



Transfer Pricing Requirements And New Penalties in Malaysia

This is a summary of the Transfer Pricing Requirements in Malaysia

TP Guidelines (“TPG”)

The 2012 TPG superseded the Guidelines previously issued in year 2003, and was intended to provide detailed guidance to taxpayers on how to comply with the requirements of the law under Section 140A of Income Tax Act 1967 and the TP Rules 2012. The 2012 TPG is applicable to:

- ✓ Controlled transactions between associated persons, where at least one party is assessable or chargeable to tax in Malaysia; and
- ✓ Applies to both cross-border transactions and domestic related party transactions. The TPG need not be applied to domestic controlled transactions if it can be proven that any TP adjustments will not alter the total tax payable by both parties.

The 2012 TPG was updated on 15 July 2017 with one new chapter on Commodity Transactions (Chapter X) and an updated version of three existing chapters as follows:

- Chapter II – The Arm’s Length Principle
- Chapter VIII – Intangibles
- Chapter XI – Documentation

The guidelines reinforces that companies involved in related party transactions in Malaysia must prepare a TP documentation for the relevant year of assessment.

Key Takeaway



- ❖ TP Documentation is to be prepared annually
- ❖ Changes in Form C disclosure items for related party transactions and interest expenses paid to related companies
- ❖ CbyC Rules are applicable for companies with consolidated revenue of more than RM3 billion
- ❖ New penalty rates have been introduced



- ✓ Companies with gross income more than RM25 million, and the total amount of related party transactions more than RM15 million; OR
- ✓ Companies with financial assistance by related parties more than RM50 million.

Companies who fall below this threshold may opt to prepare a limited scope TP documentation instead of a full scope TP documentation. A full scope report may consists of the following:

- a) Organizational structure
- b) Nature of business/industry and market conditions
- c) Controlled transactions
- d) Pricing policies
- e) Assumption, strategies and information regarding factors that influenced the setting of pricing policies
- f) Comparability, functional and risk analysis
- g) Selection of the transfer pricing method
- h) Application of the transfer pricing method
- i) Financial information
- j) Other relevant/supporting documents

A simplified TP documentation consists of items (a), (c) and (d) above. Taxpayer is allowed to apply any method other than the five methods described in the TPG provided it results in arm's length outcomes. While the TP documentation has to be prepared, it does not need to be submitted unless requested by the tax authorities.

Tax Return Form

Effective from year of assessment 2014, the income tax return form includes a disclosure on whether TP documentation has been prepared. From FY 2019 onwards, the income tax return form was amended again to include additional disclosures as follows:

- a) Disclosure on whether tax payers carry out controlled transactions under Section 139 and 140A

Tax payer is to disclose all type of transactions they are involved in with a related party and the amount. Tax payer would also have to declare if TP documentation have been prepared.

- b) Disclosure of whether the taxpayer is subject to interest restriction under Section 140C.

In 2019, the tax authorities introduced Restriction on deductibility of interest under Section 140C of the Income Tax Act 1967, in effect from 1 July 2019 onwards. They also released the Restriction on Deductibility of Interest Rules 2019 and the Guidelines aimed at restricting the deduction of interest expense in relation to cross border transaction. The Rules are applicable to:

- ✓ companies who have been granted any financial assistance in a controlled transaction;
- ✓ the total amount of any interest expense for all such financial assistance exceeds RM500,000 in the basis period.

The maximum amount of interest that is deductible is 20% of the Tax EBITDA. The balance is allowed to be carried forward.



Income Tax (Country-by-Country Reporting) Rules 2016 (“CbyCR Rules”)

In 2017, the tax authorities issued the CbyCR Rules followed by the Labuan CbyCR Regulation, effective from 1 January 2017 and is applicable to MNE Groups with total consolidated group revenue of at least RM 3 billion. The rules state that the ultimate parent (reporting entity) would have to complete the CbyC Report and submit it to the tax authorities on or before 12 months from the last day of the reporting FY (i.e. 31 December 2018 if the tax payer’s year end is 31 December 2017).

There is also a requirement to notify the tax authorities if the tax payer is a reporting entity or a non-reporting entity in Malaysia entity on or before the last day of the reporting FY (i.e. 31 December 2017 if the tax payer’s year end is 31 December 2017). They also need to declare in the form C if CbyC is relevant to them and if notification has been submitted.

Type of entity	Details
Reporting entity	The reporting entity shall notify the Director General in writing if it is the ultimate holding entity. Notification will have to include details of all Malaysian and foreign non-reporting constituent entities
Non-reporting entity	The Malaysian subsidiary does not have to submit the CbyCR but they shall notify the Director General in writing of the identity and tax residence of the reporting entity. There are two types of notification for non-reporting entity as follows: <ul style="list-style-type: none"> a. Notification for non-reporting entities whose reporting entity is in Malaysia b. Notification for non-reporting entities whose reporting entity is outside Malaysia

TP Audit Framework 2019

For Companies who fail to comply, penalties will be imposed under subsection 113(2) of Income Tax Act 1967 (“ITA”) and the TP Audit Framework 2019. The rates from the framework are as follows, divided between normal cases and voluntary disclosure cases (“VD”):

Condition	Penalty rate	
	Normal case	VD
Understatement or omission of income	100%	
Taxpayer did not prepare TP documentation	50%	N/A
Taxpayer has prepared and submitted the TP documentation with the VD but not in accordance to the requirements; OR; Taxpayer has prepared a comprehensive and good quality TP documentation but failed to submit within timeline provided.	30%	20%
Taxpayer has prepared and submitted a comprehensive and good quality TP documentation with the VD in accordance to the requirements; OR; Taxpayer has prepared a comprehensive and good quality TP documentation and submitted within timeline provided.	0%	0%



TP Penalties and Power to Disregard Structures

✓ Failure to furnish contemporaneous TP documentation

With the introduction of Section 113B of the ITA, any person who fails to furnishing a contemporaneous TPD shall be liable to the following:

- Fine of not less than RM20,000 and not more than RM100,000; or
- Imprisonment for a term not exceeding six (6) months; or
- Both.

The new section also empowers the Director General to impose a penalty as stated in (a) if taxpayer is not prosecuted for failure to furnish TP contemporaneous documentation. Taxpayers can appeal on the decision with the Special Commissioners of Income Tax but the burden of proof is on the taxpayers.

✓ 5% surcharge on TP adjustments

Under Section 140A (3C), the Director General may impose a surcharge of not more than 5% of the total transfer pricing adjustments regardless if there is any additional taxes payable by the taxpayers. Any surcharge imposed shall be treated as collection tax and would not be treated as a tax payable under any other provision within the ITA.

✓ Power to disregard structure in controlled transactions

Under S140A (3A) and (3B), the Director General will be empowered to disregard any related party transaction structure adopted by the company if he is of the opinion that:

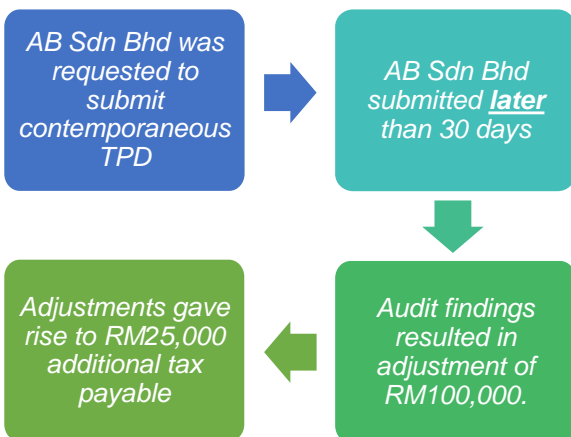
- The economic substance of that transaction differs from its form; or
- The commercial reality of that transaction differs from the arrangement which would have been adopted by an independent party.

In these circumstances, the Director General will be allowed to make adjustments to the structure to reflect the structure that would have been adopted in a third party arrangement.

✓ Failure to comply (after adjustments have ben issued)

Penalties will be imposed under subsection 113(2) and the TP Audit Framework 2019. The rates can range from 30% to 100% depending on whether the TP documentation is prepared contemporaneously in accordance with the requirements and submitted within 14 days.

Illustration on Penalties



	Current penalty regime (RM)	Proposed penalty regime (RM)
Fine between RM20k and RM100k. (assumed at minimum penalty amount)	-	20,000
5% surcharge x 100,000		5,000
Additional tax payable	25,000	25,000
Penalty on additional tax (assumed at 35%)	8,750	8,750
Total (Approximately 75% addition)	33,750	58,750



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