

PwC Alert

Transfer Pricing
Documentation
- ‘Tick the Box’
requirement in the
2014 Tax Return



With effect from the year of assessment (YA) 2014, taxpayers are required to confirm in the income tax return form C under Box R4 whether they have prepared contemporaneous transfer pricing documentation by ticking the relevant box. As such, taxpayers need to ensure that the transfer pricing documentation is prepared in a timely manner to adhere to the requirements including the “tick the box” requirement.

This follows on from the requirement in the Income Tax (Transfer Pricing) Rules 2012 (“Transfer Pricing Rules”) which require taxpayers to prepare and maintain contemporaneous transfer pricing documentation at the point of developing, implementing, and reviewing controlled transactions. The Transfer Pricing Guidelines 2012 issued on 20 May 2012 provide further assistance to taxpayers in determining what is an acceptable transfer pricing arrangement as well as the extent of documentation required to support their related party transactions.



What taxpayers need to know

1. What is the “tick the box” requirement?

The tax return form C has been revised to include new particulars under Part R. One of the questions in this section is whether the transfer pricing documentation has been prepared and it requires a ‘yes’ or ‘no’ response.

2. What does it mean if I tick “no”?

Ticking ‘no’ indicates that no transfer pricing documentation has been prepared. This could be because:

- i. the taxpayer has no related party transactions; or
- ii. the taxpayer needs to prepare documentation and is not in compliance with the Transfer Pricing Rules.

3. Why are taxpayers required to prepare such documentation?

The purpose of preparing transfer pricing documentation is to establish whether the taxpayer's related party transactions have been conducted in compliance with the arm's length standard. It also assists in facilitating any review by the tax authorities of the transfer pricing arrangements of a particular taxpayer. The transfer

pricing documentation does not have to be submitted together with the tax returns but will have to be made available to the tax authorities upon request.

4. What is the content of contemporaneous Transfer Pricing Documentation?

The Transfer Pricing Guidelines specifically outline the information and documentation required to form transfer pricing documentation. This typically includes the following:

- i. Organisational structure and business information about the taxpayer
- ii. Nature of the business, industry and market conditions under which the taxpayer operates
- iii. Details of the related party transactions (controlled transactions)
- iv. Pricing policies including the factors that influenced the setting of such pricing policies
- v. Functional analysis describing the functions undertaken, risks born and assets utilised by the taxpayer
- vi. Economic analysis and selection of the appropriate transfer pricing method
- vii. Comparability analysis

5. Who should prepare full transfer pricing documentation and who should prepare partial transfer pricing documentation?

Basically the Guidelines apply wholly to all taxpayers meeting the following conditions:

- i. Taxpayers carrying out businesses with a gross income of more than RM25 million, and a total amount of related party transactions of more than RM15 million; and
- ii. For taxpayers providing financial assistance and such financial assistance is more than RM50 million. Transactions involving financial institutions are excluded.

Taxpayers who fall under the above scope of the Guidelines need to prepare contemporaneous transfer pricing documentation.

For taxpayers who do not fall under the above scope of the Guidelines, they may opt to prepare partial transfer pricing documentation covering specific requirements of the Guidelines.

6. Are domestic transactions covered?

Yes. They are covered by both the Transfer Pricing Rules and the Guidelines.





7. Who is a related party?

Generally, companies are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making management decisions. Under the Guidelines, two 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. This includes joint ventures, consortiums and companies controlled by relatives. Some examples are illustrated in the Guidelines.

8. What are the acceptable transfer pricing methodologies?

The five acceptable transfer pricing methods are as follows:

- i. Comparable Uncontrolled Price (CUP) method;
- ii. Resale Price (RP) method;
- iii. Cost Plus (CP) method;
- iv. Profit Split (PS); and
- v. Transactional Net Margin method (TNMM).

Taxpayers need to select and apply the most appropriate transfer pricing methods to the controlled transaction in determining the arm's length nature of such transaction.

9. Transfer Pricing Rules requires comparability analysis to be done on a year-on-year basis. Do I need to prepare annual Transfer Pricing Documentation to be able to tick "yes" in the Form C?

If a taxpayer meets the criteria to prepare Transfer Pricing Documentation, they would need to prepare Transfer Pricing Documentation for YA2014 in order to tick 'yes' in the 2014 tax return and this would similarly apply to future years. This is in line with the requirement to prepare contemporaneous Transfer Pricing Documentation.

10. How is the arm's length nature of a taxpayer's results determined?

It is mentioned in the Guidelines that an arm's length range refers to a range of figures that are acceptable in establishing the arm's length nature of a controlled transaction. The Guidelines further elaborates that the facts and circumstances of a case are therefore important in determining a range, or the point in a range, that is the most reliable estimate of an arm's length price or allocation. Another point to note is that the Guidelines specify that the points or data in the range of results should not deviate substantially otherwise it may indicate that the comparables used are not reliable.



11. Are business restructurings an area of focus by the tax authorities?

During audits, the tax authorities tend to focus on business restructuring and its impact on the related party transactions. Furthermore, the Forms MNE and JCK also have a tick the box question on whether a business restructuring has been carried out for a particular year.

12. How do I demonstrate that intra-group services are conducted on an arm's length basis?

The taxpayer needs to consider:

- i. The nature of the service;
- ii. The value or extent of the benefit of the service to the recipient;
- iii. The costs incurred by the service provider in providing the service;
- iv. The functions involved in providing the service;
- v. The amount an independent recipient would be prepared to pay for similar services in comparable circumstances;
- vi. Other options realistically available to the recipients.

Considering the above, the taxpayer needs to be able to substantiate with supporting documents that:

- i. Services have been rendered;
- ii. Service recipients receive benefits that are of economic or commercial value;
- iii. Such services are not a duplication of activities carried out by the service recipients; and
- iv. Charges for such services must be consistent with the relative benefits intended from the services.

13. How do I set the arm's length interest rate for intra-group financial assistance?

When determining the arm's length interest rate, appropriate indices such as the Kuala Lumpur Inter Bank Offered Rate (KLIBOR), prime rates offered by the bank and/or specific rates quoted by banks for comparable loans can be used as a reference point. Appendix A of the Guidelines outlines the information and documentation requirement pertaining to intra-group financial assistance.

14. How does a taxpayer prepare transfer pricing documentation that is contemporaneous when there is lack of information of the comparable companies during the year the company prepares its transfer pricing documentation?

The Guidelines specify that in preparing the documentation, the arm's length transfer price must be determined before pricing is established based upon the most current reliable data that is reasonably reliable at the time of determination. However, taxpayers should review the price based on data available at the end of the relevant year of assessment and update the documentation accordingly.

15. Do the Guidelines provide any penalty provision?

Yes. The following penalty rates are applicable:

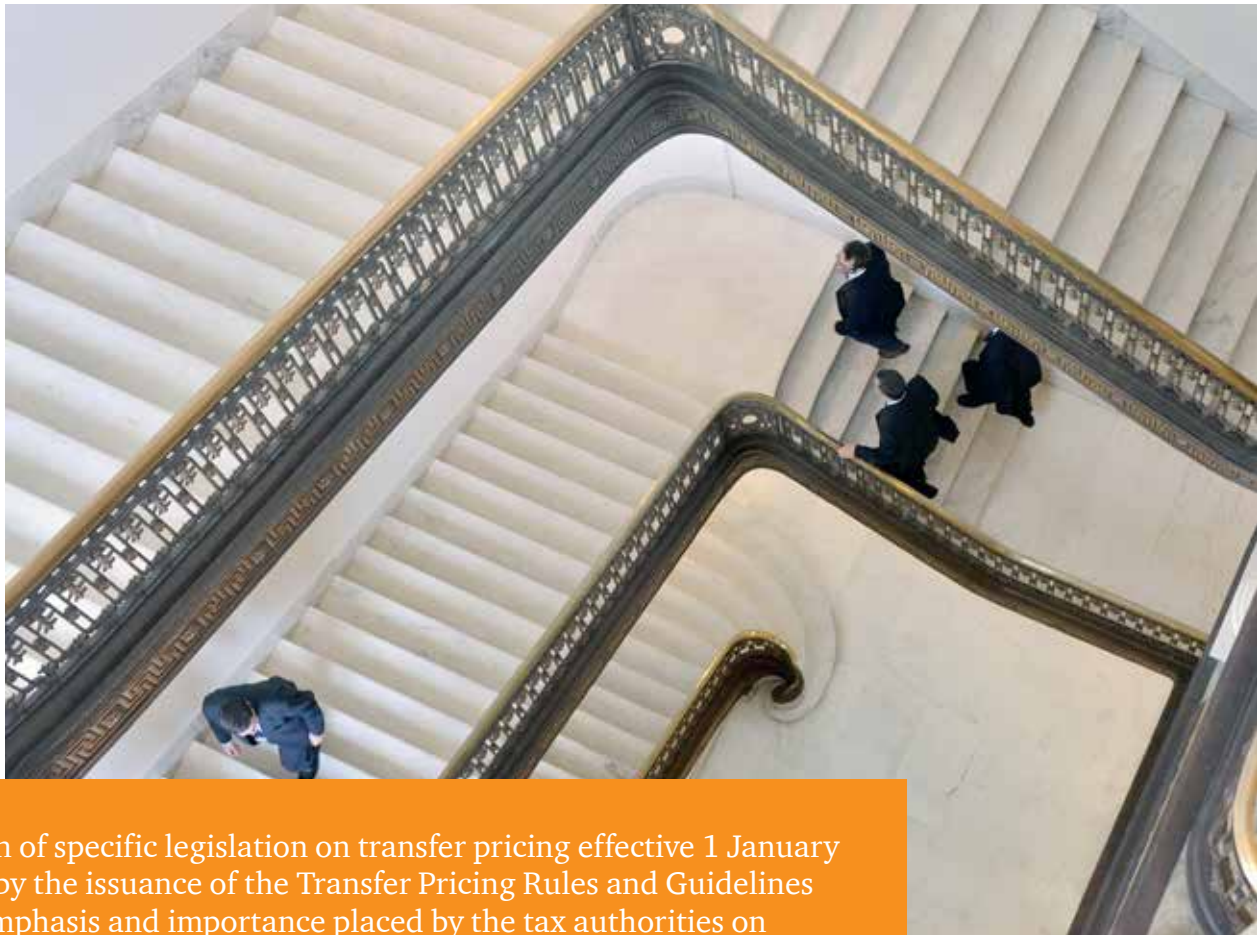
If there is no contemporaneous transfer pricing documentation	35%
If there is transfer pricing documentation prepared, but not according to requirements in the Guidelines	25%
If the taxpayer does not fall under the scope of the Guidelines, and does not prepare a contemporaneous transfer pricing documentation	25%

The Guidelines also mention that the penalty rate shall be increased by 20% as compared to the last penalty rate imposed for the previous offence but limited to a sum not exceeding 100% of the amount of tax undercharged, where:

- i. The taxpayer obstructs or interferes with a transfer pricing audit; or
- ii. The taxpayer fails to comply with the arm's length principle after previous transfer pricing audits.

In addition to the above, the Inland Revenue Board (IRB) has implemented the Monitoring Deliberate Tax Defaulters (MDTD) programme whereby non-compliant taxpayers are identified through tax audits and will be monitored by the IRB on a yearly basis until no repeated or new offences are committed.

Conclusion



The introduction of specific legislation on transfer pricing effective 1 January 2009, followed by the issuance of the Transfer Pricing Rules and Guidelines underline the emphasis and importance placed by the tax authorities on transfer pricing. This new “tick the box” requirement in the tax return Form C is a means of monitoring taxpayers’ compliance with the rules that are in place. As such, it is increasingly important that taxpayers pay greater attention to their pricing of related party transactions, as well as ensure that robust and contemporaneous transfer pricing documentation to support such arrangements is maintained.

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