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Transfer Pricing

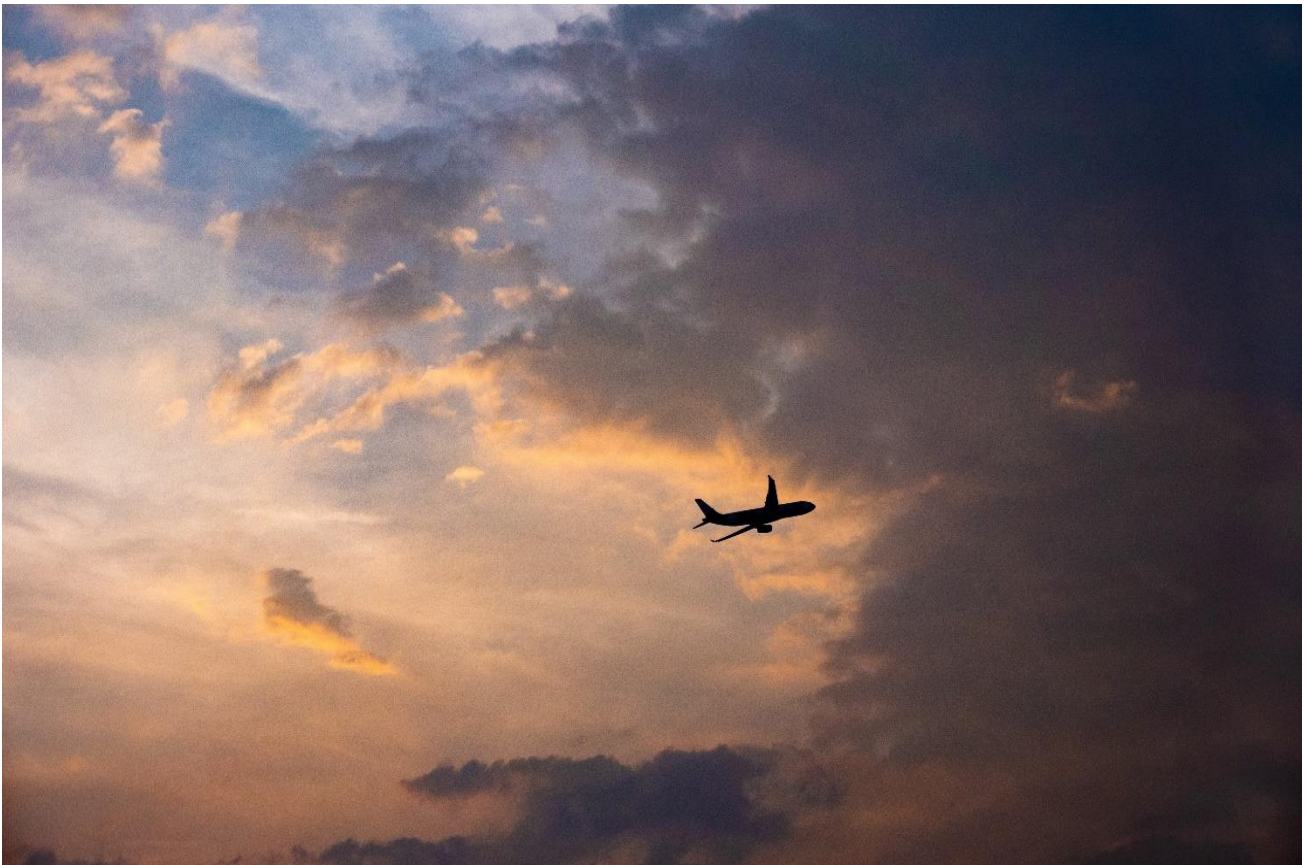
Important Updates for 2021



What is Transfer Pricing ?

Transfer pricing generally refers to ***inter-company pricing arrangements*** for the transfer of goods, services and intangibles between '***associated persons***'. Transfer pricing laws and guidelines ensure fairness of the transactions by enforcing the arm's length transaction. Based on the ***arm's length principle***, transactions between parties should be conducted at a price as if such transactions were done between independent entities.

Every taxpayer who has entered into "***controlled transactions***" with associated persons is required to ***prepare transfer pricing documentation*** (more details below), though the compliance requirements may differ depending on factors such as gross income of the business, amount of related party transactions, as well as financial assistance provided.



Definition of Control and Associated Persons

A person has “**control**” of a company if he is able to exercise control, whether direct or indirect over the company’s affairs and in particular, if he possess share capital or voting power in the company.

Associated person includes:

- (a) persons one of whom has control over the other;
- (b) individuals who are relatives of each other; or
- (c) persons both whom are controlled by some other person.

A “person” includes a company, a body of persons, a limited liability partnership and a corporation sole.

The definition of **related companies** is provided in Section 7 of the Companies Act 2016. This includes holding and subsidiary companies as well as the same persons holding more than 50% of the shares in each of the two or more companies.

The TP Guidelines 2012 states that two (2) companies are **associated companies** with respect to each other if:

- one of the companies participates directly or indirectly in the management, control or capital of the other company; or
- the same persons participate directly or indirectly in the management, control or capital of both companies.

The Income Tax Act, 1967 extends the arm’s length principle to transactions between **relatives**, meaning a parent, child (including stepchild and child adopted in accordance with any law), brother, sister, uncle, aunt, nephew, niece, cousin, ancestor or lineal descendant.

Summary of important changes in 2021

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.

Effective from 1.1.2021

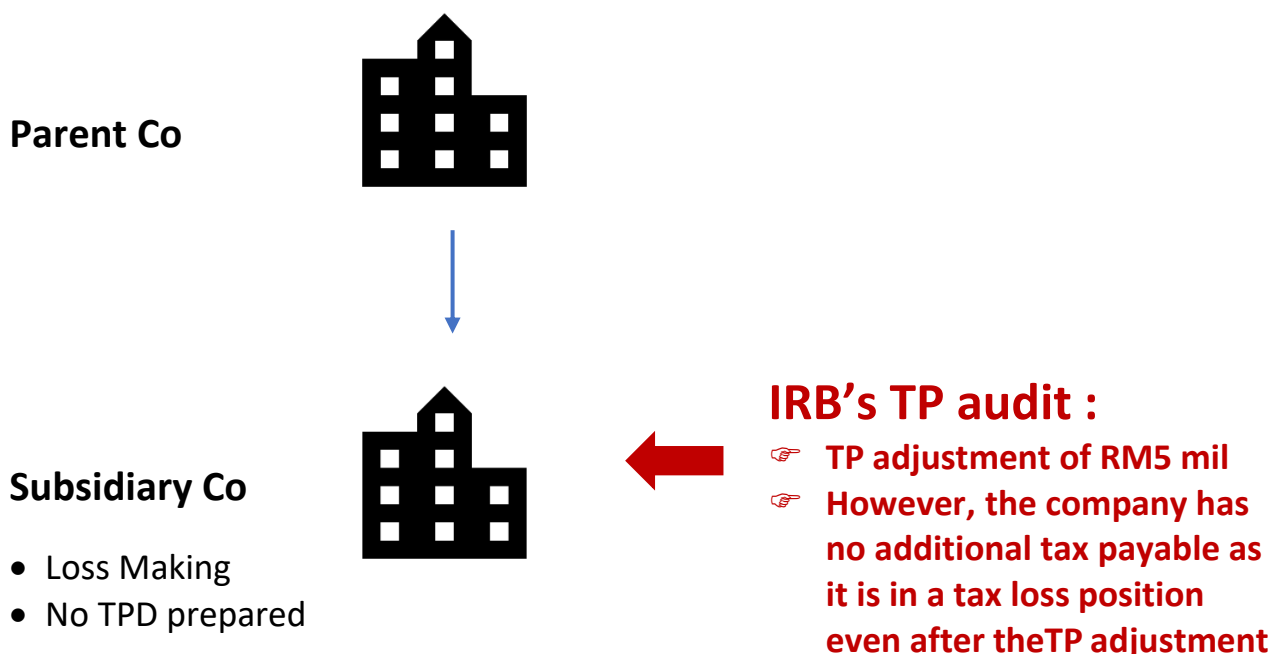
1. [Section 113B] Penalty for failure to submit TPD to the IRB on time	
Details	Implications
<p>Where there is a prosecution and on conviction – a taxpayer is liable to a fine of between RM20,000 and RM100,000 or to imprisonment for a term up to 6 months, or both.</p> <p>Where there is no prosecution – a taxpayer may be imposed a penalty of between RM20,000 and RM100,000.</p>	<p>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.</p>
2. [Paragraph 11.2.3 of MTPG] Timeline for submission of TPB to IRB upon request	
Details	Implications
<p>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.</p>	<p>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.</p>
3. [Paragraph 11.3.5 of MTPG] no penalty imposed by the IRB during a TP audit	
Details	Implications
<p>Penalties under Section 113B and/or Section 113(2) will not be imposed in cases, where the commencement of TP audit cases is on or after 1.1.2021 and:</p> <ol style="list-style-type: none"> 1. The TPD documents were submitted within 14 days, and 2. TPD fulfils the requirements of the TP Rules and MTPG. 	<p>To avoid penalties being imposed, taxpayers must comply with the TPD requirements strictly, including:</p> <ul style="list-style-type: none"> • Preparation of contemporaneous TPD; • TPD is of good quality in accordance with the IRB's MTPG; <p>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).</p>

Effective from 1.1.2021 (Cont'd)

4. [Section 140A(3C)] Surcharge on TP adjustments made during a TP audit	
Details	Implications
<p>Surcharge may range from 0% to 5% on the amount of increase of income or reduction of tax deduction, arising from TP adjustments.</p>	<p>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.</p>
5. [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	
Details	Implications
<p>The IRB can make appropriate TP adjustments if it is of the view that:</p> <ul style="list-style-type: none"> a. The economic substance of controlled transaction differs from its form; or b. The controlled transaction differs from commercially acceptable transactions undertaken by independent parties. 	<p>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.</p>

Example

Calculation of New Surcharge and New Penalty



Previously:

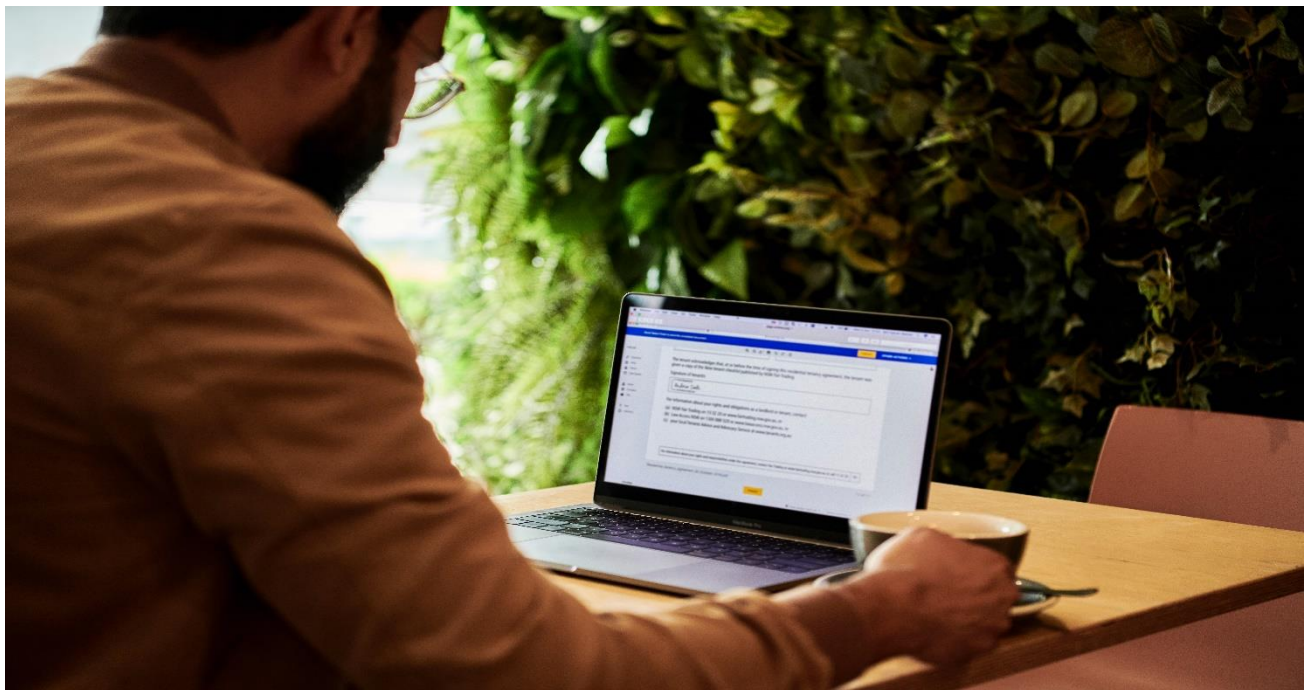
- No provision in the law to impose surcharge or penalty for loss making entities.

Now:

- Surcharge at up to 5% i.e. Up to RM250,000.
- Penalty for failure to furnish TPD – Between RM20,000 to RM100,000.

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**.



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	Prepare TPD with a new benchmarking analysis
Year 2	2020	Prepare financial update of the benchmarking analysis
Year 3	2021	Prepare financial update of the benchmarking analysis
Year 4	2022	Update full set of TPD with new search of benchmarking analysis

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	✓	✗

Contact Us:

C. F. Ng & Co. (AF 1279)

No. 7-7 (Level 7), Jalan USJ 9/5Q
Subang Business Centre
47620 UEP Subang Jaya
Selangor, Malaysia



Contact Persons:

Managing Partner: anthony.ng@cfng-co.com

Tax Director: june.gan@cfng-co.com

Tax Manager: karliang.chow@cfng-co.com

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