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Malaysia introduces new Transfer Pricing Rules 2023

EY Tax Alert (Special Edition)

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Coverage of this Alert

- Introduction of new TP Rules
- Contemporaneous TP documentation requirements
- Arm's length range
- Comparability analysis
- Intangible property
- Other notable points

Key highlights:

- Contemporaneous transfer pricing (TP) documentation must be prepared prior to the due date for filing the tax return and the date of preparation must be stated on the documentation
- Enhancement of TP documentation requirements – focuses on the preparation of robust TP analysis
- Sets the "arm's length range" that will be applied in determining the arm's length price in a controlled transaction
- Increases emphasis on the accurate delineation of the controlled transaction based on economically relevant characteristics for comparability analysis purposes
- Continued focus on the importance of Development, Enhancement, Maintenance, Protection and Exploitation (DEMPE) analysis for intangible property and cost contribution arrangements

The Inland Revenue Board of Malaysia (IRB) has released new Transfer Pricing Rules, cited as the Income Tax (Transfer Pricing) Rules 2023 [P.U.(A) 165] (new TP Rules), dated 29 May 2023.

The changes set out in the new TP Rules are summarized below.

Introduction of new TP Rules

- The Rules have effect for the year of assessment (YA) 2023 and subsequent YAs.
- The Income Tax (Transfer Pricing) Rules 2012 [P.U. (A) 132/2012] (2012 TP Rules) are revoked.

Contemporaneous TP documentation requirements

- Inclusion of schedules (see Schedules 1, 2 and 3 to the new TP Rules) which elaborate on the information required to be documented as part of the TP documentation. Additional information requirements include the following:

  - **Schedule 1** Multinational Enterprise Group Information – the information required is similar to the Master File requirements provided in the IRB's TP Guidelines[1]
  - **Schedule 2** Taxpayer Business Information – the information required is similar to the IRB's TP Guidelines, with additional disclosures on the local organization chart (headcount and heads of departments, including whether they are expatriates or Malaysians)) as at the end of the basis period, pricing policies (effect of material changes) for each type of controlled transaction and comparability analysis (including comparability adjustments, selection of methods and reasons for the aggregation of transactions).
  - **Schedule 3** Cost Contribution Arrangement (CCA) Information and Documents – the information required is similar to the IRB's TP Guidelines (updated in 2017), with additional disclosures on the management and control of the DEMPE of tangible and intangibles assets used in CCA activities.

- Requires taxpayers to state the **date on which the contemporaneous TP documentation is completed.** The TP documentation must be brought into existence prior to the due date for furnishing the tax return.
- Requires taxpayers to include documents which form the foundation of, which support the development of, or which were referred to in developing the TP analysis.
- Includes provisions on the preparation and furnishment of contemporaneous TP documentation – use of reliable information, data retention and the requirement to furnish the documentation within 14 days from the date of request by the IRB.
- The Director General (DG) of the IRB is given the power to issue any guidelines to facilitate the implementation of the new TP Rules.

Arm's length range

- Sets the "arm's length range" that will be applied in determining the arm's length price in a controlled transaction. Tightened the "arm's length range" by introducing a range of figures or a single figure falling between the **value of the 37.5 percentile to the 62.5 percentile** of the data set as acceptable by the DG to determine whether the arm's length price has been applied in a controlled transaction.

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[1] Malaysian Transfer Pricing Guidelines 2012 (revised in July 2017)

- Explains that the price for a controlled transaction **may be regarded as the arm's length price if it falls within the arm's length range**. That said, the DG may still adjust the price of a controlled transaction to the median or any point above the median, due to comparability defects which cannot be quantified, identified or adjusted.
- Further explains that if the price of a controlled transaction is outside the arm's length range, the arm's length price shall be taken to be the median.
- A surcharge of up to five percent may be imposed on TP adjustments made by the DG.

Comparability analysis

- Further guidance on comparability analysis including the accurate delineation of a controlled transaction before determining a comparable uncontrolled transaction, and functional analysis considerations for the accurate delineation of a controlled transaction.
- Additional condition for the use of data from years under examination and prior years - i.e., the DG should be satisfied that the life cycles or business cycles of the property/services are not impacted by the conditions of commercial or financial relations between associated persons.
- Further emphasizes the purpose of using prior year data - i.e., to assist in the selection of comparable and not for the use of multiple year averages.
- Stipulates that taxpayers must ensure that the basis for the method selected is supported by explanations and reasons that the method selected and the profit level indicator are appropriate as a better approximation to determine the arm's length price, and are based on the facts and circumstances (including the economically relevant characteristics of the controlled transaction which has been accurately delineated).
- The DG is given the power to review the method and replace this with another method he believes to be more appropriate.

Intangible property

- Emphasises that the contributor to the value of the intangible property through DEMPE is entitled to an arm's length consideration, regardless of legal ownership.
- The owner of intangible property is not entitled to any income attributable to that intangible property if he neither performs the functions nor controls the functions or risks related to the DEMPE of the intangible property.
- The above provisions are similar to the IRB's TP Guidelines.

Other notable points

- **New, enhanced or amended definitions of certain terms in the new TP Rules** include "Multinational Enterprise Group", "Profit Level Indicator". "Intangible Property" and "Marketing Intangibles", some of which are similarly defined in the IRB's TP Guidelines.
- **Certain provisions under the 2012 TP Rules have been removed**, including the re-characterization of transactions, and the provision for offsetting adjustments.

Practical considerations for taxpayers

The new TP Rules are very much welcomed, as they provide further clarity and guidance on the application of the arm's length principle. However, taxpayers should note the following issues:

- The DG is still given the power to make adjustments to the median point or above under the new TP Rules, even if the price at which the controlled transaction is entered into is within the arm's length range.
- The new TP Rules remain silent on what constitutes a comparability defect and how can it be addressed.
- Additional TP documentation requirements for taxpayers, in particular extensive information required under Schedule 1 relating to Multinational Enterprise Groups. This is particularly onerous for taxpayers that are part of a Group to which the Master File requirements do not apply.
- Burden of proof is on taxpayers to maintain records, documents and intercompany transaction workings to demonstrate that the related party transactions are commercially rational and economically relevant.
- Continued burden on taxpayers to prove that their prior year data is reliable in the absence of financial data of comparable companies for the relevant YA.
- Silent on the use of a non-Malaysian benchmarking studies for the purpose of comparability analysis.
- The 2012 TP Rules stipulated that a TP adjustment on one of the persons in a controlled transaction may be offset by an adjustment on the assessment of the other person in that transaction, upon request by that other person. This provision has been removed from the new TP Rules effective from YA 2023. While the IRB's TP Guidelines still allows for a corresponding adjustment (upon request), this would now be at the discretion of the DG.

Next steps for taxpayers

- Taxpayers should start planning, preparing and gathering relevant group level information and documentation to satisfy the requirements of Schedule 1 to the new TP Rules.
- Taxpayers must re-assess the current operational conditions to determine if there are any material changes and accordingly, prepare contemporaneous TP documentation before the date of filing of the tax return.
- For transactions involving intangibles, including CCAs, an assessment of the relative value of contribution by each party, comparability of contributions and a DEMPE analysis, as relevant, are required to determine the arm's length price.

How EY can help you

- We can assist with the timely preparation of robust contemporaneous TP documentation which are in line with the requirements of the new TP Rules

- We can assist you in enhancing and improving existing TP documentation and analysis by applying the principles in the new TP Rules

- We can advise you on the appropriate TP policies and pricing mechanisms, as well as assist in reviewing existing contractual arrangements and assessing the TP implications and considerations in light of the new TP Rules and updated TP Guidelines

- We can assist you in TP audit defense and support you in technical TP issues to address queries from the IRB

- We can assist in the application for Advance Pricing Agreements to gain certainty on the appropriate TP methodology and/or application of Mutual Agreement Procedures to resolve double taxation issues

A separate communication on the EY Tax Webinar to discuss the new TP Rules will follow this alert shortly.

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