

Global Transfer Pricing Landscape

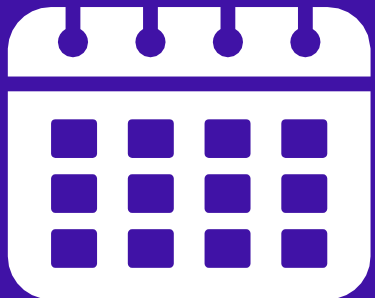
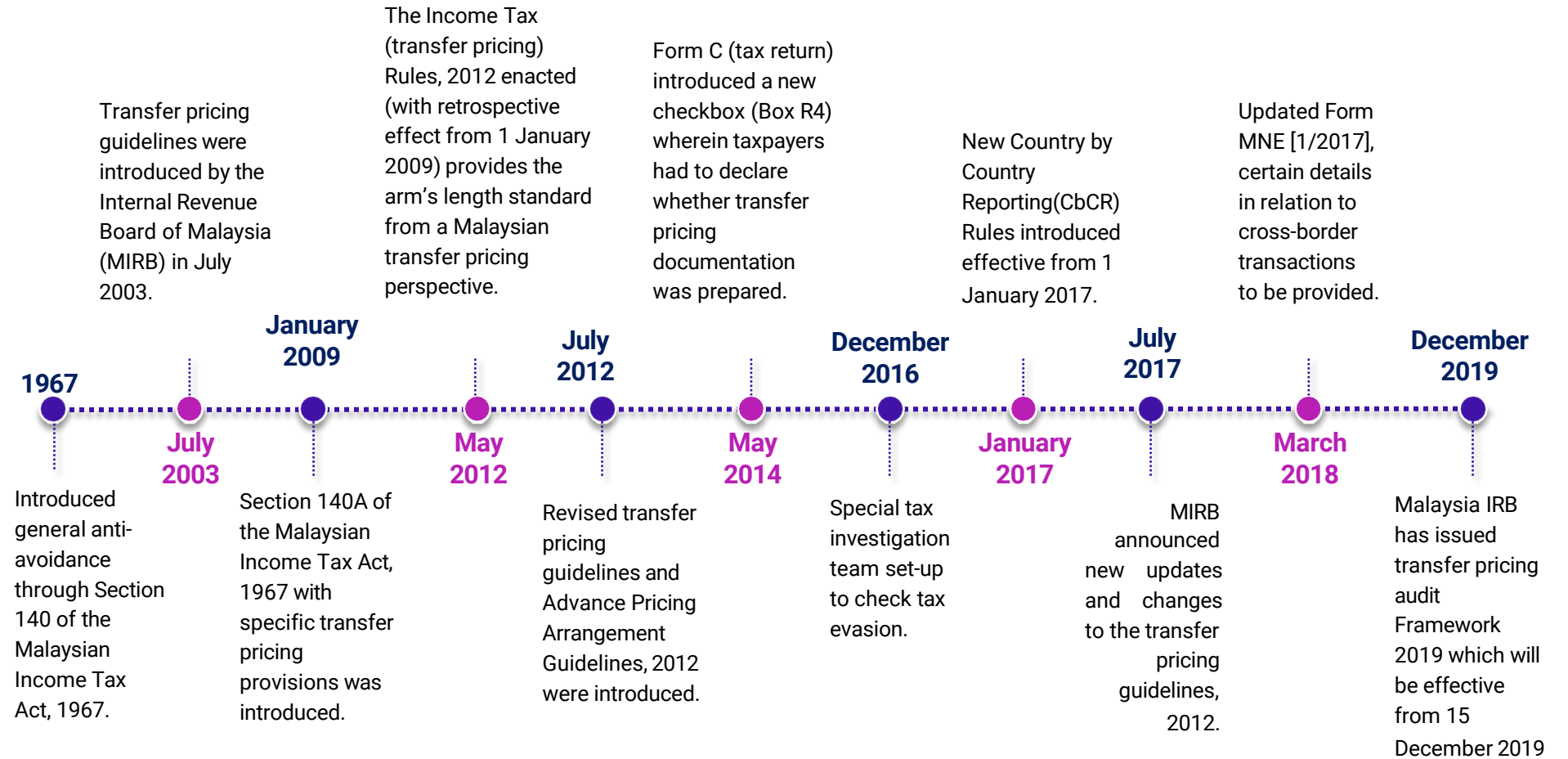
Malaysia

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Highlights



Introduction

Section 140 of the Malaysian Income Tax Act, 1967 empowers the Director General to disregard certain transactions which are believed to have a direct or indirect effect of altering the incidence of tax. In such cases, the director general has powers to re-compute or adjust income and impose a tax liability on the person.

Furthermore, Section 140A introduced with effect from 1 January 2009, requires taxpayers to determine and apply the arm's length price to controlled transactions. This Section further allows the director general to disallow transactions undertaken between Associated Enterprises(AEs), if he has reasons to believe that such transactions are excessive or not at arm's length.

The introduction of the transfer pricing rules and guidelines in 2012 guided the taxpayers on the exact documentation requirements from a Malaysian transfer pricing perspective.

In December 2016, the government appointed a CEO for the IRBM and a special team comprising of 272 intelligence officers and tax investigators to look into tax evasion.

In January 2017, the final rules for annual Country by Country Report (CbCR) were introduced which were aligned with Action Plan 13 of the Base Erosion and Profit Shifting (BEPS) project of the Organization for Economic Co-operation and Development (OECD).

Associated Enterprises (AEs)

According to the guidelines, two companies are regarded as AEs if one company participates directly/indirectly in the management, control or capital of the other company; or in case the same persons participate directly/indirectly in the management, control or capital of both the companies.

Furthermore, any Permanent Establishment (PE) needs to be treated as distinct and separate enterprise from its head office or other branches.

Exemptions from Guidelines

Specific exemptions are provided from the applicability of guidelines in the following cases:

- Person being an individual not carrying on business;
- Person having business with gross income below MYR 25 million or total related party transactions below MYR 15 million;
- Person providing financial assistance below MYR 50 million;
- Transactions involving financial institutions;
- Transactions between two persons who are assessable to tax in Malaysia and it can be proven that any adjustments made will not alter the total tax payable by such persons.

Transfer Pricing Documentation

Contemporaneous documentation

Contemporaneous documentation needs to be prepared **at the point when the taxpayer is developing or implementing any arrangement or transfer pricing policy with its related parties.**

The list of documents required:

- Organizational structure
- Nature of business or industry and market conditions
- Details of controlled transactions
- Pricing policies
- Comparability, functional and risk analysis
- Selection of a transfer pricing method
- Application of the transfer pricing method
- Supporting documents for developing the transfer pricing analysis

Furthermore, taxpayers need to review the price at the end of the year and update the documentation if there are any material changes.

The updated version of transfer pricing guidelines, 2012 (UTPG) clarifies that the comparable search can be updated every three years (rather than annually), as long as the operational conditions remain unchanged. However, it specifies that the financial data needs to be updated every year.

Arm's Length Principle

In line with OECD's guidelines, IRBM has adopted the arm's length principle as a basis for benchmarking intra-group transactions.

The arm's length principle, as per UTPG will now focus on achieving transfer pricing outcomes in line with value creation and align returns with value creation.

Selection of method

Although the taxpayer is given the right to choose any method, the guidelines encourage using transactional profit methods only in cases when traditional transactional methods cannot be reliably applied.

Furthermore, the guidelines specifically disregard methods that are based on global formulary apportionment on the convention that such arrangements are arbitrary and could not be considered a reliable approximate of arm's length conditions.

Comparability period

For comparability analysis, multiple year data of comparables may be used. However, for benchmarking a controlled transaction, the results of uncontrolled transactions for the same base year must be taken.

Certain Specific Transactions

Intra-group services

Guidelines caution to check for non-chargeable (non beneficial) elements in the following services:

- Shareholder activities;
- Duplicative services;
- Services that provide incidental/passive association benefits; or
- On-call services.

For intra-group services, the taxpayer needs to evaluate the following factors (benefit test):

- Economic or commercial value of benefits received from services;
- Willingness of independent enterprise to pay for similar services; and
- The charges for intra-group services must be consistent with the benefits received.

The guidelines further provide that for intra-group services, the service recipient may apply an external Comparable Uncontrolled Price (CUP) method together with a benefit test. With regard to service provider, the guidelines suggest that both the CUP method and the Cost Plus Method (CPM) may be applied.

Cost contribution arrangements

The Malaysian guidelines accept intra-group Cost Contribution Arrangements (CCA). To demonstrate whether CCA accords to arm's length principle, the following matters should be addressed:

- CCA should be entered into with prudent and practical business judgment.
- Reasonable estimation must be made for the expected benefit from CCA.

- Terms of the CCA should be agreed upon up-front and in accordance with economic substance, judged by reference to circumstances known or reasonably foreseeable at the time of entering into the arrangement.

Intangibles (other than the CCA)

The UTPG has provided a detailed guidance on existence of intangibles and categories of intangibles.

The revised guidance explains the concept of economic ownership of intangibles and analyzing transactions involving Development, Enhancement, Maintenance, Protection and Exploitation of Intangibles (DEMPE).

The UTPG also provides detailed guidance on determining arm's length price offer transactions involving intangible properties using various methods and valuation techniques.

Intra-group loans

For intra-group loans, the CUP method is considered most reliable. Local indices such as the Kuala Lumpur Inter Bank Offered Rate (KLIBOR) may be readily used to benchmark intra-group loans.

Commodity Transactions

A new Chapter X has been introduced to the transfer pricing guidelines explaining the applicability of the CUP method for commodity transactions.

Reporting and Compliance

Income tax return

Income tax return should be filed within seven months of the end of the financial year of the company.

All Malaysian companies having related party transactions during the year are required to disclose their domestic and cross-border related party transactions under Part N of the income tax return (Form C).

Furthermore, Part R4 of Form C explicitly requires taxpayers to state whether documentation has been prepared or not.

Submission of documentation

Taxpayers are not required to submit documentation on an annual basis. However, it needs to be submitted to the IRBM within 30 days of the request.

Additional disclosure forms

IRBM may ask taxpayer to provide additional details in Form MNE (cross-border transactions) or Form JCK (domestic transactions), as may be applicable. The taxpayer is required to provide such details within 30 days.

Recently, IRBM brought certain changes in Form MNE, requiring additional details in relation to cross-border transactions for undertaking transfer pricing risk–assessment process.

The updated Form MNE [Pin 1/2017], requires the following additional information:

- Name of the company and country in which the taxpayer has entered into

cross-border transaction if such country has a lower tax rate compared to Malaysia.

- Information in relation Research and Development (R&D) activities performed by the taxpayer.
- Information in relation to financial assistance received from related parties.
- The following group information in relation to brand name or intellectual property, if any, held by the group or its related parties:
 - Name of the legal owner and its location; and
 - Details of related companies performing R&D activity.

APA and MAP Procedures

The taxpayer may apply for a unilateral or bilateral Advance Pricing Agreement (APA) for a period of three to five years. Moreover, the taxpayer can also apply for rollback provisions for preceding financial years if it can be

demonstrated that the facts and circumstances surrounding those years are substantially the same.

Only taxpayers who are a company or a PE of a company can apply for APA, if they fulfil the following criteria:

- The taxpayer has a turnover exceeding MYR 100 million; and the value of the proposed APA transactions exceeds the following limits:
 - For sales, if it exceeds 50% of the turnover;
 - For purchases, if it exceeds 50% of the total purchases;
 - For other transactions, if the total value exceeds MYR 25 million.

- All covered transactions must relate to income that is chargeable to tax in Malaysia.
- In cases involving financial assistance, where the value of transactions exceed MYR 50 million.

After entering into an APA, the taxpayer needs to file annual compliance reports for relevant transactions.

The taxpayer may also apply for a Mutual Agreement Procedure (MAP) within a specified time limit as may be applicable as per the relevant tax treaty. In case, the time limit is not specified under the relevant treaty, the time limit of three years, mentioned in Article 25 of the OECD’s model Tax Convention on Income and Capital shall prevail.

Penalties and Other Consequences of Non-compliance

Following penalties may be applicable:

| Particulars | Rate of penalty (Percentage of tax adjusted) | | |
|--|---|--|--|
| | Normal case | Voluntary disclosure after taxpayer has been informed but before the audit commences | Voluntary disclosure before the case is selected for audit |
| Understatement or omission of income | 100%* | 35% | 15% |
| Non-maintenance of contemporaneous documentation | 35% | NA | 15%* |
| Documentation not prepared according to the guidelines | 30% | 20% | 10% |
| Taxpayer exempt from guidelines but transfer prices not at ALP | 25% | | |

* In a media release dated 17 April 2017, the IRBM released a statement on the imposition of penalty at 100% with effect from 1 January 2018

Furthermore, in cases of repetition of offence, the rate of penalty shall be increased by 20% as compared to the last penalty rate imposed for the previous offence but to a maximum of 100% of the amount of tax adjusted, where:

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

Notwithstanding the above, the Director-General may use his power under subsection 124(3) of the Malaysian Income Tax Act, 1967 to abate or remit the penalty imposed

BEPS/CbCR Applicability

On 27 January 2016, Malaysia became one of the signing members of the Multilateral Competent Authority Agreement (MCAA) which enables the automatic exchange of CbCR information within its signing members.

Malaysia had formally announced the implementation of CbCR requirements in line with Action 13 of OECD/G20 BEPS Project.

The final rules in relation to the annual CbCR were recently introduced in Malaysia effective from 1 January 2017, namely the Income Tax (CbCR) Rules 2016 (hereinafter referred to as 'Rules').

- The newly introduced Rules apply to Malaysian-parented MNC groups with total consolidated group revenue of at least MYR 3 billion in the financial year preceding the reporting year.

- The information submission mandated by the Rules will be in the form of the CbCR to be submitted to the Director General on or before 12 months from the last date of the reporting financial year.
- The reporting entity to be either the ultimate parent company or surrogate holding company, which would be a Malaysian resident entity of the group appointed to file the report as a substitute for the ultimate holding company.
- Each Malaysian resident entity to notify the Director General in writing of the group's reporting entity on or before the last day of the reporting financial year.

There are three separate CbCR notification forms prescribed by MIRB, which include:

- Annex B - For Reporting entity
- Annex C1 - For non-reporting entities located in Malaysian Tax Jurisdiction.
- Annex C2 - For non-reporting entities located outside the Malaysian Tax Jurisdiction.



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