

Malaysia introduces new transfer pricing and APA rules

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In brief

Malaysia has introduced new Income Tax (Transfer Pricing) Rules 2023 (TP Rules 2023), which were gazetted on May 29, and which will apply to years of assessment (YA) 2023 onward. The TP Rules 2023 make significant changes to Malaysian transfer pricing regulations, principally increasing the level of documentation requirements, particularly for Multinational Enterprise (MNE) groups, providing prescriptive guidance on the arm's-length range, and tightening compliance requirements in relation to transfer pricing documentation deadlines.

Action item: Given the changes to the prescriptive definition of an arm's-length range, taxpayers should review their current transfer pricing positions to analyze whether they remain at arm's length from a Malaysian transfer pricing perspective. Taxpayers also should take steps to prepare documentation on a contemporaneous basis in line with requirements under the TP Rules 2023 for YA 2023 onward, in seeking to avoid imposition of compliance penalties ranging from MYR 20,000 to 100,000 (approximately USD 4,000 to 21,000) per YA by the Malaysian Inland Revenue Board (IRB).

The Income Tax (Advance Pricing Arrangement) Rules 2023 (APA Rules 2023), also gazetted on May 29, supersede the Income Tax (Advance Pricing Arrangement) Rules 2012 (APA Rules 2012) with immediate effect. The APA Rules 2023 primarily prescribe additional documentation requirements for pre-filing meeting requests and restrict the category of APAs that can be applied for transactions involving counterparties in tax jurisdictions with which Malaysia has a double tax agreement.

Action item: Taxpayers looking to pursue an APA should review their APA strategy in light of the changes introduced by the APA Rules 2023.

The key takeaways from the TP Rules 2023 and APA Rules 2023 are discussed below.

In detail

Income Tax (Transfer Pricing) Rules 2023

Definition of 'contemporaneous' transfer pricing documentation

The TP Rules 2023 defines contemporaneous transfer pricing documentation as documentation that is brought into existence prior to the due date for furnishing a return in the basis period for a YA in which a controlled transaction is entered into.

Observation: The prior TP Rules 2012 had regarded as ‘contemporaneous’ documentation that is brought into existence at the point a transaction is being developed or implemented, or updated to reflect material changes in a particular basis period prior to the due date for furnishing a return. The revised definition under the new TP Rules 2023 imposes the requirement to prepare transfer pricing documentation for each YA prior to the due date of furnishing the tax return, thus clarifying the requirement to prepare contemporaneous transfer pricing documentation for each YA.

Content of contemporaneous transfer pricing documentation

The TP Rules 2023 incorporate the detailed documentation requirements previously outlined under the Malaysian Transfer Pricing Guidelines (Malaysian Guidelines), with the following key additions:

Information on the MNE Group for the relevant basis period (Schedule 1 of the TP Rules 2023)

- The MNE Group’s worldwide organizational structure that shows the location and ownership linkages among all entities in the MNE Group transacting with the Malaysian taxpayer.
- A description of the MNE Group’s businesses that are relevant to the business of the Malaysian taxpayer, including:
 - The MNE Group’s businesses, products and services, geographic markets, and key competitors.
 - The supply chains of those businesses, products, and services.
 - The MNE Group’s business models and strategies.
 - The business drivers of the MNE Group’s business profit.
 - The industry, market, regulatory, and economic conditions in which the MNE Group operates.
 - The business activities of each entity in the MNE Group and the functional analysis describing their contributions, including functions performed, assets used, and risks assumed.
 - Changes to the MNE Group’s structure through restructuring, acquisition, or divestiture.
- A description of the MNE Group’s intangible property that are used in or applied to the Malaysian taxpayer, including:
 - The strategy for the development, ownership, and exploitation of intangible property in that basis period, including the location of research and development facilities and the location from which the research and development is managed.
 - A list of the intangible property and the names of the entities in the MNE Group that have legal ownership of that intangible property.
 - A list of agreements among the entities concerning the intangible property, including cost contribution arrangements, cost sharing agreements, research service agreements, and license agreements.
 - The MNE Group’s transfer pricing policies relating to research and development and the intangible property.
 - Any transfer of interests in the intangible property among the entities in that basis period, including the names of the entities, and the countries in which they carry on business, and the amount of compensation involved.
- The MNE Group’s financial activities that are connected to the business of the person in Malaysia, including:

- The MNE Group's financial activities, including the MNE Group's inter-entity financial activities, and financing arrangements with lenders who are not associated persons.
- Identification of any entity of the MNE Group that provides a central financing function for the MNE Group.
- A description of the MNE Group's transfer pricing policies relating to financing arrangements between associated persons.
- Financial and tax position of the MNE Group, including:
 - The MNE Group's annual consolidated financial statements relating to the business of that person in Malaysia, and
 - A list and brief description of the MNE Group's existing unilateral APAs, and other tax rulings, relating to the allocation of income among countries.

Observation: The revised documentation requirements introduce content that was broadly covered under the master file only. This is a significant increase in documentation requirements for Malaysian taxpayers, as:

- Master file requirements that historically applied only to MNE Groups with consolidated revenues of EURO (EUR) 750 million/MYR3 billion (whichever threshold is applicable) now apply to all taxpayers who are part of an MNE Group which cross the thresholds for full scope documentation. **Note:** Full scope documentation is required for taxpayers with gross revenues of MYR 25 million (approximately USD 5 million) and above, and/or that have related-party transactions of MYR 15 million (approximately USD 3 million) and above. For taxpayers with financial transactions, the applicable threshold is financial assistance of MYR 50 million (approximately USD 11 million) and above.
- Information that may not be readily accessible by the Malaysian taxpayer now has to be obtained and documented prior to the deadline for filing the return for the relevant basis period. This can present challenges to many MNE Groups, as the Organisation for Economic Co-operation and Development (OECD) recommended timeline allows for the master file to be prepared within 12 months from the MNE Group's financial year-end.

Business Information (Schedule 2) and Cost Contribution Arrangements (Schedule 3)

The business information (typically covered under a local file) outlined under Schedule 2 principally replicates requirements previously outlined under the Malaysian Guidelines, and can be viewed as broadly aligning with the principles under the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations issued by the OECD (OECD Guidelines).

Observation: Although the requirements outlined under Schedule 2 broadly align with the principles outlined under the OECD Guidelines, Malaysian documentation requirements are more substantive than the standard local file in relation to the level of detail and supporting documentation (e.g., business plans, management information, forecasts, and projections) that must be attached. Where the supporting documentation outlined in the TP Rules 2023 is not relevant to the analysis, taxpayers must clearly state the non-applicability of these documents.

Since the extensive documentation requirements now form part of Malaysian legislation, taxpayers should commence preparation early to compile the necessary information in seeking to avoid imposition of penalties.

Requirement to date the transfer pricing documentation

From YA 2023 onward, taxpayers must date the transfer pricing documentation upon its completion.

Observation: The IRB currently accepts documentation that is submitted within 14 days of written request as 'contemporaneous' transfer pricing documentation. This additional requirement related to requested documentation

further enforces the requirement to have contemporaneous documentation prepared prior to the deadline of the return. Failing to do so could result in penalties ranging from MYR20,000 to MYR100,000 (approximately USD 4,000 to 21,000) per YA.

Selection of best method

The TP Rules 2023 effectively replace the hierarchy of methods outlined under the TP Rules 2012 with the best method approach outlined under the OECD Guidelines.

The TP Rules 2023 also require taxpayers to provide an explanation and reasons as to why the method selected — and profit level indicator, if the Transactional Net Margin Method (TNMM) is applied — is considered to provide the best approximation of the arm's-length price.

The Director General (DG) may replace the selected method with the most appropriate method if there is reason to believe that the selected method is not the most appropriate method.

Data available at the point of preparation

Taxpayers must determine an arm's-length price based on the most current information that is reasonably available at the time of determination.

Observation: Additional clarification will need to be sought on the application of three-year weighted averages/latest-year data to assess current-year results, as comparable data would not be available at the point the documentation is prepared.

Adjustment to an arm's-length price

The arm's-length range is defined as a range of figures or a single figure falling between the value of **37.5 percentile to 62.5 percentile** of the data set.

Observation: The TP Rules 2023 seek to provide clarity on the definition of the 'arm's length range' in a Malaysian context. Taxpayers should review their existing transfer pricing policies to analyze whether transfer prices are at arm's length from a Malaysian perspective, as the range applied is narrower than the interquartile range adopted in many other jurisdictions.

Where the transfer price falls within the arm's-length range, that price is considered to be at arm's length. If the transfer price falls out of the arm's-length range, the arm's-length price shall be taken to be the median.

This is qualified by allowing the DG to adjust the transfer price to a median (or any point above the median and within the arm's-length range) where there are comparability defects between the uncontrolled transaction(s) and tested transaction.

Observation: In addition to reviewing the transfer prices adopted based on the definition of the arm's-length range as per the TP Rules 2023, taxpayers should review the comparability of the selected comparables to analyze whether a reliable arm's-length range is arrived at; failing which, the DG still reserves the right to apply an arm's-length price that is at least at the median of the range of comparable results.

Income Tax (Advance Pricing Arrangement) Rules 2023

Application for an APA

Taxpayers that carry on cross-border transactions may apply for an APA, subject to the following:

- Where the counterparty is from a country that has a double tax agreement with Malaysia under section 132 of the Income Tax Act 1967 (the Act), the taxpayer may only apply for a bilateral APA or multilateral APA; or

- Where the counterparty is from a country that does not have a double tax agreement with Malaysia, the taxpayer may only apply for a unilateral APA; or
- For an arrangement under section 132 of the Act, a permanent establishment may apply for a bilateral APA or multilateral APA where such application shall be made on its behalf by its head office.

Observation: Taxpayers that wish to apply for an APA involving a counterparty in a jurisdiction which has a double tax agreement with Malaysia now may only consider a bilateral APA or multilateral APA. This may be a decision taken by the tax authorities in light of administrative considerations relating to potential Mutual Agreement Procedure (MAP) applications, in the event the tax authority in the counterparty's jurisdiction disagrees with the findings of the APA in a tax audit.

Request for a pre-filing meeting

Under the prior APA Rules 2012, taxpayers were required to first request a pre-filing meeting, in which the key aspects of the APA are discussed on a high-level basis with the tax authorities.

Taxpayers now must provide the following documentation and information in their request for a pre-filing meeting:

- Transfer pricing documentation prepared in accordance with the TP Rules 2023.
- Name, addresses, and tax file references of the taxpayer and other persons involved in the proposed APA, whether in Malaysia or outside Malaysia.
- Proposed covered transaction.
- Proposed period covered by the APA.
- Description of the critical assumptions under which the proposed transfer pricing methodology will operate and the events that should be taken into account when considering those assumptions.
- Financial statements and tax computations that are available at least for the latest three years prior to the application.
- A written indication whether the income in relation to the covered transactions is tax exempted by the other competent authority.

Observation: The extent of documentation required for the pre-filing meeting is now substantial and mirrors documentation typically requested by the tax authorities after the pre-filing meeting and for the formal application. For newly established taxpayers with less than three years of operations, discussions may be held as to the stability of the taxpayer's business and proposed covered transactions, for the proposed period covered by the APA.

Timeline for submission of APA application

Taxpayers now are given six months (instead of two months) after receiving positive notification from the DG to submit the formal application.

Application for rollback

A rollback may be allowed for not more than three YAs immediately preceding the covered period. If a rollback is granted, taxpayers must submit the revised tax computations for the relevant YAs within 30 days of the signing of the APA.

Observation: The period of rollback was not specified in the APA Rules 2012. In practice, the IRB typically has considered rollbacks for up to a period of three years.

Revocation

The DG now may revoke the APA if the taxpayer fails to disclose any occurrence of voluntary disclosure, investigation, audit, or incentive approval.

Fees

The fee payable for an APA application now depends on the speed in which the application is made.

In respect of an application for a new APA, a nonrefundable application fee of (1) MYR 5,000 (approximately USD 1,000) applies if the application is made within two months after receipt of the notification from the DG to proceed, or (2) MYR 10,000 (approximately USD 2,000) if the application is made after two months but within six months after receipt of the notification from the DG. In respect of an application for a renewal, a nonrefundable application fee of MYR 5,000 (approximately USD 1,000) applies.

Let's talk

For a deeper discussion of how Malaysia's new TP and APA rules might affect your business, please contact:

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