TaXavvy
Progressive Updates to Transfer Pricing Guidelines 19 July 2017

Welcome to our **TaXavvy – Progressive Updates to Transfer Pricing Guidelines** which brings to you the key changes being made to the Inland Revenue Board's Transfer Pricing Guidelines 2012

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Overview and key changes

Overview

The Inland Revenue Board (IRB) has started to update its Transfer Pricing Guidelines 2012 (TPG 2012) progressively. The first wave of updates were recently published on the IRB's website. The updated and new chapters are as follows:

1. The Arm's length principle (updated)
2. Intangibles (updated)
3. Documentation (updated)
4. Commodity transactions (new)

The update signals that the IRB is stepping up its practices in keeping with global developments of cross-border businesses and global transfer pricing (TP) practices. The updates also embraces the OECD's Transfer Pricing Guidelines and Base Erosion and Profit Shifting (BEPS) Project.

Key changes arising from the updated and new chapters

1. Increased emphasis on aligning profits to value creation
2. A more stringent scrutiny on the roles and value added by Malaysian entities
3. More depth in analysing roles in relation to intangibles
4. Greater details on risk analysis that is expected to be incorporated into the TP documentation
5. Evaluating commodity transactions using the Comparable Uncontrolled Price ('CUP') method whilst adhering to the stringent requirements in using this method
6. Guidance on Country-by-Country Reporting requirements both for Master file and Local file

Emphasis on aligning profits with value creation

Value creation and being adequately compensated for such value is one of the overarching themes of the updated guidelines. Functions undertaken, contractual risks borne and assets employed define the value that is created/added by Malaysian entities within a MNE's supply chain; profits need to be aligned to such value creation. There is additional guidance on whether control over risks are retained or transferred by an entity. Examples which illustrate the above include:

- ***Example 1*** which highlights that a Malaysian entity's investment in branding activities represent a value created by the Malaysian entity although the requirements to undertake such branding activities are not spelt out in the contract.
- ***Example 3*** illustrates that an investor who outsources its daily investment activities to a fund manager does not necessarily transfer control of its investment risk to the fund manager where it is able to prove that a scheduled monitoring of the fund manager's activities is in place and that the investor makes policy decisions with respect to the investments.

Deeper perspective on intangibles

In addition to reinforcing that intangibles for TP purposes does not depend on accounting and legal definitions, intangibles include government licenses and contractual rights such as license for Network Service Provider (NSP) and Production Sharing Contract (PSC) for exploration and production of oil and gas.

It is emphasised that the legal owner of intangibles needs to share the profits from the exploitation of the development, enhancement, maintenance, protection or exploitation (DEMPE) of the intangibles with other entities of the group to reflect the level of DEMPE contributed by such entities.

In line with the thematic focus on value creation, it is also stated that Malaysian subsidiaries which are categorised as of Multinational Corporations (MNCs) which carry out substantial advertising, marketing and promotion (AMP) activities contribute to the development of such marketing intangibles and should be adequately compensated for such role.

The guidelines also suggest that with the passage of time, payment for know-how should be progressively offset/reduced to reflect learning curve.

Documentation requirements

The chapter on documentation has been updated to incorporate the requirements for Master file and Local file. Financial data and suitability of existing comparable companies (used in the benchmarking analysis) should be reviewed and updated every year in order to apply the arm's length principle reliably. However, the comparable searches can be updated every three years rather than annually.

Audit and penalties

The risk of penalties will continue to underpin the preparation of TP documentation. The updated chapter on documentation states that the legal burden of proof of an arm's length price rests with the taxpayer and penalties for incorrect return will continue to be imposed where the actual conduct differs from information furnished in the TP documentation.

Let’s talk

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