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In this article, Song explains Malaysia's new transfer pricing rules, reviewing key changes like the shrinking of the arm's-length range that defines an acceptable financial result of a controlled transaction entered by taxpayers, and the timing mismatch between transfer pricing documentation and the Masterfile required of some large MNEs.

On May 29 the Inland Revenue Board of Malaysia (IRBM) published the Income Tax (Transfer Pricing) Rules 2023 (TPR 2023), effectively superseding the prior regulatory framework under the Income Tax (Transfer Pricing) Rules 2012. The latest development is slated to be operative from the assessment year 2023 onward and signifies a notable shift in the IRBM's approach to transfer pricing compliance.

TPR 2023 encompasses a suite of amendments that bear significant implications for taxpayers, particularly in relation to the preparation of transfer pricing documentation (TPD). The three key highlights of the recent updates and their implications for taxpayers are presented in this article.

Stricter TPD Requirements

TPR 2023 sets forth the requirements for the contents and format of localized TPD. For TPD to meet the standard of a contemporaneous TPD, it must disclose:

- schedule 1: multinational enterprise group information;
- schedule 2: taxpayer's business information;
- schedule 3: cost contribution arrangements information;
- an index to documents, including the indication of nonapplicability of the information, data, or documents in the TPD; and
- the date on which the TPD is completed.

It is important to note that all taxpayers must provide the information as required in schedule 2 of the TPR 2023, while the schedule 1 information concerning MNE groups applies exclusively to taxpayers operating both within and outside Malaysia. Taxpayers engaged in cost contribution arrangements must also provide additional details as outlined in schedule 3.

The TPD for a specific year should be prepared and ready before the deadline for submitting the tax return for that assessment year. The completion date must be shown on the TPD. In Malaysia, corporate taxpayers are obligated to file their tax returns within seven months of the end of the financial year. For example, companies with a financial year ending December 31, 2023, must submit tax returns by July 31, 2024.

TPR 2023 and the Masterfile

The information requirement in schedule 1 closely resembles what is commonly included in a Masterfile. A Masterfile is only required for MNE groups with consolidated group revenue exceeding MYR 3 billion in a financial year, in accordance with the country-by-country reporting thresholds. Under the new rules, regardless of group revenue, Malaysian companies within MNE groups are obligated to disclose extensive information. The added requirements will translate into increased compliance costs when preparing a TPD.

A Masterfile must be submitted by the ultimate (or surrogate) holding company of an MNE Group residing in Malaysia to authorities within 12 months of the end of the financial year. But the local TPD now requires that the same information be made available when the tax return is filed, seven months from the end of the financial year. The misalignment poses a challenge for large MNE groups striving to comply with the evolving regulations.

The TPR 2023 has ushered in a more comprehensive compliance framework, extending its reach to those entities that fall below the Masterfile thresholds. While these changes aim to enhance transparency and fairness in transfer pricing, they will also necessitate a meticulous approach and careful coordination, taking into account the distinct timelines involved in local TPD and Masterfile preparation. Navigating these complexities will be crucial for Malaysian companies seeking to comply while effectively managing associated costs.

Failure to meet the TPR 2023 rigorous requirements for a contemporaneous TPD may result in substantial penalties ranging from MYR 20,000 to MYR 100,000 (about $21,000), under section 113B of the Malaysian Income Tax Act 1967, in any of the following circumstances:

- failure to submit the TPD within 14 days of the IRBM request;
- failure to provide the information required in the TPR 2023; or
- failure to complete the TPD by the tax return filing deadline.

Narrower Arm's-Length Range

In recent years, the IRBM largely adopted the globally accepted arm's-length range (ALR) — the interquartile range that encompasses points falling between the 25th and 75th percentiles of the dataset. However, with the introduction of TPR 2023, Malaysia has established its own ALR, narrowing it down to a percentile range of 37.5 to 62.5. This is a considerably narrower range relative to the former. The OECD allows statistical tools that take account of a central tendency to narrow the range of a sizeable number of observations, for example, interquartile ranges or other percentiles, to help enhance the reliability of the analysis.

If the transfer price of a controlled transaction entered into by taxpayers or the financial result of the taxpayers falls outside the ALR, the IRBM is empowered to make an adjustment to the median. Notably, the median is defined in TPR 2023 as the midpoint of the arm's-length range — a calculation using a simple mathematical formula, an average of the value of 37.5 and 62.5 percentiles. This formula deviates from the commonly used 50th percentile point.

Malaysia is the first country to adopt a percentile ALR of 37.5 to 62.5. The narrower ALR may render existing comparability studies obsolete because previous transfer pricing analyses would have used the broader interquartile range. The redefined ALR means that the IRBM has more capacity to make transfer pricing adjustments. Taxpayers need to reassess existing transfer pricing policies to align with the new ALR from 2023 onward. Taxpayers should undertake a thorough review of comparables to ensure a higher degree of matching in selecting the comparable set. Proactive measures will be necessary to ensure that transfer prices remain within the confines of this more restrictive range of acceptable results. These measures will help companies withstand adjustments and safeguard the integrity of transfer pricing practices.

Misaligned Benchmarking Analysis Data

TPR 2023 provides that the results of a controlled transaction should be compared with the results of an uncontrolled transaction undertaken or carried out during the same year as the taxpayer's transaction (comparison on a year-on-year basis).

It also highlights that the taxpayer must determine an arm's-length price based on the most current reliable information, data, or documents reasonably available at the time. If current-year data is not available, taxpayers are allowed to use prior-year data in the selection of comparables. The rules further clarify that the use of multiyear averages (weighted average results) is no longer acceptable.

The Challenge of Up-to-Date Financial Data

Taxpayers may encounter difficulties obtaining up-to-date financial data for the current year with the TPD now required to be completed before the tax return filing deadline. This timing discrepancy presents a significant challenge, particularly when applying the transactional net margin method for the benchmarking analysis. It is almost impossible for taxpayers to obtain the financial data of comparable companies in the same benchmark year. This information would usually be available publicly seven months after the end of the companies' financial year, coinciding with the tax return filing deadline. It is therefore unlikely that the results can be compared on a year-on-year basis.

In response, the IRBM allows taxpayers to use the prior year's data (comparing the financial results of the taxpayer for financial year 2023 with benchmarking results from financial year 2022). However, this approach might not accurately capture the market conditions or the economic landscape of the respective years.

The IRBM expects taxpayers to update the benchmarking results as soon as the most current data become available (likely after the tax return filing deadline), or to update the data during the IRBM tax audit. The timing mismatch between TPD preparation and the actual assessment during a tax audit is a further compliance hurdle for taxpayers.

Conclusion

The year 2023 marks a significant milestone in the landscape of transfer pricing practices in Malaysia with the newly issued TPR 2023. These rules, set to take effect from the assessment year 2023 onward, usher in a more rigorous compliance framework, particularly with the narrower ALR and the more stringent requirements for contemporaneous TPD. While these changes are aimed at enhancing transparency and fairness in transfer pricing, they will also bring practical challenges for taxpayers.

The narrower percentile ALR of 37.5 to 62.5 is the first in the world, diverging from the established interquartile range practiced by many tax jurisdictions. This change offers the IRBM greater leeway to make adjustments and will require businesses to reassess transfer pricing policies to maintain more meticulous compliance.

Navigating these regulatory changes effectively will be essential for businesses in Malaysia. Businesses will need to adapt proactively to the new compliance requirements, embracing precise, up-to-date documentation and vigilant financial monitoring while factoring in the evolving complexities of data availability and regulatory timelines. The new rules emphasize the importance of aligning transfer pricing practices with the dynamic landscape of international tax regulations to ensure compliance and effectively minimize risks. ■