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GLOBAL TRANSFER PRICING SERVICES

Global Transfer Pricing Review

Malaysia

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TAX



Malaysia



KPMG observation

The Malaysian tax authority is serious about implementing and monitoring transfer pricing compliance. This is signalled by a new check box that has been inserted in/on the 2014 tax return form. Transfer pricing guidelines were first introduced in Malaysia in 2003. While the Malaysian tax authority continues its scrutiny of traditional related party transactions involving sales and purchases of goods and provision of intra-group services, they are now scrutinizing royalty and trademark payments as well as intra-group financing arrangements. In addition, they have developed new concepts on marketing intangibles.

KPMG in Malaysia observes that transfer pricing audits are intensifying year-by-year. In particular, payment of significant intra-group charges has become a very contentious area. Many taxpayers are now fighting an uphill audit battle due to a lack of documentation supporting the arm's length nature of such charges. Also, more companies are beginning to appeal through the judicial system to settle their transfer pricing disputes with the Malaysian tax authority. The first transfer pricing case was heard by the Special Commissioner of Income Tax in 2010. A decision in favor of the taxpayer was recently announced in November 2013. Having in place robust transfer pricing documentation and the availability and accessibility of supporting source documentation were the key lessons learnt from this maiden transfer pricing court case. The Malaysian tax authority has subsequently appealed to the High Court. The Malaysian tax authority is also encouraging taxpayers to apply for Advance Pricing Agreements (APAs) to achieve certainty on their transfer prices rather than wait for an audit.

It is noteworthy to mention that the Malaysian Inland Revenue Board (MIRB) is continuing to enhance its transfer pricing knowledge through participation in international seminars, meetings and conferences. In this regard, the MIRB has co-authored and contributed a section on the Malaysian transfer pricing capacity building experiences to the United Nations Practical transfer pricing manual for Developing Countries, which was issued in October 2012.

Basic information

Tax authority name

Lembaga Hasil Dalam Negeri (Malaysian Inland Revenue Board or MIRB).

Citation for transfer pricing rules

The arm's length provision is set out in Section 140A of the Malaysian Income Tax Act 1967 (the Act). Section 140A requires taxpayers to determine and apply the arm's length price for their transactions with an associated person for the acquisition or supply of property or services. Along with the introduction of Section 140A, the concept of thin capitalization was also introduced, but implementation has been deferred until the end of December 2015.

Income Tax (Transfer Pricing) Rules 2012 (TP Rules 2012) were released to the public on 11 May 2012. The scope of Transfer Pricing (TP) Rules 2012 applies to the acquisition and supply of goods (including tangible and intangible goods), services between associated persons and intra-group financing. Both local and cross-border transactions are covered under TP Rules 2012.

Effective date of transfer pricing rules

Section 140A became effective from 1 January 2009. Prior to this date, transfer pricing adjustments were made based on the general anti-avoidance provision. TP Rules 2012 are applied retroactively, from 1 January 2009.

The transfer pricing guidelines issued in 2003 were revised in July 2012.

What is the relationship threshold for transfer pricing rules to apply between parties?

The scope of TP Rules 2012 applies to transactions between 'associated persons.' Generally, a relationship is deemed to exist if there is a shareholding relationship of more than 50 percent. However, the Malaysian transfer pricing guidelines also consider a relationship to exist if one party participates directly or indirectly in the management, control, or capital of the other party or the same person participates directly or indirectly in the management, control and capital of both companies.

What is the statute of limitations on assessment of transfer pricing adjustments?

The statute of limitation is 5 years upon the expiration of a particular year of assessment, except in cases of investigations, fraud, willful default, or negligence. Malaysia is currently in year of assessment 2014. For example, in year of assessment 2014, an assessment can be issued as far back as year of assessment 2009.

Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be prepared or submitted to the revenue authority on an annual basis (e.g. with the tax return)?

As previously mentioned, with effect from year of assessment 2014, taxpayers are required to declare in the annual tax return forms, whether they have prepared transfer pricing documentation.

Besides that, the amount of transactions with associated persons are also needed to be disclosed in the annual tax return forms.

In July 2011, Form MNE [2/2012] was introduced by the MIRB to collect certain information from taxpayers relating to their cross-border transactions. This is issued only to selected taxpayers and aims to complement the information already disclosed in the annual tax returns. The introduction of this Form can be viewed as a major step towards the introduction of formal transfer pricing returns in the future.

What types of transfer pricing information must be disclosed?

The annual tax return forms require taxpayers to declare whether they have prepared transfer pricing documentation, as well as the disclosure of the amount of transactions with associated persons for the following type of transactions:

- sales to associated persons
- purchases from associated persons
- other payments to associated persons
- loans to/from associated persons
- receipts from associated persons.

On the other hand, the Form MNE [2/2012] can be segregated into four sections:

- general information
- particulars of transaction with foreign related companies
- particulars of financial assistance with foreign related companies
- other information including a declaration whether transfer pricing documentation has been prepared for the relevant year, a declaration of any business restructuring for the taxpayer and its related parties in the group during the year or the last 5 years, and an overall characterization of the company.

What are the consequences of failure to prepare or submit disclosures?

For disclosures which are part and parcel of the annual tax return forms, failure to furnish information relating to the disclosures could render the annual tax return form as an incorrect return, which on conviction, could result in a fine of not less than 1,000 Malaysian ringgits (MYR) and not more than MYR10,000 (approximately 3,000 US dollars (USD)).

Transfer pricing study overview

Is preparation of a transfer pricing study required – i.e. can the taxpayer be penalized for mere failure to prepare a study?

No.

Other than complying with a requirement per the previous question, describe the benefits, if any, of preparing and maintaining a transfer pricing study?

The documentation can serve as a first line of defense in the event of a tax audit and may assist the taxpayer to obtain a lower penalty rate. With transfer pricing documentation, transfer pricing adjustments made during tax audits by the MIRB will be subject to a lower penalty rate of 25 percent as opposed to 35 percent. Further, based on the transfer pricing audit framework, the taxpayer can have penalty protection (i.e. nil penalty) if its transfer pricing documentation is deemed contemporaneous.

Under the self-assessment system, the burden of proof is on the taxpayer to show that its transactions with associated persons have been carried out on an arm's length basis. To demonstrate this, taxpayers are required to prepare contemporaneous transfer pricing documentation based on TP Rules 2012 and the Malaysian transfer pricing guidelines.

To satisfy the requirement and/or obtain the benefits, are there any requirements on when the transfer pricing study must be prepared and submitted?

Documentation should be prepared contemporaneously (that is, taxpayers need to ensure that transfer pricing documentation is prepared when developing or implementing a transaction with associated person(s). Where there are material changes, the transfer pricing documentation should be updated prior to the due date for furnishing a tax return for that year of assessment).

There is no requirement to submit the documentation but it must be readily available upon request by the MIRB.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

Yes.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

Transfer pricing methods

Are transfer pricing methods outlined in Chapter II of the OECD Guidelines acceptable?

Yes.

Is there a priority among the acceptable methods?

TP Rules 2012 provide that traditional transactional methods should be considered first before transactional profit methods.

If there is no priority of methods, is there a “best method” rule?

As indicated above, the preference is for traditional transactional methods. However, the Malaysian transfer pricing guidelines recognize that the method requiring the fewest adjustments and providing the most reliable measure of an arm’s length result is preferred by the MIRB.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer’s transfer pricing documentation, how long does the taxpayer have to submit its documentation?

Documentation should be made available to the MIRB within 30 days from the date of request.

If an adjustment is proposed by the tax authority, are dispute resolution options available to the taxpayer outside of competent authority?

A dispute resolution department has been set up recently by the MIRB to resolve matters prior to court proceedings. With respect to the judicial system the first level of the appeal is generally to the Special Commissioner of Income Tax through the submission of a Form Q.

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

Transfer pricing adjustments made during a tax audit which result in additional tax payable will be subject to a general penalty rate of 35 percent of the additional taxes payable. A lower penalty rate of 25 percent will apply where transfer pricing documentation is prepared and nil where the transfer pricing documentation meets the contemporaneous requirement

To what extent are transfer pricing penalties enforced?

Always.

What defences are available with respect to penalties?

The availability of a local contemporaneous transfer pricing documentation will assist taxpayers to appeal for a lower penalty rate. In addition,

the MIRB will also take into account if the taxpayer has acted in good faith and fully cooperated during the tax audit.

What trends are being observed currently?

Transfer pricing audits have intensified and are expected to continue to intensify in Malaysia. In addition to the usual focus on transactions involving sales and purchases of goods, the Malaysian tax authorities are also increasing their scrutiny on payments for intra-group services as well as looking into intra-group financing arrangements and payments in relation to intangible properties.

Common audit triggers include companies exhibiting consistent losses, fluctuating profitability or those making very low profits. Companies with significant amounts of related party transactions, especially payments for intra-group services, royalties or intangible property and companies that have undergone supply chain or business restructurings are also likely to be selected for a tax audit.

Special considerations

Are secret comparables used by tax authorities?

Yes, based on the MIRB’s internal database.

Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

Yes, it is a preference of the MIRB to use local companies as comparables. The use of foreign comparable companies in a benchmarking analysis will most likely not be sufficient to convince the MIRB of the arm’s length outcome.

Do tax authorities have requirements or preferences regarding databases for comparables?

In Malaysia, a local benchmarking analysis is carried out manually based on publicly available directories and by extracting financial accounts from the Companies Commission of Malaysia. At present, there are no good quality commercial databases for local companies.

What level of interaction do tax authorities have with customs authorities?

Presently low, however, the MIRB and the Royal Malaysian Customs

Department have signed a memorandum of understanding on joint audit, where auditors from both departments will work together.

Are management fees deductible?

Yes, except for those relating to shareholder or custodial activities, duplicative services, services that provide incidental or passive association benefits and on-call services (note: the deductibility of on-call services can be reviewed on a case-by-case basis), or when taxpayers fail to provide evidence to support the receipt of management services and commercial benefits accrued to the local entity. The MIRB is intensifying their review on payments for intra-group services during transfer pricing audits to determine whether the payments comply with the arm’s length principle. The MIRB has been very strict and in many recent transfer pricing audits, companies are finding it difficult to produce sufficient and reliable evidence to justify the arm’s length nature of their payments.

Are management fees subject to withholding?

Yes, if payment of the management fees is for services performed by non-residents in Malaysia. If services were performed outside Malaysia, withholding tax would not be applicable.

Are year-end transfer pricing adjustments permitted?

Yes. However, they may attract enquiries from MIRB and there are also indirect tax implications to be considered in respect of such adjustments.

Other unique attributes?

None.

Other recent developments

The Malaysian transfer pricing guidelines revised in July 2012, prescribed certain thresholds for the application of the guidelines to ease taxpayers’ compliance cost burden. The guidelines are applicable where at least one person is assessable and chargeable to tax in Malaysia, the taxpayer’s gross income exceeds MYR25 million, and total amount of related party transactions exceeds MYR15 million or, where the taxpayer receives or provides financial assistance, the financial assistance exceeds MYR50 million.

For a person carrying on a business, taxpayers who fall outside the scope of the guidelines may still opt to comply fully or comply with limited documentation requirements (that is, organization chart, description of controlled transaction (including functional analysis) and pricing policies).

A transfer pricing audit framework effective from 1 April 2013 was released to provide clarity and guidance on how transfer pricing audits would be carried out. MIRB has acknowledged that good quality contemporaneous transfer pricing documentation can provide penalty protection for the taxpayer and also introduced a new penalty regime for voluntary disclosure.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Extensive.

If extensive, is the competent authority effective in obtaining double tax relief?

Sometimes.

When may a taxpayer submit an adjustment to competent authority?

Normally, a taxpayer may initiate a mutual agreement procedure (MAP) if there is a risk of double taxation and there is a treaty agreement with the foreign counterparty. In most cases, this is after being issued the Notice of Additional Assessment.

May a taxpayer go to competent authority before paying tax?

Yes. The taxpayer is permitted to initiate a competent authority negotiation even before the issuance of the Notice of Additional Assessment and paying taxes. Once the Notice of Assessment/Notice of Additional Assessment is issued, the taxpayer needs to remit payment within 30 days; otherwise a penalty for late payment will be imposed.

Advance pricing agreements

What advance pricing agreement (APA) options are available, if any?

Effective 1 January 2009, Section 138C was introduced in the Act. Section 138C allows taxpayers to apply for APAs to reach an agreement with the MIRB on prices of goods and services that would be transacted in the future with associated persons.

In addition, the Income Tax APA Rules 2012, released on 11 May 2012 provide guidance on the application process and timeline. The APA Rules 2012 apply retrospectively, with effect from 1 January 2009.

An application for unilateral, bilateral or multilateral APAs is done via a prescribed form which contains details as may be required by the Director General of the MIRB.

Is there a filing fee for APAs?

At the moment, to encourage taxpayers to apply for APAs, no fees are imposed. However, taxpayers will bear any overseas traveling and accommodation expenses incurred by the Malaysian government in relation to bilateral or multilateral APAs.

Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

To date, there is no published data on APAs.

Please provide some information on how successful the APA program is and whether there are any known difficulties?

Not applicable.

Language

In which language or languages can documentation be filed?

The documentation can be prepared in Bahasa Malaysia or English.

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Publication name: Global Transfer Pricing Review

Publication number: 133196

Publication date: June 2014