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SPECIAL COMMISSIONERS OF INCOME TAX

YA DR. SYARLIZA BINTI WARNOH, YA MAZNI BINTI NAWAWI & YA ZURINA BINTI MOHD

1 DISEMBER 2023

SECTIONS 113(2), 140 & 140A INCOME TAX ACT

TRMSB V. DIRECTOR GENERAL OF INLAND REVENUE (PKCP (R) 20-21/2015, PKCP (R) 142-144/2015)

The Taxpayer is a company incorporated in Malaysia and a part of Thomson Reuters Group. Thomson Reuters Global Resources ("TRGR") executed the Local Vendor Agreements: Information and Dealing Products in 2003, 2008 and 2010. Pursuant to the Agreements, the Taxpayer was appointed to market and sell TRGR's products in the form of "information services" and "dealing services" in Malaysia. The Taxpayer prepared Transfer Pricing Documentation for fiscal years ended 31.12.2006, 31.12.2007, 31.12.2008, 31.12.2009 and 31.12.2010 ("Transfer Pricing Documentation") whereby it was stated that the Taxpayer had made payment for distribution fee to its related parties. The "Operating Margin" ("OM") was selected as the profit level indicator ("PLI") for its distribution activities. The Taxpayer selected nine (9) companies for the purposes of the benchmarking study. However, the Director General of Inland Revenue ("DGIR") rejected five (5) out of them, and replaced with three (3) new comparable companies. The DGIR applied Section 140 Income Tax Act 1967 ("ITA 1967") for Year of Assessments ("YAs") 2007 and 2008 and applied Section 140A ITA 1967 for YAs 2009 to 2011 in raising the additional assessments vide issuance of the Notices of Additional Assessment ("Forms JA") for YA 2007 to 2011 respectively. Dissatisfied with the additional assessments raised, the Taxpayer filed notices of appeal against the said Forms JA.

The Taxpayer contended that it had earned 2.0% OM on its distribution activities which was within the interquartile range earned by comparable, independent distributors under similar circumstances and consistent with the arm's length standard. No adjustment should be made when the profit margin adopted was considered as a price within the interquartile range. The DGIR did not dispute on the 2% targeted operating profit margin resulted from the distribution activities for YAs 2007 and 2008. However, for YAs 2009 to 2011, the DGIR rejected the 2% targeted operating profit margin by including Selling, General and Administrative ("SGA") costs to the Appellant's computation of the operating profit margin. Paragraph 2.80 Organization for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines ("OECD Guidelines") provided that non-operating income and expenses were considered as "exceptional and extraordinary" and should not be part of the determination of the Taxpayer's operating profit margin. It was further contended that Pan-Asian comparable were permissible to be used in comparability analysis if they were sufficiently comparable. No local company carried out the similar distribution services as the Taxpayer globally and the local comparable used by the DGIR did not have business operations in various continents.

Further, the DGIR only requested for the use of local comparable companies for YAs 2009 to 2011 despite knowing that the Taxpayer's business as a distributor did not change in the YAs 2009 to 2011. The DGIR also had no basis to reject the Taxpayer's local comparable companies merely because this comparable companies recorded lower revenue. The DGIR did not provide a transfer pricing report or detailed functional analysis to the Taxpayer to explain his basis for rejecting the comparable companies selected by the Taxpayer. The Taxpayer argued that it had duly provided all Transfer Pricing Documentation and relevant supporting documents. It even went above and beyond the minimum needed to provide a local benchmarking analysis to the DGIR despite this was not a mandatory requirement.

In response, the DGIR argued that the computation in arriving at the rate of 2% based on the formula of OM was not shown in the Transfer Pricing Documentation. It merely concluded that the OM for distribution activities was 2% and was within the interquartile range of the comparable companies.

The adjustments by the DGIR which were based on the information furnished by the Taxpayer show that the rate for OM for YAs 2007 and 2008 was below than 2% and was not at arm's length as reported in the Transfer Pricing Documentation. Paragraphs 2.77 and 2.78 including 2.80 OECD Guidelines showed that the exclusion of non-operating items from determining the net profit indicator was to determine whether the independent comparable companies would be materially affected by such exclusion of the non-operating items. The Taxpayer excluded certain expenses from SGA costs without providing explanation or reasons on such exclusion.

For YAs 2009 to 2011, besides the issue of the computation of the operating profit margin for distribution activities, Section 140A ITA 1967 was applied in which the Taxpayer was required to prepare a benchmarking analysis in accordance with sub rule 6 Income Tax Transfer Pricing Rules 2012 ("TP Rules 2012"). Out of nine (9) local comparable companies that had been selected by the Taxpayer, it was discovered that apart from having low turnover, five (5) of the comparable companies had different function from the Appellant and did not fulfill the requirement of the comparability factors as provided under the sub rule. Hence, the DGIR rejected five (5) comparable companies and replaced with three (3) new comparable companies which resulted in tax adjustments for YAs 2009, 2010 and 2011. Based on the benchmarking analysis by the DGIR had shown that the OM of the Appellant was below the lower quartile range of the seven (7) comparable companies, outside the interquartile range and hence, the adjustment of the profit margin of the Appellant had been made by the DGIR.

On 01.12.2023, the Special Commissioners of Income Tax ("SCIT") rejected the Taxpayer's appeals and decided that the Taxpayer had failed to prove the Forms JA were excessive and wrong. Further, the DGIR was correct in law and facts to impose penalties under Section 113(2) ITA 1967 for YAs 2007 to 2011.

- *Editorial Note*

The Taxpayer has the right to file an appeal against the decision by the SCIT within 21 days from the date of the decision