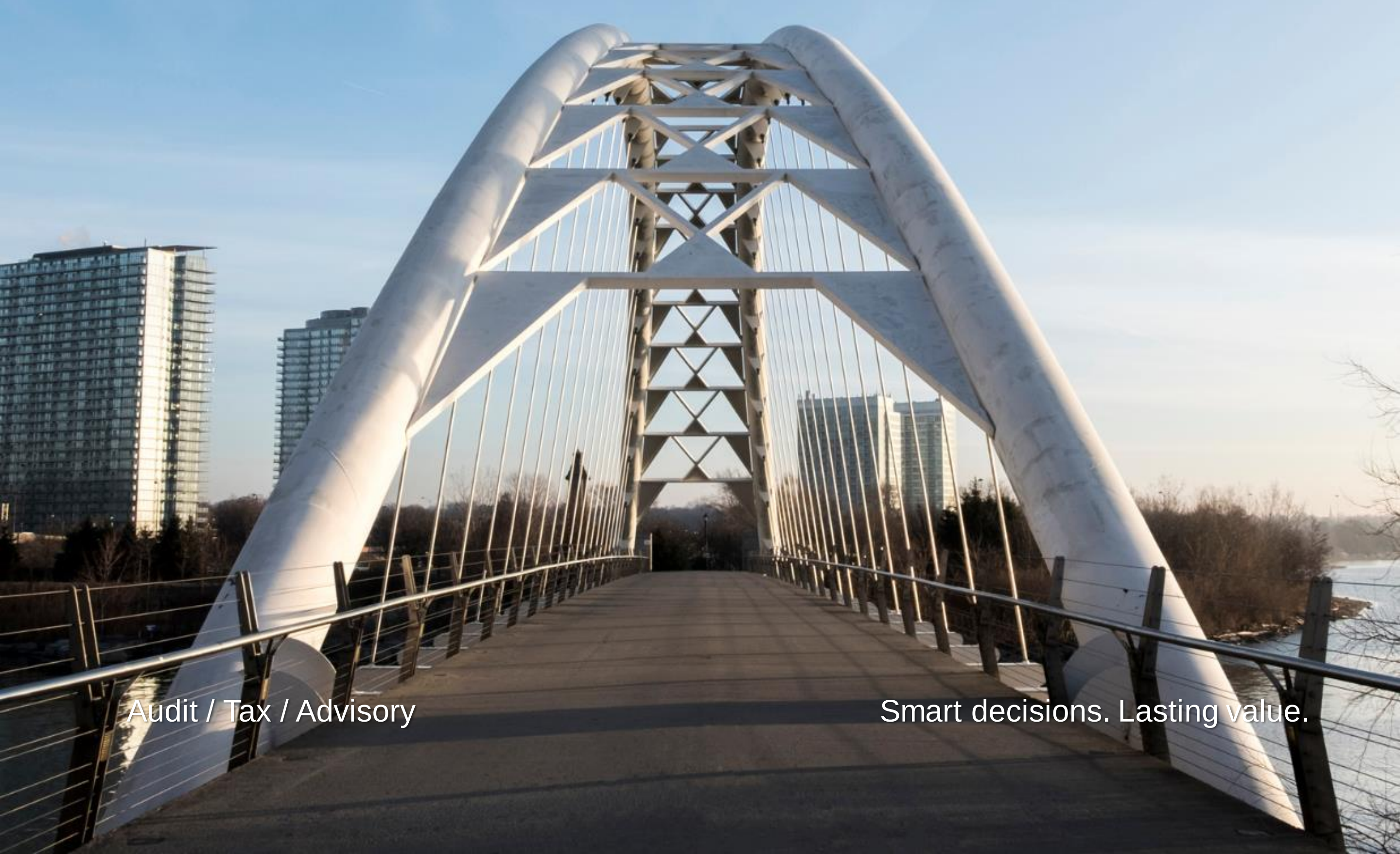
Decoding Malaysia's Latest

Transfer Pricing Rules in 2023

June 2023



Audit / Tax / Advisory

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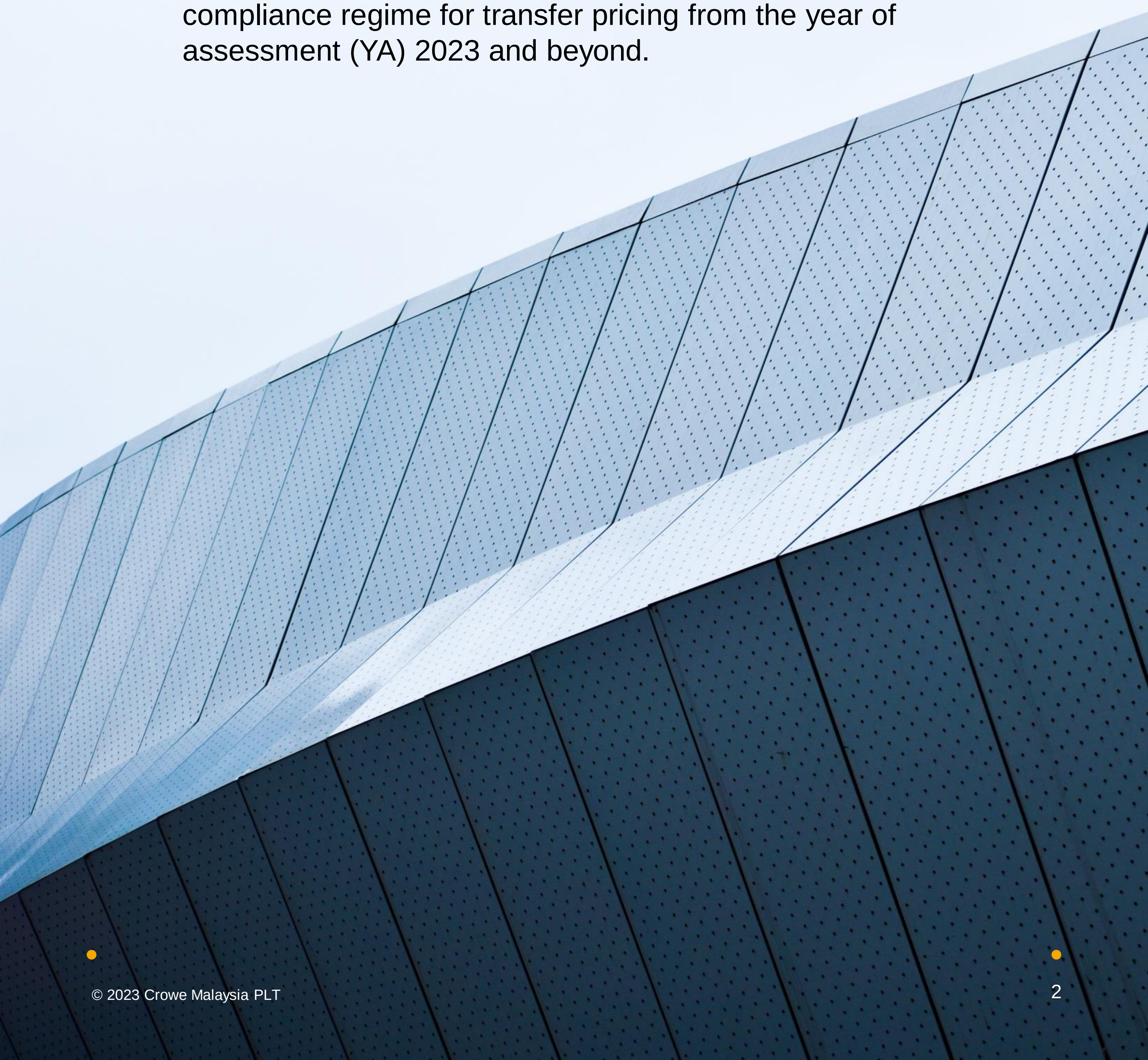
On 29 May 2023, the Income Tax (Transfer Pricing) Rules 2023 ("TP Rules 2023") were gazetted, signifying a major development in Malaysia's transfer pricing landscape and marking a stricter transfer pricing compliance regime.

These legislative developments come amidst a backdrop of some high profile tax cases at the Courts in Malaysia. The issuance of the TP Rules 2023 empowers the Inland Revenue Board ("IRB") with unprecedented powers, leading to a tighter compliance regime for transfer pricing from the year of assessment (YA) 2023 and beyond.



Greater requirement to maintain transfer pricing documentation (“TPD”)

Legislation update

In the past, taxpayers were required to maintain contemporaneous TPDs on a yearly basis. However, there was no statutory deadline imposed by the IRB as TPDs were only required to be made available upon request. Effective YA 2023 onwards, a contemporaneous TPD is one that must state the completion date and contain a list of mandatory information and documents. Rule 4 requires taxpayers to prepare contemporaneous TPDs before the due date for furnishing a return in the basis period for a YA in which a controlled transaction is entered into. In short, the TPD must be dated on a date before the tax filing due date to be contemporaneous.

Although not required to be filed to the IRBM when a tax return is filed, Rule 5(3) of the TP Rules 2023 now provides that a contemporaneous TPD must be furnished to the IRB within 14 days upon request. Failure to submit a contemporaneous TPD on time can attract penalties ranging from RM20,000 to RM100,000 for each YA and/or imprisonment for up to 6 months or both, as stated in Section 113B of the Income Tax Act 1967 (“ITA”),.

Crowe’s observation

Companies engaging in controlled transactions should take immediate measures to ensure compliance with the new requirements. It is recommended that companies should first update and complete their TPD up to the latest YA i.e., YA 2022, so that it can start preparing TPD for YA 2023 onwards.

The timeline for compliance varies depending on the financial year end of companies. It is important to take note that the companies with the FYE 31 January 2023 will be the first group affected by the TP Rules 2023. These companies shall need to file their tax returns by 30 September 2023 (i.e. 7 months after the FYE plus one-month grace period based on the Tax Filing Program for the Year 2023 issued by the IRB on 31 May 2023). Similarly, TPDs must be prepared by the time the tax returns are filed to the IRB to be regarded as contemporaneous TPD.

List of mandatory information to be included in the TPD

Legislation update

Under the Rule 4(2) of the TP Rules 2023, a list of mandatory information has been listed for disclosure by Multinational Enterprise ("MNE") Groups and local business entities, as outlined in Schedule 1 and Schedule 2 of the TP Rules 2023. A summary of the information that are required to be disclosed is shown below:

MNE Group Information under Schedule 1	Business Information under Schedule 2
a) MNE Group's organizational structure and ownership structure. b) Description of the MNE Group's businesses (e.g., products, services, supply chain, business model, business drivers and industry information). c) Description of the MNE Group's intangible property. d) MNE Group's financial activities. e) Financial and tax position of the MNE Group.	a) Organizational structure including ownership structure, management reporting lines between management of the business and its associated persons as well as a local organization chart. b) Nature of the business, industry and market conditions – this includes business models, strategies and corporate business plans relevant to the business. c) Controlled transactions. d) Details of the pricing policies for each type of controlled transactions. e) Assumption, strategies and information regarding factors that influence the setting of pricing policies. f) Functional, asset and risk analysis including the risk analysis framework. g) Comparability analysis (e.g., description of comparable transactions and details regarding the basis and criteria for selection). h) Selection of the transfer pricing methodologies. i) Application of the transfer pricing methodologies. j) Financial information.

Note: Please refer to Schedules 1 and 2 of the TP Rules 2023 for the complete list.

List of mandatory information to be included in the TPD (cont.)

Legislation update

Companies that are involved in cost contribution arrangements ("CCA") are required to disclose the information and documents under Schedule 3 of the TP Rules 2023. Apart from this, companies are also expected to include supporting documents, references and any foundational documents for the transfer pricing analysis.

Rule 4(3) further notes that where any of the information, data or other related documents required under Rule 4(2) is not applicable to the person who enters into a controlled transaction, the person shall indicate the non-applicability of the information, data or documents in the contemporaneous TPD.

Crowe's observation

The introduction of a detailed list of mandatory information into the TP Rules 2023 represents a shift away from the IRB's previous stand in allowing some flexibility for companies to decide the level of detail that is required when preparing a TPD.

Where such mandatory information is not applicable, companies are bound by law to disclose its non-applicability. Prior to this, the information to be documented in TPDs prepared by companies was outlined in Chapter XI Documentation of the Malaysian Transfer Pricing Guidelines ("MTPG"). This list of recommended information under the MTPG that may be included by companies in preparing the TPD is not law binding.

Having a set of TPD may not warrant full compliance if companies do not address the requirements of Rule 4(2) of the TP Rules 2023 adequately.

Penalties ranging from RM20,000 to RM100,000 under Section 113B of the ITA may still be applicable even if the TPD is submitted within the 14 days timeline, if taxpayers fail to meet the stringent definition of a contemporaneous TPD.

It is envisaged that greater efforts are needed and more resources must be dedicated in managing transfer pricing compliance requirements going forward to avoid penalties. Specifically, companies need to establish a robust internal record-keeping system to ensure that relevant transfer pricing information is appropriately captured and maintained in accordance with the TP Rules 2023. The existing TPDs would need to be reviewed and enhanced to a more comprehensive level for YA 2023 and onwards. This may also result in an overall increase in the cost of compliance, particularly for companies that routinely engage in controlled transactions as part and parcel of their day-to-day business operations.

Enhanced powers to make transfer pricing adjustments and redefining the arm's length range ("ALR")

Legislation update

Rule 13 of the TP Rules 2023 affirms the Director General's powers to make transfer pricing adjustments and introduces new provisions for the Director General to make transfer pricing adjustments in circumstances where the price of the controlled transaction entered into by a person is within the ALR or outside the ALR.

The Director General may adjust the price of the controlled transaction to the median or any point above the median within the ALR where:

- The uncontrolled transaction is the kind which has a lesser degree of comparability; or
- Any of the comparability defects cannot be quantified, identified or adjusted.

Where the price falls outside the ALR, the arm's length price shall be taken to the median of the range under Rule 13(2)(b) of the TP Rules 2023.

To make things more complicated, the ALR has a much narrower definition in the TP Rules 2023. The ALR is now defined as a range of figures or a single figure falling between the value of the 37.5 percentile to 62.5 percentile of the data set. The median is the mid-point of the arm's length range. The globally acceptable ALR is the interquartile range (i.e., a point between the 25th percentile and 75th percentile).

Enhanced powers to make transfer pricing adjustments and redefining the arm's length range ("ALR") (cont.)

Crowe's observation

The enhanced powers of the Director General would appear to be a reaction to transfer pricing cases argued at the Courts in Malaysia. In particular, the Sandakan Edible Oils (SEO Case) had previously affirmed the globally accepted principles regarding what constitutes an arm's length range.

In the SEO case, the usage of one single point, i.e. the median point, by the IRB to determine the arm's length price was ruled to have been arbitrary in nature and the Court ruled in favour of the taxpayer in this particular case.

With the introduction of Rule 13, the Director General is given the legal power to restate the arm's length price to the median point (or above) vis-à-vis the globally acceptable principle where any point within the ALR is suffice to justify the transfer pricing position of the taxpayer.

The narrower ALR of 37.5 percentile to 62.5 percentile in the TP Rules 2023 may also render current comparability studies outdated, as previous transfer pricing analyses would have been performed using the interquartile range. For YA 2023, companies must take immediate steps to re-evaluate their transfer pricing positions. This may include refining the benchmarking analyses to support transfer pricing policies that are currently in place and, where applicable, making necessary changes to such policies for YA 2023 to ensure compliance and mitigate the risk of penalties.

Changes at a glance

The table below summarizes the key differences between the TP Rules 2012 and TP Rules 2023, highlighting the changes in timelines, information disclosure and the determination of arm's length prices, among others:

Items	TP Rules 2012	TP Rules 2023
Timeline to prepare TPD	• No statutory timeline so long as the TPD is made available upon request by the IRB.	*Rule 4(1)* • TPD must be dated and be ready by tax return filing deadline.
Information to be disclosed in a TPD	• Does not include the list of information required in a TPD. Instead, it is covered under MTPG. • The list of information under the MTPG is similar to the Schedule 2 - Information on Company.	*Rule 4(2)* • Information on MNE Group (Schedule 1) • Information on Company (Schedule 2) • Information on Cost Contribution Arrangement (Schedule 3) • Any relevant supporting documents • Date of completion of the TPD
Furnishment of a contemporan-eous TPD	Not applicable	*Rule 5(1)* The Director General may, by notice under his hand require any person to furnish the contemporaneous TPD in writing within fourteen (14) days from the date of service.
Determination of arm's length price ("ALP")	• Discuss on the transfer pricing methods.	*Rule 5(1)* A person shall determine an ALP based on the most current reliable information, data or documents that are reasonably available at the time of determination.

Changes at a glance (cont.)

Items	TP Rules 2012	TP Rules 2023
Comparability of transactions	The application of data for comparability from other years prior to or after that basis period is allowed if complete and accurate data are available.	*Rule 7(6)(b)* The application of data for prior years shall only be used to assist in the selection of the comparable and not for the use of multiple year averages. This implies that multiple year averages (weighted average) are no longer applicable.
Definition of ALR	Not included in the TP Rules 2012 but generally applied the OECD Guidelines between the 25th percentile and 75th percentile.	*Rule 13(5)* "Arm's Length Range" means a range of figures or a single figure falling between the value of 37.5 percentile to 62.5 percentile of the data set.
Transfer pricing adjustment	Not included in TP Rules 2012. However, in practice, the IRB would adjust the margins that fall below the median to the median of the ALR.	*Rule 13(2)* • Margins that fall outside ALR, will be adjusted to Median. • Margins that fall within the ALR would generally be acceptable.
Intangible property ("IP")	A person shall be deemed to be an owner of an IP and is entitled to any income attributable to that property if the expenses and risks associated with the development of the IP are borne by that person.	*Rule 11(6)* The owner of the IP is not entitled to any income attributable to that IP if he neither performs the functions nor controls the functions or risks related to the development, enhancement, maintenance, protection or exploitation ("DEMPE") of the intangible property.
Offsetting adjustment	Any adjustment in respect of an assessment made on one of the persons in a controlled transaction may be reflected by an offsetting adjustment on the assessment of the other person in that transaction upon request by that other person.	Removal of the offsetting adjustment clause. This may imply that there will be no offsetting adjustment (corresponding adjustment) allowed by the IRB, even if it is being requested by the other person.

Conclusion

The changes introduced in the TP Rules 2023 have far-reaching implications for taxpayers involved in transfer pricing transactions in Malaysia. These regulatory updates reflect the Malaysian Government's commitment to addressing concerns surrounding base erosion and profit shifting ("BEPS") not only for multinational groups operating within Malaysia but also among domestic companies benefiting from preferential tax incentives. Notably, Malaysia has emerged as the first country in Southeast Asia to formally define our own "arm's length range" that deviates from established international standards as outlined by the Organization for Economic Cooperation and Development ("OECD").

This departure from the OECD standards on transfer pricing necessitates careful planning of transfer pricing practices across the region for multinational corporations. To ensure compliance, companies must now proactively prepare their TPDs on an annual basis, in advance of filing their tax returns. Failure to meet this requirement may expose companies to potential penalties. Therefore, it is essential for persons who are responsible for transfer pricing compliance such as Chief Financial Officers, Finance Managers and Tax Managers to understand and acknowledge the latest development and put in place comprehensive plans to ensure that they do not run afoul of the new rules for the coming YA 2023 and beyond.

In conclusion, the TP Rules 2023 mark a pivotal shift from a "wait and see" approach to transfer pricing compliance in Malaysia. They emphasize the importance of maintaining up-to-date and contemporaneous TPD, making it a vital component of tax compliance for businesses operating in the country. Companies are urged to stay vigilant, adapt their transfer pricing strategies, and align them with the evolving regulatory landscape. By proactively adjusting their practices, companies can navigate the complexities of transfer pricing in Malaysia and mitigate the risk of penalties.

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