determine parameters of a significant or material tax risk (e.g. materiality, approval limits, level of tax risks).
- Ascertain the impact of the tax risks to the business.
- Plans to manage commercial and tax risks, limiting the impact on the business.
- Internal guidance on when significant or new transactions should be escalated within the organisation and/or external advice sought.

The above represents a list of samples evidence or processes that the IRBM may look for during an assessment of the organisation’s tax corporate governance process. Whilst this list is by no means exhaustive in nature, it is also not limited to third party transactions. In fact, the above may also apply to related party transactions and would also form part of the evidences that can be presented to the IRBM to showcase that related party transactions are subjected to similar tax corporate governance processes.

Therefore, organisations can enhance their existing governance framework by including the transfer pricing documentation (and relevant supporting documentation and analysis) to document related party transactions and address tax risks that may arise from transfer pricing adjustments. This will ensure that all current and future related party transactions are appropriately identified and evaluated within the context of the Malaysian Transfer Pricing Guidelines.

Key Benefits of Transfer Pricing Documentations from a Tax Risk Perspective

Malaysian companies should take note that the timely preparation of the transfer pricing documentation for recurring transactions as well as transfer pricing studies for future transactions are essential to mitigate any transfer pricing risks that may already be in existence. The preparation of these documentations would enhance the overall tax corporate governance practices of the organisation as they would include an analysis of past and future related party transactions, as the case may be. The benefits of documenting related party transactions through a transfer pricing documentation or study would result in the overall tax risk of the organisation being lowered. Such benefits may include the following:

- Effective 1 January 2021, any failure to submit a transfer pricing documentation upon request by the IRBM within the stipulated timeframe (typically 14 days) would carry a penalty ranging from RM20,000 to RM100,000 for each year of assessment. As such, overall compliance with the statutory requirements for maintaining the transfer pricing documentation on a yearly basis helps to mitigate the risk of any penalties arising from late submission of transfer pricing documentation.
- Identification of significant related party transactions and evaluation of the arm's length nature of such transactions based on the guidance under the Malaysian Transfer Pricing Guidelines. Such on-going assessment and identification play a role to lower the overall risk of adjustment in the event of any tax audit initiated by the IRBM. A proper internal review process shall also help to enhance the overall tax corporate governance of the organisation. Evidence of such review process can be presented to the IRBM during any tax audit and may serve as qualitative evidence to dissuade the authority from making any transfer pricing adjustment on related party transactions that have been subjected to a robust internal review process in line with the TCGF.
- Preparation of *ex-ante* analysis for future related party transactions including preparation of relevant economic analyses (e.g., benchmarking analysis or Comparable Uncontrolled Price analysis) to serve as evidence that proposed transactions seek to comply with the arm's length principle under the Malaysian Transfer Pricing Guidelines. Such analysis shall lend support that new transactions entered into by the organisation with related parties are not biased in nature, but are sufficiently analysed and supported by documentary evidence prior to implementation.

Concluding Remarks and Next Steps

Going forward, Malaysian corporate taxpayers should ensure timely preparation of the transfer pricing documentation for historical related party transactions by the time the tax returns are submitted as well as undertake appropriate transfer pricing analyses for future transactions. Such documentary evidence remains a key element of the overall tax compliance process in Malaysia and is often a determinant of successful outcomes during transfer pricing audits. Organisations that are keen may also go one step further and consider participation in the TCGF Program hosted by the IRBM to obtain participation status. Such an awarded status would be valid for three years and accords special benefits to organisations such as reduced compliance scrutiny and an expedited tax refund process.

Overall, the TCGF introduced by the IRBM is a positive step towards enhancing the integrity of the Malaysian tax system. However, taxpayers must take swift actions to not only enhance their compliance but also embed the compliance process with regard to transfer pricing documentation within their overall tax governance approach. By doing so, taxpayers will be able to reduce their exposure to tax risks in the form of transfer pricing adjustments.

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