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Transfer Pricing

Important Updates for 2021

Summary

The Finance Act 2020 was gazetted on 31 December 2020 and has been operative since 1 January 2021. Amongst others, there are several new provisions found in the Finance Act 2020 that aim to strengthen the enforcement for transfer pricing (“TP”) compliance in Malaysia. On another note, the Inland Revenue Board ("IRB") has also updated the timeline for furnishing TP Documentation (“TPD”) in the Malaysian TP Guidelines ("MTPG") on 29 January 2021.

The key changes that will take effect from 1 January 2021 are:

Section 113B
Introduction of **new penalty of between RM20,000 to RM100,000** for failure to submit TPD to the IRB on time.

Section 140A(3C)
Introduction of new surcharge of not more than **5% on TP adjustments** made during a TP audit. TP adjustments are adjustments made to transfer prices between related parties which the IRB does not consider to be at arms’ length.

Updated para 11.2.3 and 11.3.5 of MTPG
Period to submit TPD to IRB has been shortened from 30 days to **14 days**, and circumstances where no penalty is imposed by the IRB.

Section 140A(3A) & (3B)
The IRB is empowered to **disregard the structure** in a controlled transaction and make TP adjustments to the structure that the IRB thinks fit.

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Effective from 1.1.2021

<table>
<tr><th>New Updates</th><th>Details</th><th>Implications</th></tr>
<tr><td>[Section 113B]
Penalty for failure to submit TPD to the IRB on time</td><td>Where there is a prosecution and on conviction – a taxpayer is liable to a fine of between RM20,000 and RM100,000 or to imprisonment for a term up to 6 months, or both.

Where there is no prosecution – a taxpayer may be imposed a penalty of between RM20,000 and RM100,000.</td><td>TPD is made mandatory for companies undertaking related party transactions (also known as "controlled transactions"). The TPD must be contemporaneous (i.e. up-to-date) and penalties shall be imposed if a taxpayer fails to furnish the contemporaneous TPD in a timely manner upon request by the IRB.</td></tr>
<tr><td>[Paragraph 11.2.3 of MTPG]
Timeline for submission of TPD to the IRB upon request</td><td>Period to submit the TPD to the IRB has been shortened from 30 days to 14 days. This requirement will apply to TP audit cases which commence on or after 1.1.2021.</td><td>Taxpayers who fail to submit the TPD to the IRB within 14 days upon request will be penalised under Section 113B which carries penalties of between RM20,000 and RM100,000.</td></tr>
<tr><td>[Paragraph 11.3.5 of MTPG]
Cases where no penalty will be imposed by the IRB during a TP audit</td><td>Penalties under Section 113B and/or Section 113(2) will not be imposed in cases, where:
<table><tr><th>Commencement of TP audit cases</th><th>Submission of TPD to the IRB</th><th>TPD compliance</th></tr><tr><td>Prior to 1.1.2021</td><td>Within 30 days</td><td rowspan="2">TPD fulfils the requirements of the TP Rules and MTPG.</td></tr><tr><td>On or after 1.1.2021</td><td>Within 14 days</td></tr></table></td><td>To avoid penalties being imposed, taxpayers must comply with the TPD requirements strictly, including:
• Preparation of contemporaneous TPD;
• TPD is of good quality in accordance with the IRB's MTPG;
• Upon request by the IRB, to submit the TPD to the IRB within 14 days (for TP audits that commenced from 1.1.2021 onwards).</td></tr>
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Effective from 1.1.2021 (cont'd)

New Updates	Details	Implications
[Section 140A(3C)] **Surcharge** on TP adjustments made during a TP audit	**Surcharge may range from 0% to 5%** on the amount of increase of income or reduction of tax deduction, arising from TP adjustments.	The surcharge is imposed on the amount of TP adjustment, not on the additional tax liability. Hence, non-taxable entities that are enjoying tax incentives, having tax losses, etc. have higher TP risk as compared to the years before 1 January 2021.
[Section 140A(3A) & (3B)] Power to **disregard a structure** in a controlled transaction and **make TP adjustments** to a structure that the IRB thinks fit	The IRB can make appropriate TP adjustments if it is of the view that: a. The economic substance of a controlled transaction differs from its form; or b. The controlled transaction differs from commercially acceptable transactions undertaken by independent parties.	Business structure adopted by taxpayers which are related to each other may be scrutinized by the IRB from the commercial perspective. If the resulting controlled transactions do not reflect commercial reality, the IRB may recharacterize the transaction and make appropriate TP adjustments it thinks fit.

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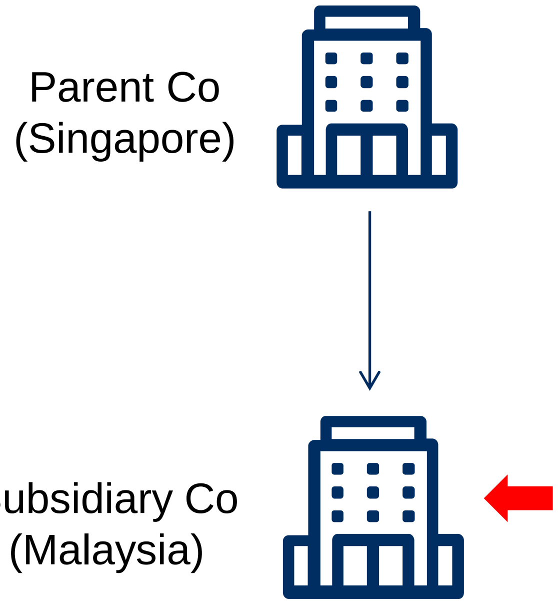
Example

Calculations of the

- **New Surcharge under Section 140A(3C)**
- **New Penalty under Section 113B**



- Loss Making
- No TPD prepared

IRB's TP audit:
- TP adjustment of **RM5 mil**
- However, the company has **no** additional tax payable as it is in a tax loss position even after the TP adjustment

	Section	Penalty Regime	Surcharge or penalty
Previous regime	No provision in the law to impose surcharge or penalty for loss making entities	N/A	**NIL**
From 1.1.2021 onwards	S140A(3C) – Surcharge on TP adjustment	Surcharge at up to 5%	**Up to RM250k**
	S113B(4) – Failure to furnish TPD	Between RM20k and 100k	**Up to RM100k**

WHO is liable to prepare a TPD?

- Companies that undertake the controlled transactions (i.e. sales and purchases of goods, provision of services, intra-group financing arrangements and use of intangible properties).
- A **Full TPD** is required when a company has:-
    - Annual gross income **exceeding RM25 mil** and total related party transactions **exceeding RM15 mil** per annum; or
    - Provision of financial assistance exceeding **RM50 mil** for non-financial institutions.
- Otherwise, taxpayers that fall below the thresholds may opt to prepare a **Limited TPD**.

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WHEN to prepare a TPD?

A TPD should be prepared and is regarded as **contemporaneous** under the following circumstances:

- At the time a person is developing or implementing any controlled transaction; and
- Annual review of the existing TPD prior to the due date for filing of tax return (i.e. Form C) for a year of assessment.

- The information contained in the TPD, in particular, the financial data and suitability of the comparable companies (entities which are used for comparison purposes in a TP study) should be **reviewed and updated every year** in order to apply the arm's length principle reliably.
- In addition, a company is required to update the full set of TPD together with a fresh search of the comparable companies through a benchmarking study **every three (3) years**.

Example:

Year	Year of Assessment	TPD compliance
Year 1	2019	Preparation of a TPD with a new benchmarking analysis
Year 2	2020	Preparation of financial update of the benchmarking analysis
Year 3	2021	Preparation of financial update of the benchmarking analysis
Year 4	2022	Update of full set of TPD with a new search of benchmarking analysis

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HOW to prepare a TPD?

- A good quality TPD that complies with the MTPG shall include the following contents:

Contents of Documentation	Full TPD	Limited TPD
Group Overview / Company Background	√	√
Controlled Transactions	√	√
Pricing Policies • Includes a comparability study to ensure the correctness of arm's length prices	√	√
Industry Analysis	√	×
FAR Analysis (Functions, Assets and Risks)	√	×
Selection and application of TP Method	√	×
Benchmarking Analysis	√	×
Financial Analysis	√	×

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Contact us

Crowe KL Tax Sdn Bhd Level 15, Tower C Megan Avenue II
12, Jalan Yap Kwan Seng
50450 Kuala Lumpur
Malaysia

Tel. +603 2788 9898

Start the conversation with us

Corporate Tax Compliance

Foo Meng Huei
Executive Director
menghuei.foo@crowe.my
+603 2788 9898 Ext 12501

Voon Yuen Hoong
Executive Director
yuenhoong.voon@crowe.my
+603 2788 9898 Ext 12522

Wong Man Yee
Executive Director
manyee.wong@crowe.my
+603 2788 9898 Ext 12519

Liza Ooi Yap Lin
Director
liza.ooi@crowe.my
+603 2788 9898 Ext 12557

Tax Advisory

Chong Mun Yew
Executive Director
munyew.chong@crowe.my
+603 2788 9898 Ext 12523

Indirect Tax

Fam Fui Chien
Manager
fuichien.fam@crowe.my
+603 2788 9898 Ext 12504

Norhayati Ruslan
Manager
norhayati.ruslan@crowe.my
+603 2788 9898 Ext 12597

Transfer Pricing

Song Sylvia
Executive Director
sylvia.song@crowe.my
+6016 2191573
+603 2788 9898 Ext 12514

Global Mobility Services

Shalina Binti Jaafar
Executive Director
shalina.jaafar@crowe.my
+603 2788 9898 Ext 12505

Business Outsourcing

Esther Chan
Manager
esther.chan@crowe.my
+603 2788 9898 Ext 12546

Our offices
(West Malaysia)

Kuala Lumpur
Level 16, Tower C,
Megan Avenue 2,
12 Jalan Yap Kwan Seng,
50450 Kuala Lumpur,
Malaysia

+603 2788 9898 Main
+603 2788 9899 Fax

Klang
Suite 50-3, Setia Avenue,
No. 2, Jalan Setia Prima
SU13/S,
Setia Alam, Seksyen U13,
40170 Shah Alam,
Selangor, Malaysia

+603 3343 0730 Main
+603 3344 3036 Fax

Ipoh
A-2-16, 2nd Floor, Wisma MFCB
1, Persiaran Greentown 2
Greentown Business Centre
30450 Ipoh, Perak Darul Ridzuan
Malaysia

+605 238 0411 Main

Penang
Level 6, Wisma Penang Garden,
42 Jalan Sultan Ahmad Shah,
10050 Penang, Malaysia

+604 227 7061 Main
+604 227 8011 Fax

Melaka
52 Jalan Kota Laksamana 2/15,
Taman Kota Laksamana, Seksyen 2,
75200 Melaka, Malaysia

+606 282 5995 Main
+606 283 6449 Fax

Johor Bahru
E-2-3 Pusat Komersial Bayu Tasek,
Persiaran Southkey 1,
Kota Southkey,
80150 Johor Bahru,
Johor, Malaysia

+607 288 6627 Main
+607 338 4627 Fax

Muar
8, Jalan Pesta 1/1,
Taman Tun Dr. Ismail 1,
Jalan Bakri, 84000 Muar,
Johor, Malaysia

+606 952 4328 Main
+606 952 7328 Fax

Our offices
(East Malaysia)

Kuching
2nd Floor, C378, Block C,
iCom Square,
Jalan Pending,
93450 Kuching,
Sarawak, Malaysia

+6082 552 688 Main
+6082 266 987 Fax

Miri
Lot 2395, Block 4,
Bulatan Business Park,
Jalan Bulatan Park, 98000 Miri,
Sarawak, Malaysia

+6085 658 835 Main
+6085 655 001 Fax

Bintulu
1st floor, Lot 4542-4543,
Jalan Abang Galau Shophouse,
Kampung Masjid, 97000 Bintulu,
Sarawak, Malaysia

+6086 333 328 Main
+6086 334 802 Fax

Sibu
1st & 2nd Floor, No. 1 Lorong
Pahlawan 7A2, Jalan Pahlawan,
96000 Sibu, Sarawak, Malaysia

+6084 211 777 Main
+6084 216 622 Fax

Labuan
Lot 36, Block D, Lazenda Centre,
Jalan OKK Abdullah, P.O. Box
81599, 87025, Labuan, Malaysia

+6087 417 128 Main
+6087 417 129 Fax

Kota Kinabalu
Damai Plaza 3, 3rd Floor, C11, Jalan
Damai 88300, P.O. Box 11003,
88811 Kota Kinabalu, Sabah, Malaysia

+6088 233 733 Main
+6088 238 955 Fax

Contact us

Crowe Malaysia PLT
Level 16, Tower C
Megan Avenue 2
12, Jalan Yap Kwan Seng
50450 Kuala Lumpur
Malaysia

Tel. +603 2788 9999

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