IRBM's Strategies, Actions and Experiences in TP Audits or Investigations

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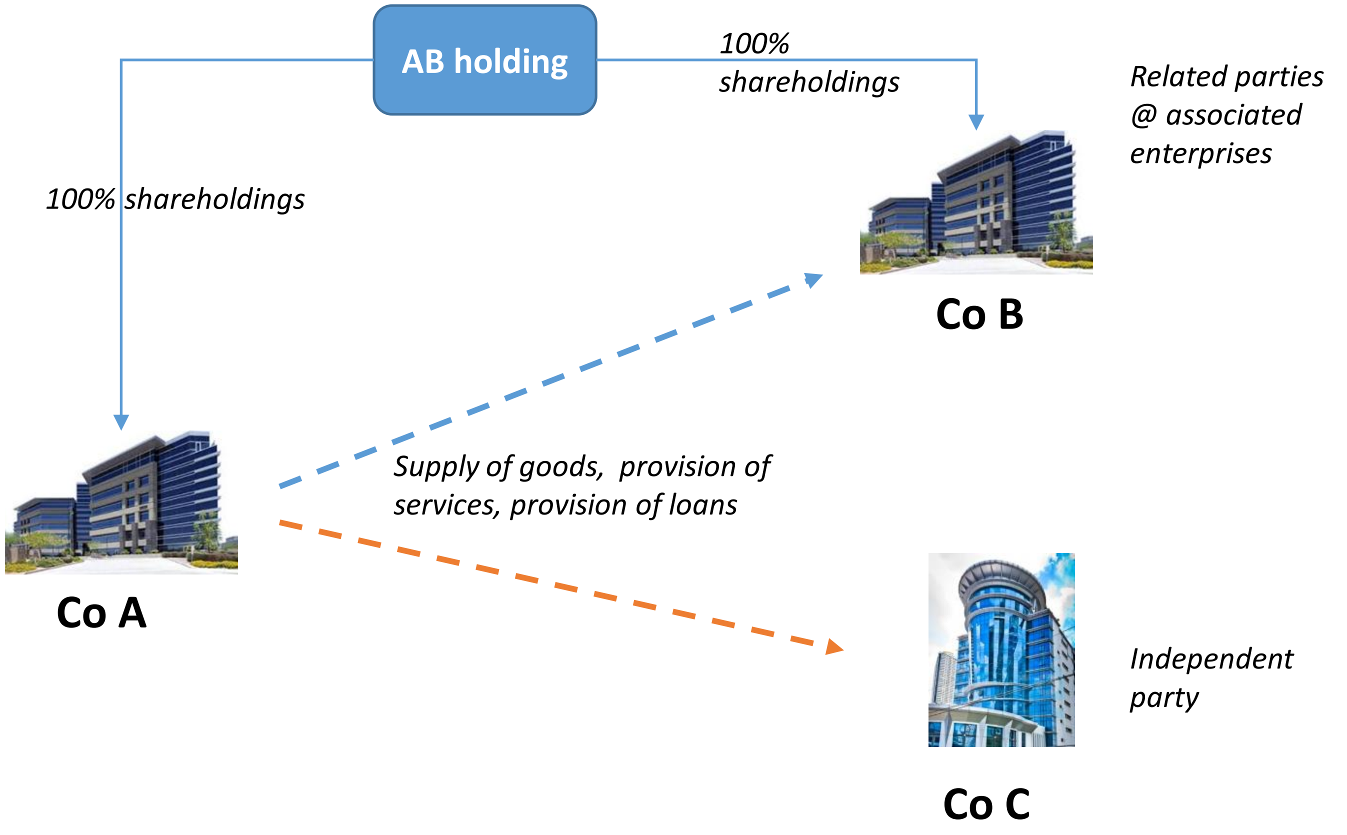
Presentation outline

1. Introduction
2. Rules & Regulations in TP Compliances
3. Recent changes in Malaysian tax law
4. Important things in preparing the TPD
    a. Scope
    b. Characterisation
    c. TP Method
5. Experience sharing
6. Key takeaways
7. TPD flowchart and self test

Introduction

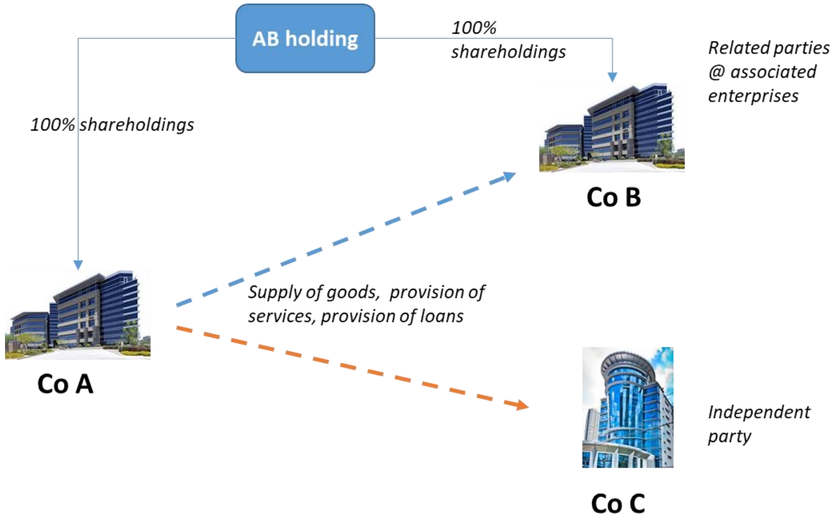
Introduction – What is transfer price (TP)**?**

*“intercompany pricing arrangements for the transfer of goods, services and intangibles between **associated persons**”*



*“Ideally, the **transfer price** should not differ from the prevailing market price which would be reflected in a transaction between **independent persons**”*

Introduction – Why is TP relevant?



- ✓ The price set will affect the financial result of Co A, B and C – the profit that they earned – tax contributed

- ✓ The different tax rate will be the motive for them to set the pricing mechanism – minimal ETR for the group [e.g If Co A is taxed in Singapore (17%) and Co B is in Malaysia (24%), the higher price will be set by Co A ➔ Co B in order to get better ETR for the group.

<u>Scenario - The interco price is charged at market price</u>

	Co A [manufacturer] Singapore	Co B [distributor] Malaysia	Group level
Revenue	4,000	5,000	9,000
COS	(1,000)	(4,000)	(5,000)
PBT	3,000	1,000	4,000
Tax rate	17%	24%	[redacted]
Tax to be paid	510	240	750

<u>Scenario - The interco price is charged at non-market price</u>

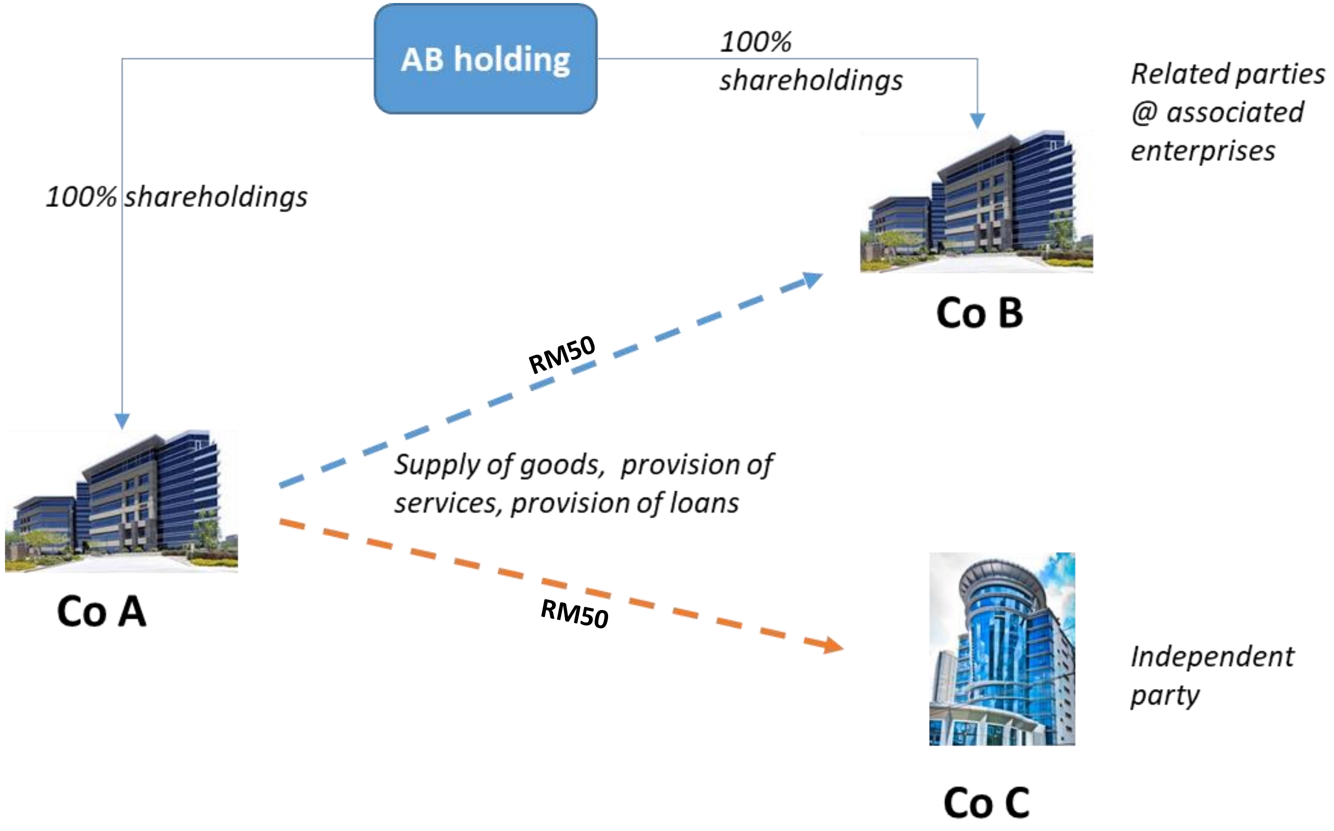
	Co A [manufacturer] Singapore	Co B [distributor] Malaysia	Group level
Revenue	5,000	5,000	10,000
COS	(1,000)	(5,000)	(6,000)
PBT	4,000	0	4,000
Tax rate	17%	24%	[redacted]
Tax to be paid	680	0	680
		diff	(70)

Introduction – How to ensure TP is acceptable

To avoid shifting of profits from high tax jurisdictions to no/low tax jurisdictions, most countries have TP rules in their domestic tax legislation. This is to prevent profit shifting and to ensure profit are taxed at the place where value is actually created

TP rules – stated that control transactions must fulfilled Arm's Length Principal (ALP)

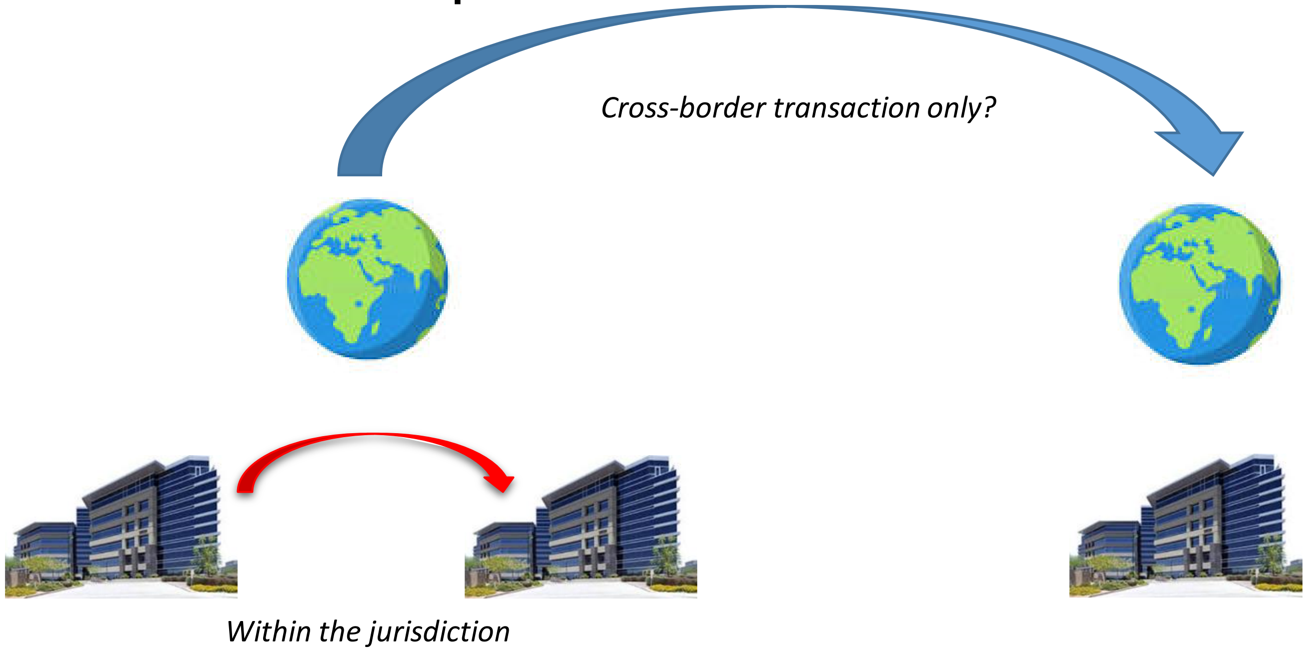
ALP – the terms and conditions of control transactions may not differ from whose who transact in uncontrol environment



Introduction – Where & Who should implemented TP**?**

Taxpayers who are involved in controlled transactions are generally required to prepare and maintain a transfer pricing documentation

This includes taxpayers involved in domestic controlled transactions where at least one party enjoys tax incentives or suffers from continual losses, or is taxed at a different rate, such that the effect of that transaction would result in adjustments that alter the total tax payable



Rules & Regulations governing TP compliances in Malaysia

- ❑ Income Tax Act 1967
- ❑ Income Tax Act (Transfer Pricing) Rules 2012 [P.U.(A) 132/2012]
- ❑ Malaysia Transfer Pricing Guidelines 2012
- ❑ Transfer Pricing Audit Framework [latest 15.12.2019]

Provision on TP in Income Tax Act 1967

- S140A POWER TO SUBSTITUTE PRICE AND DISALLOWANCE OF INTEREST ON CERTAIN TRANSACTION
- S140A(2) Transaction (for the acquisition or supply of property or services) with <u>associated person</u> for a year of assessment, it shall determine and apply at the **arm's length** price for such transaction
- S140A(3) arm's length price (alp) is price between independent persons – if > or <, DG may substitute the price to reflect alp
- S140A(5) A controlled transaction is transaction between:
  a) Person one of whom has control over the other
  b) Individuals who are relatives of each other; or
  c) Persons both of whom are controlled by some other person

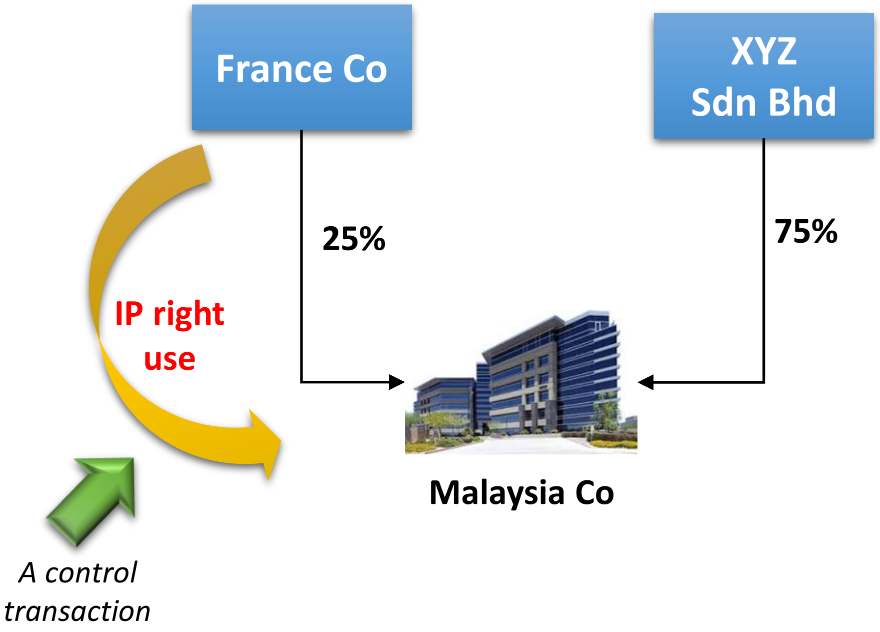
Recent changes in Malaysian tax law – wef 1.1.2019

- **S140A(5A)** with effect from **1.1.2019** to expand the meaning of control under S139 for the purposes of transfer pricing – control exists when the share capital held by a person or third person is <u>20% or more and</u> meets **one** of the following conditions:
  - (a) The business operations of that person depends on the propriety rights, such as patents, non-patented technological know-how, trademarks, or copyrights, provided by the other person or a third person;
  - (b) The business activities, such as purchases, sales, receipt of services, provision of services, of that person are specified by the other person, and the prices and other conditions relating to the supply are influenced by such other person or a third person; **or**
  - (c) Where one or more of the directors or members of the board of directors of a person are appointed by the other person or a third person.

Recent changes in Malaysian tax law – wef 1.1.2019

Example on subparagraph **140A(5A)(a)**:

*France Co holds a **25%** shareholding in Malaysia Co and the remaining 75% is held by XYZ Sdn Bhd. Malaysia Co **relies entirely on the intellectual property (IP) owned by France Co** in its production activities in Malaysia. Given that France Co holds shares in Malaysia Co more than 20% and Malaysia Co relies entirely on the IP of France Co, thus under this provision, it can be said that France Co has control over Malaysia Co for TP purposes*



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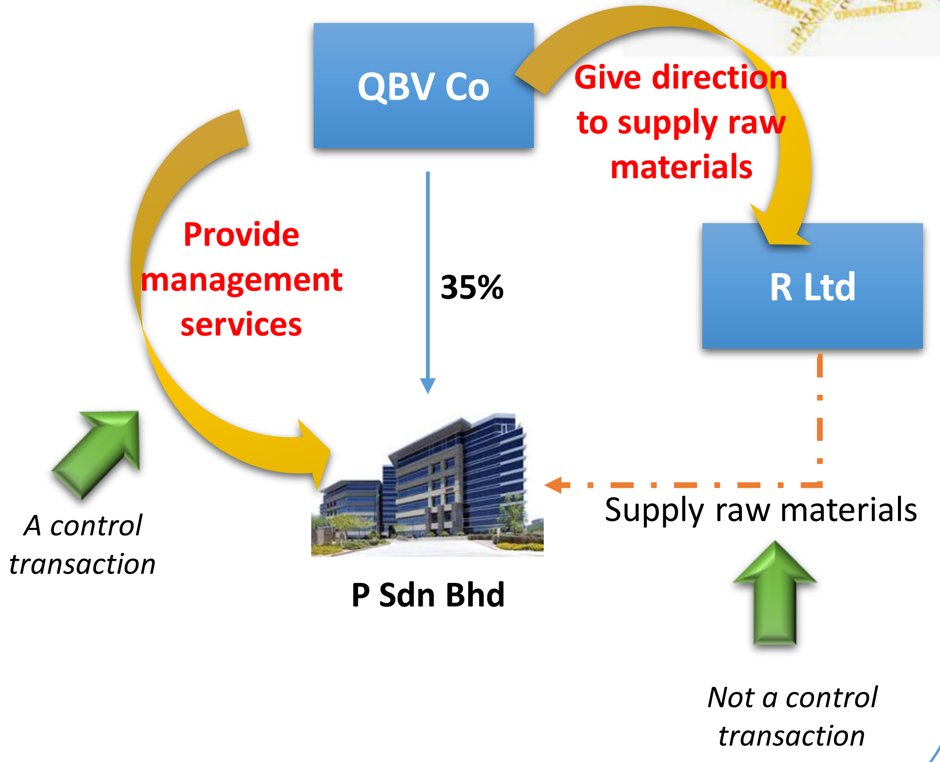
Example on subparagraph **140A(5A)(b)**:

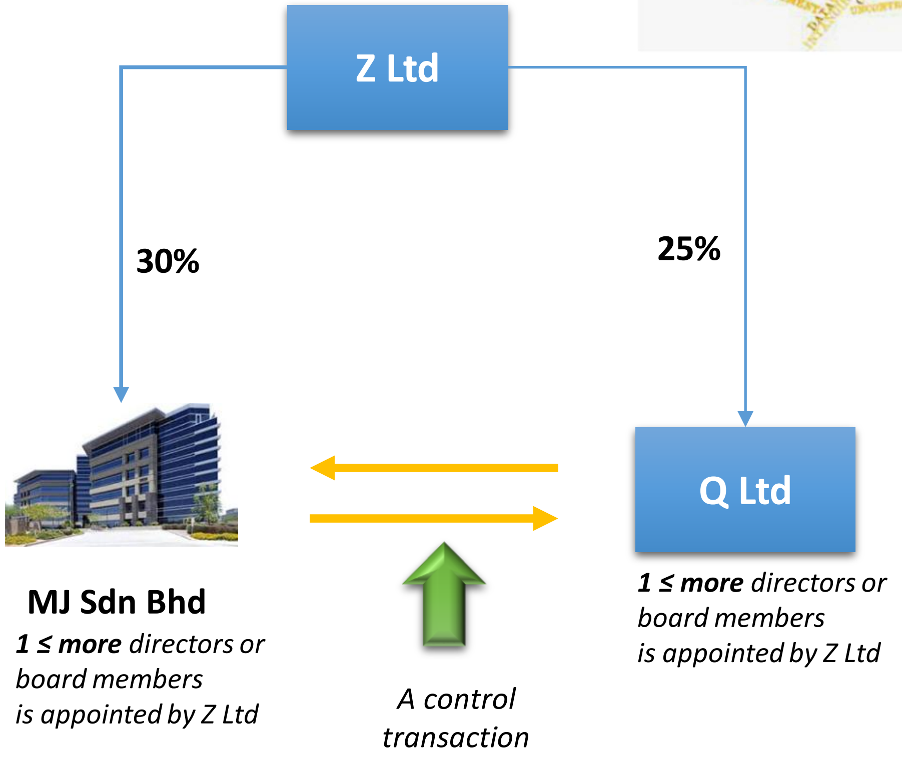
*QBV Company in Netherlands holds **35% stake** in P Sdn Bhd and QBV also provides management services to P Sdn Bhd. In addition, **QBV has also directed R Ltd** in Germany to **supply raw materials** to P Sdn Bhd. Therefore, it indicates transaction between QBV and P Sdn Bhd is a control transaction for TP purposes. However, transaction between R Ltd and P Sdn Bhd is not a control transaction since R Ltd does not hold shares in P Sdn Bhd*



Recent changes in Malaysian tax law – wef 1.1.2019

Example on subparagraph **140A(5A)(c)**:

Z Ltd has shareholding in MJ Sdn Bhd and Q Ltd, 30% and 25% respectively. Transactions between MJ Sdn Bhd & Q Ltd (Singapore) is a control transaction for TP purposes since Z Ltd (UK) has the authority to appoint one or more directors or board members in both MJ Sdn Bhd and Q Ltd.



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Recent changes in Malaysian tax law – wef 1.1.2021

Section **113B** – Failure to Furnish ***Contemporaneous*** TP Documentation

Failure to furnish TPD on time:

- ✓ Subsection S113B(1) – On conviction:
  Fine RM 20,000 –RM100,000 or prison term up to 6 months or both & Furnish TPD within 30 days or period decided by Court
- ✓ Subsection S113B(4) – if no prosecution:
  Penalty RM 20,000 – RM100,000
- ✓ Subsection S113B(5) – If aggrieve with this penalty, PC may appeal to SCIT – Normal appeal procedure

Recent changes in Malaysian tax law – wef 1.1.2021

INCOME TAX (TRANSFER PRICING) RULES 2012 [P.U.(A) 132/2012]

RULE	CONTENTS
1	Citation & commencement
2	Scope & application
3	Interpretation
4	Contemporaneous transfer pricing documentation
5	Method to determine arm's length price
6	Comparability of transactions
7	Transfer price for separate and combined transactions
8	Re-characterization of transactions
9	Intra-group services
10	Cost contribution arrangement
11	Intangible property
12	Interest on financial assistance
13	Adjustment by Director General
14	Permanent establishment as a separate entity

Shall include:
Org Chart, nature of business, controlled transactions, strategies, comparability, FAR, selection & application of TP method etc.

Contemporaneous:
TPD which brought into existence:

a) When a person is developing or implementing any controlled transactions: and
b) Reviewed when there are material changes

Recent changes in Malaysian tax law – wef 1.1.2021

- **SECTION 140A(3A) & (3B) – POWER TO DISREGARD STRUCTURE IN A CONTROLLED TRANSACTION**
  - ✓ Subsection 140A(3A) – DG has the power to **disregard any structure** in a controlled transaction if:
    (a) the economic substance of that transaction ***differs*** *from its form; or*
    (b) the form and substance of that transaction are the ***same*** *but the arrangement made in relation to the transaction,* ***viewed in totality, differs*** *from those which would have been adopted by* ***independent persons behaving in a commercially rational manner*** *and* ***the actual structure impedes*** *the Director General from determining an appropriate transfer price.*
  - ✓ Subsection 140A(3B) – When DG has disregards any structure, he shall make **adjustments to that structure as he thinks fit** to reflect the structure that would be adopted by independent persons dealing at arm's length having regard to the economic and commercial reality

Recent changes in Malaysian tax law – wef 1.1.2021

- ❑ **SECTION 140A(3C) – IMPOSITION OF SURCHARGE ON TP ADJUSTMENTS**
  - ✓ The DG may require PC to pay surcharge of **not more than 5%** of the amount **increase of any income** generally or **reduction of any deduction or loss**, as **consequence** of exercising his powers to **substitute** the price in respect of a transaction entered into by a person to reflect an **arm's length price** for that transaction or to **disregard any structure** adopted by a person in entering into a transaction.
  - ✓ Surcharge may be imposed on TP adjustments on all cases whether taxable or not

DG has decided that **no penalty under subsection 113(2)** of Income Tax Act 1967 shall be imposed on additional tax arising from the TP adjustment

Important things when preparing the TPD

a. SCOPE

Chapt 1- Para 1.3 of MTPGL

Para 1.3.1

- Gross income > RM25m
- RPT > RM15m
- Financial assistance > RM50m

Fully comply MTPGL

Para 1.3.2

- Gross income < RM25m
- RPT < RM15m
- Financial assistance < RM50m

Fully comply MTPGL

OR

Prepare Simple TP Doc & allow to apply other methods

Para 1.3.3

- Apply for local TP where TP adjustment made will not alter the total tax payable

Do not need to comply MTPGL

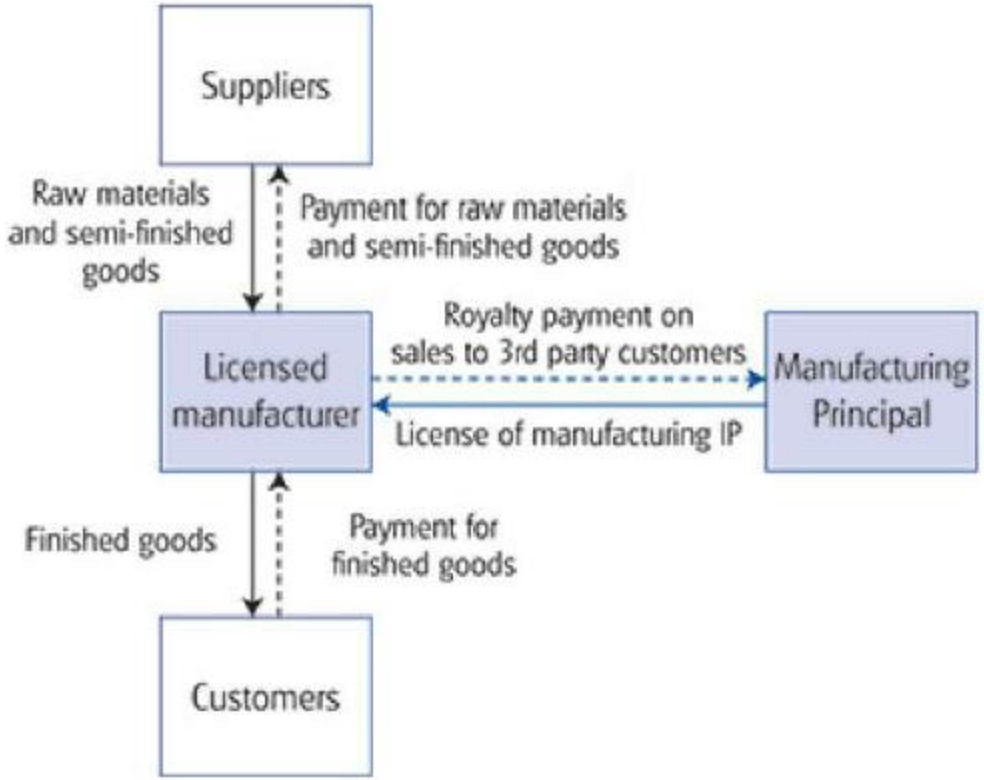
Important things when preparing the TPD

b. Characterisation

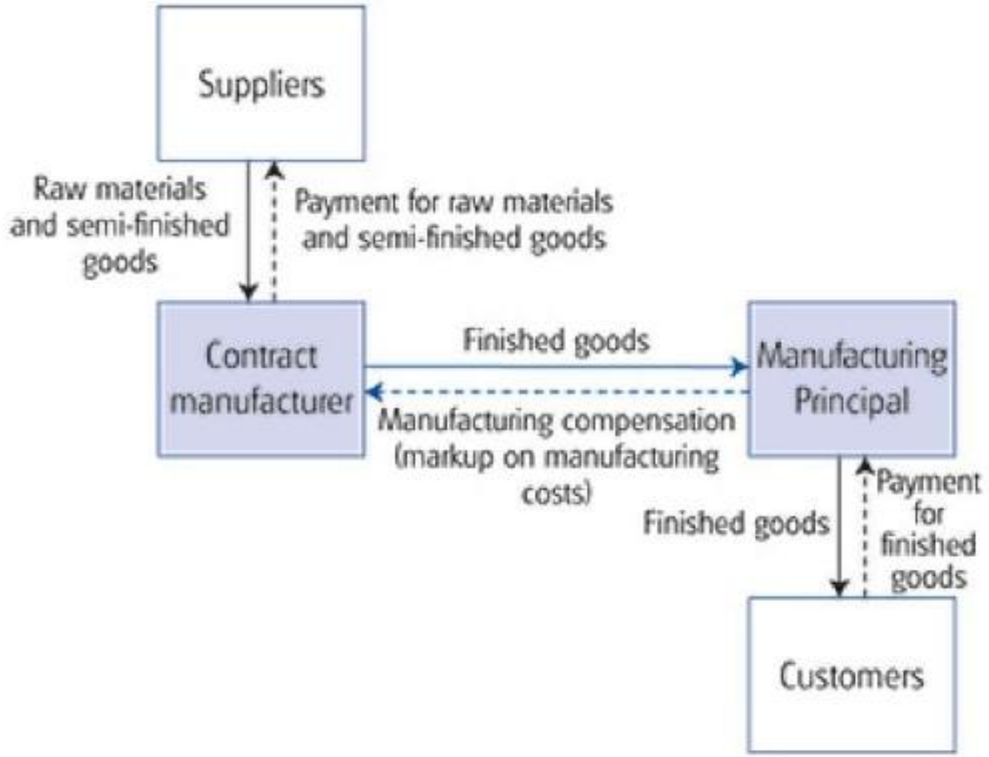
Manufacturing	Services
1. Entrepreneur/ full-fledged manufacturer	1. Commission agent
2. Licenced manufacturer	2. Limited risk distributor
3. Contract manufacturer	3. Full-fledged distributor (marketer/ distributor)
4. Toll manufacturer	

Important things when preparing the TPD

Licenced manufacturer structure

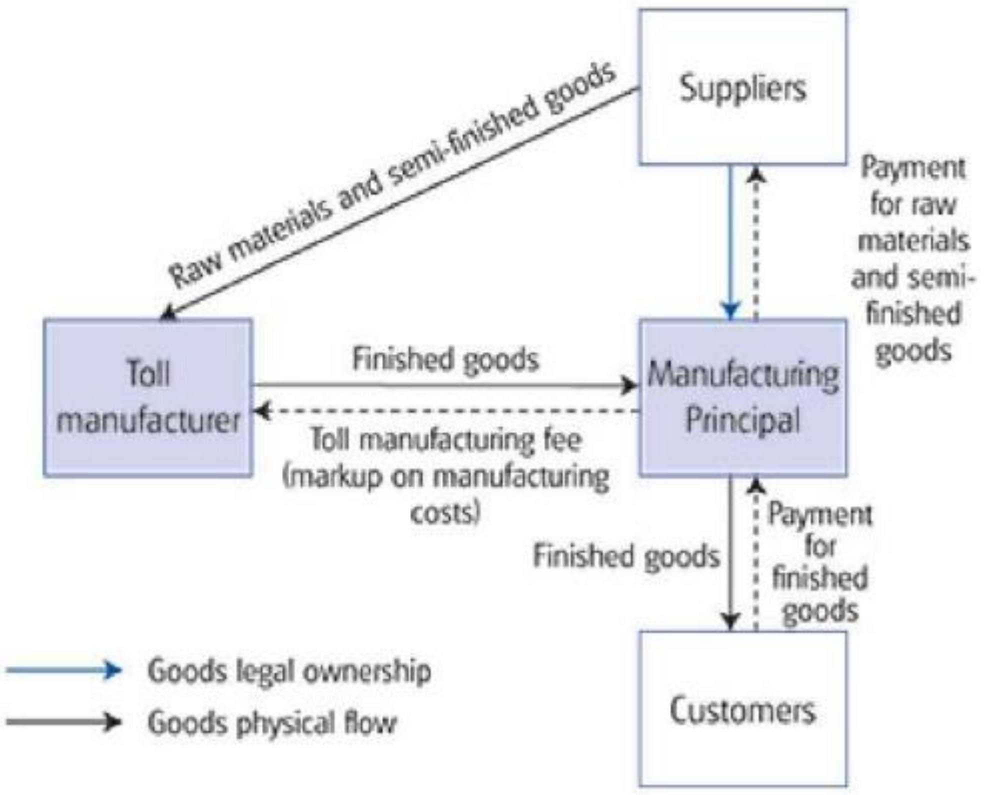


Contract manufacturer structure

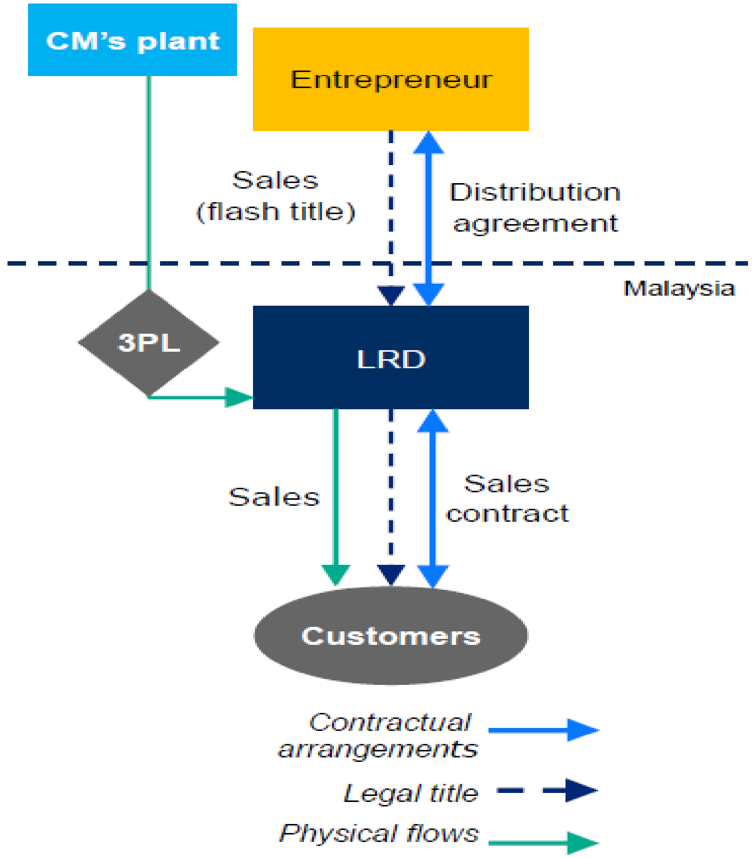


Important things when preparing the TPD

Toll manufacturer structure



Limited risk distributor (LRD)



Summary of diff characterization of manufacturers

	Full-Fledged Manufacturer	Contract Manufacturer	Toll Manufacturer
Key Functions			
Production arrangement	Produce for its own sales	Produce for the principal	Produce for the principal
Intellectual Property ("IP")	Owns the IP	Does not own IP	Does not own IP
Inventories	Owns	Owns	Does not own
Sales and Marketing	Yes	No	No
Logistics and Distribution	Yes	No	No
Key Activities			
Level of involvement	Full responsibility at every stage i.e. IP development, sales, production, after sales, logistics, etc.	Limited exposure to market volatility. Concentrate on manufacturing function	Only acts as a service provider without ownership of inventory

Summary of diff characterization of distributors

	Full-Fledged Distributor	Limited Risk Distributor	Commission Agent
Key Functions			
Marketing	Yes	Minimal	Minimal
Sales	Yes	Yes	Yes
After sales services	Yes	Yes	No
Inventory Management	Yes	Minimal	No
Key Activities			
Level of involvement	Fully responsible in all aspects of business i.e. IP development, marketing strategy development, inventory management, etc.	Limited scope of role of in-country team, with principal entity taking key risks	Receive commissions for finding clients. No involvement in inventory management.

Important things when preparing the TPD

c. TP method

Traditional transactional methods

- Comparable Uncontrolled Price Method
- Resale Price Method
- Cost Plus Method

Transactional profit methods

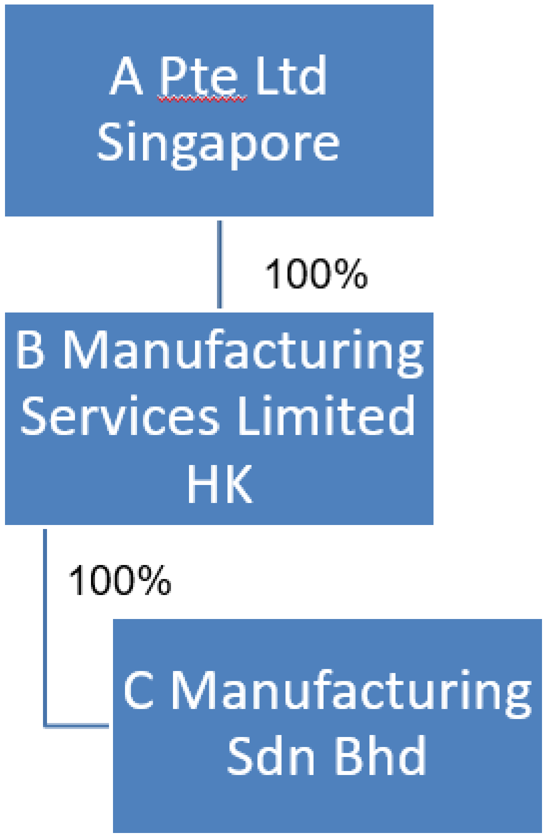
- Profit Split Method
- Transactional Net Margin Method

Outline of TPD

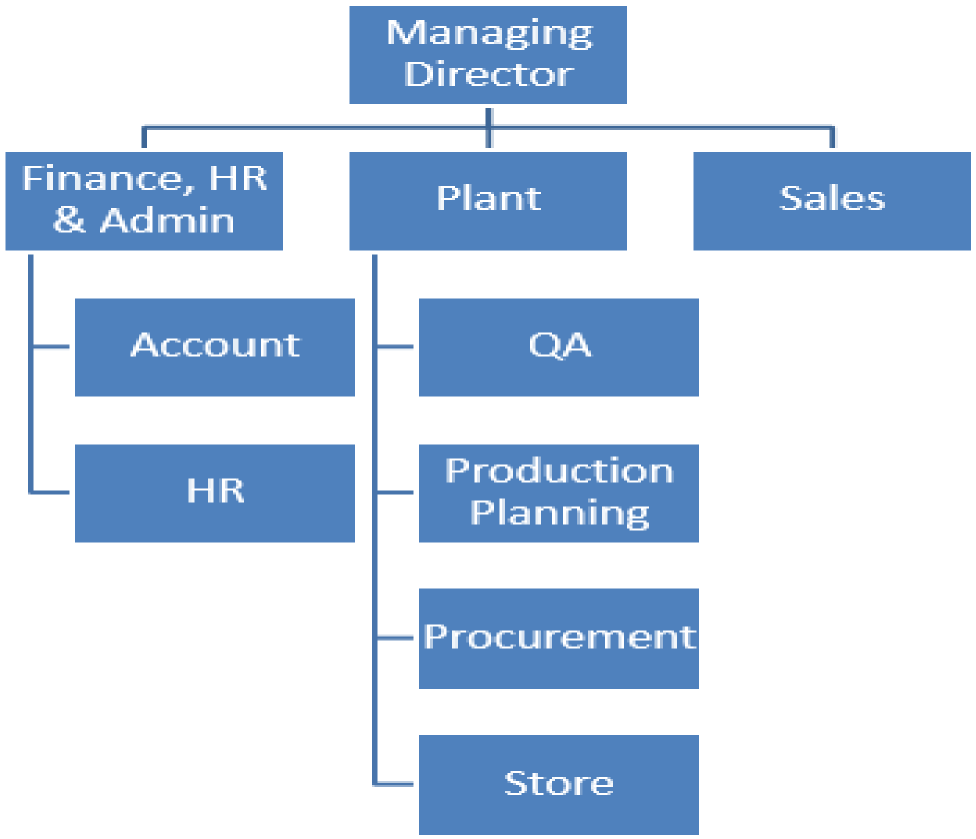
- Organizational Structure
- Industry and Market Analysis
- Control Transactions
- Pricing Policies
- FAR Analysis Including Risk Analysis Framework
- Comparability Analysis
- Transfer Pricing Method & Application of Transfer Pricing Method

Sample of group & organizational structure

Group structure



organizational structure



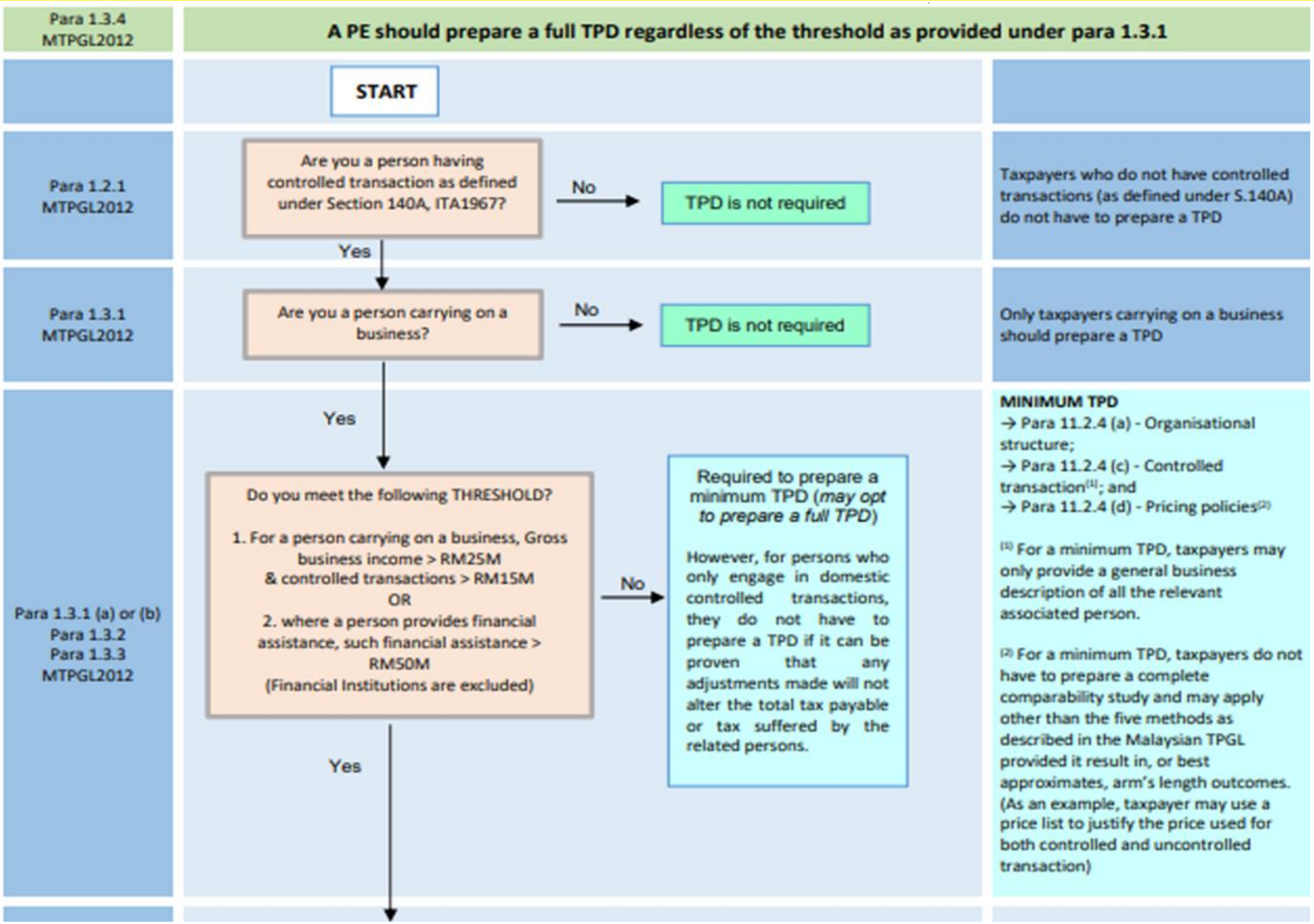
Sample of control transactions

Transaction	Entity	Country of Incorporation	Principal Activity	FYE 2020 RM'000
Purchase	B Manufacturing Services Ltd HK	HK	Manufacturing	10,000
Payment of Information technology	A Pte Ltd Singapore	Singapore	Investment Holding Co.	1,000
Interest paid	A Pte Ltd Singapore	Singapore	Investment Holding Co	500

Sample of FAR analysis & summary

Functional, risk and asset analysis	C Manufacturing Sdn Bhd	B Manufacturing Services Ltd HK	A Pte. Ltd Spore
Function			
Sales	✓	✓	✗
Planning	✓	✓	✗
Manufacturing	✓	✗	✗
Asset			
Tangible	✓	✓	✓
Intangible	✗	✗	✗
Risk			
Market risk	✓	✓	✓
Inventory risk	✓	✓	✗
FOREX	✓	✓	✓

TPD Flowchart



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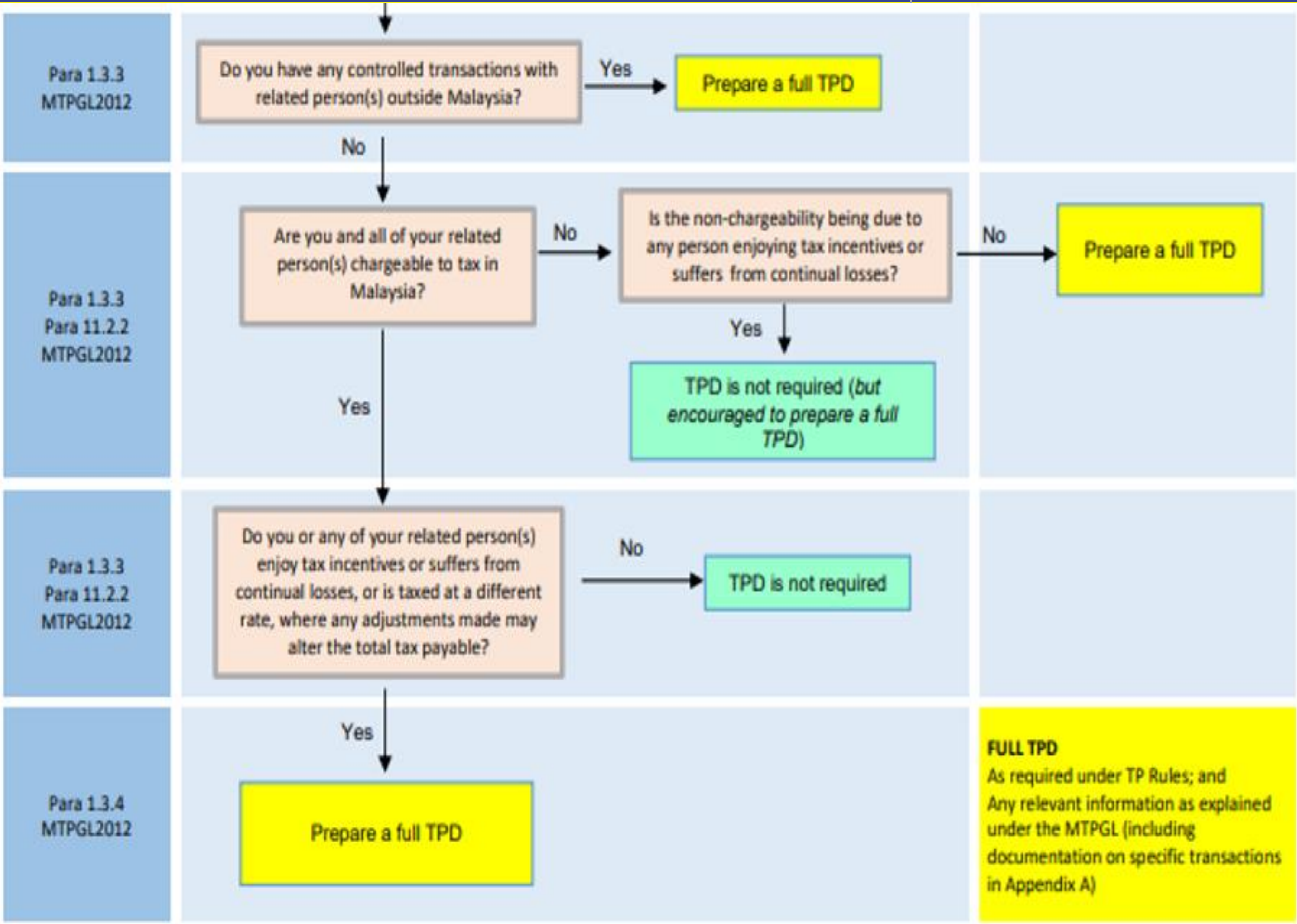
TPD Flowchart (*cont.*)



TPD Self test @

Preparation of TPD

Instructions:
This self-test contains macros and requires them to run smoothly. When prompted, kindly click 'Enable contents'.
Please select the answer to the questions below and click **ENTER**.
If no further questions appear, please click the Results button.
Your results will appear in the red box below.

Question — Select Yes or No and click ENTER

1	Do you have a controlled transaction as per Section 140A?	Yes
2	Are you a person carrying on a business?	Yes
3	Are the following thresholds met? For a person carrying on a business: Gross business income > RM25M AND Amount of controlled transaction > RM15M **OR** Where a person (excluding financial institutions) provides financial assistance: The controlled financial assistance > RM50M	
4	Do you have any controlled transactions with related person(s) outside Malaysia?	Yes

Results | Clear last answer | Clear all

Results | Clear last answer | Clear all

Full TPD is required

A full TPD is as required under the TP Rules and any relevant information as explained under the MTPGL (including documentation on specific transactions in Appendix A)

Experience sharing

- High TP risks
- Inconsistency in the GP & NP margins
- Significant reduction in the GP and NP margin
- Tax incentives

Key takeaways

- Maintain an **updated transfer pricing documentation before** the submission of the corporate income tax return
- Ensure the entity is **characterized appropriately** from the transfer pricing perspective by making reference to the analysis of the functions performed, assets employed and risks assumed by the entity
- Ensure there is **consistency** between contractual risk allocation, actual risk allocation and entity characterization. risks assumed by the entity


Q&A

Thank You

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