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Malaysia Transfer Pricing Guidelines 2024 and Transfer Pricing Tax Audit Framework 2024

Malaysia Transfer Pricing Guidelines 2024

The Inland Revenue Board of Malaysia ("IRBM") published the latest edition of the Malaysia Transfer Pricing Guidelines 2024 ("Malaysian Guidelines") on 24 December 2024. The Malaysian Guidelines are updated in line with the revisions made to Section 140A and the introduction of Section 113B of the Income Tax Act, 1967 ("the Act") as well as the Income Tax (Transfer Pricing) Rules 2023 ("TP Rules 2023"). The Malaysian Guidelines are effective from the Year of Assessment ("YA") 2023.

The key updates in the Malaysian Guidelines are:

1. Revision of thresholds for preparing contemporaneous transfer pricing documentation ("CTPD")
2. Emphasis on the application of the arm's length principle
3. Clarification of the comparability analysis framework
4. Introduction of a simplified approach for low value-adding intragroup services ("LVAS") and dealing with pass-through costs
5. Expansion of guidance on business restructuring by controlled entities and separate guidelines for intragroup financial transactions

1

Contemporaneous transfer pricing documentation

Definition of CTPD	CTPD shall be prepared in accordance with the TP Rules 2023 **and** brought into existence prior to the due date for furnishing a tax return in the basis period for a year of assessment.
Threshold for Full CTPD	Changes to the thresholds to prepare a **full** CTPD: **Malaysian Guidelines 2012 (Updated July 2017)** a) Generates gross business income of more than RM25 million and a total amount of related party transactions exceeding RM15 million; or b) Provides financial assistance of more than RM50 million. This does not apply to transactions involving financial institutions. **Malaysian Guidelines 2024** a) Generates gross business income of more than RM30 million in total and engages in cross-border controlled transactions totaling RM10 million annually; or b) Receives or provides controlled financial assistance[*] of more than RM50 million annually.
Exemption from Preparing CTPD	Under Paragraph 1.5 of the Malaysian Guidelines, the following persons are not required to prepare a CTPD: a) Individuals not carrying on a business; b) Individuals carrying on a business (including partnerships) who only engage in domestic controlled transactions; c) A person who entered into controlled transactions with a total amounting to not more than RM1 million; or d) A person who entered solely into domestic controlled transactions with another person where both parties" i. Do not enjoy tax incentives; ii. Are taxed at the same headline tax rate; or iii. Do not suffer losses for two consecutive years prior to the controlled transactions. Persons who are exempted as above must still comply with the arm's length principle for all controlled transactions entered into. All relevant documents that are related to the controlled transactions, including documentation to support and prove the determination of the arm's length price must be kept and maintained as readily available.

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[*] Financial assistance includes loans, interest-bearing trade credits, advance or debt, or the provision of any security or guarantee.

Minimum CTPD	Any taxpayer who enters into controlled transactions but does not satisfy the thresholds for full CTPD, or is exempted from preparing a CTPD under Paragraph 1.5 of the Malaysian Guidelines is still required to prepare a minimum CTPD. The reduced documentation requirements of a minimum CTPD: a) Worldwide group structure b) Organizational structure c) Controlled transaction d) Pricing policy The information required for c) and d) is confined to the "key controlled transactions". For the purposes of minimum CTPD, the following transactions are referred to as "key controlled transactions": a) Controlled transactions that are related to the taxpayer's principal activity, such as the acquisition or supply of raw materials for manufacturing activity; or b) Controlled transactions, other than those in a) above, that constitute 20% or more of the operating revenue in each YA. Even if there are no "key controlled transactions", taxpayers are still required to provide a list of all controlled transactions entered into as part of the minimum CTPD.

Kroll observations:

- Following the introduction of the TP Rules 2023 and further reiteration in the updated Malaysian Guidelines, taxpayers should ensure the CTPD is completed and dated before the filing of the income tax return (i.e., seven months after the financial year end). If the timeline for submission of the return form is extended, the completion date for the CTPD can also be extended.
- The revenue threshold has been increased by RM5 million, and the threshold for related party transactions has been relaxed to solely focus on cross-border transactions of RM10 million or more. This revised threshold reduces somewhat the compliance burden for domestic groups of companies and the number of entities required to prepare full CTPDs.
- Given the extensive documentation requirements under the TP Rules 2023, the exemptions from preparing a CTPD now somewhat reduces the compliance burden for taxpayers, especially for small and medium enterprises. Taxpayers will have to assess whether they meet the thresholds for a full CTPD or if they qualify for exemption from preparing a full CTPD, using the flow chart provided under Paragraph 1.11 of the Malaysian Guidelines.
- Taxpayers should not assume that being exempt from a full CTPD means having zero documentation requirements. Maintaining some form of documentation or computation is a practical necessity to demonstrate compliance with the arm's length principle. In addition, there may be a requirement to prepare the minimum CTPD specified in Paragraph 1.8 of the Malaysian Guidelines.
- While a minimum TPD may provide some level of defense during audits, a full CTPD remains the most reliable safeguard against transfer pricing ("TP") challenges. Given the IRBM's intensified scrutiny, taxpayers may still choose to prepare a CTPD voluntarily to better mitigate the risk of TP adjustments, even if they are technically exempted.

2 Application of the arm's length principle

Arm's Length Range	A two-step process is introduced to determine the arm's length price: 1. Calculating the arm's length range o If the tested party's pricing falls within the arm's length range, it will be regarded as arm's length price. 2. Calculating the median o If the tested party's pricing falls below the arm's length range, a TP adjustment may be made to the median (i.e., the midpoint of the 37.5 percentile and the 62.5 percentile). In addition to the above, the IRBM may adjust to the median or any point above median within the arm's length range if the IRBM believes that: a) Comparables have a lesser degree of comparability (in terms of functional profile, business strategies, product portfolios, etc.); or b) Comparability defects that cannot be identified, quantified or adjusted
Determination of Profit Level Indicator	The Malaysian Guidelines further clarified the exclusion of non-operating items or exceptional and extraordinary items in the determination of the profit level indicator ("PLI"), such as interest income/expenses and income taxes. Recurring items such as foreign exchange gains or losses and disposal of property, plant and equipment shall not be considered as exceptional and extraordinary. The nature of these items and any hedging of foreign currency exposures need to be considered before making any adjustment.

Kroll observations:

- The arm's length range has been further clarified in the Malaysian Guidelines, which is consistent with TP Rules 2023. With the tightening of the arm's length range and selection criteria of comparable companies, there would be an increased compliance burden on taxpayers to provide more detailed justification and data to support their TP position.
- Taxpayers will need to monitor their financial performance more closely and regularly update the benchmarking study to ensure that the transfer price falls within this tighter range of acceptable results and aligns with the IRBM's expectations.

3 Comparability analysis

Single Year Data vs. Multiple Year Data	Multiple year data can be used in the selection of comparables, which can improve the reliability of the comparability analysis. However, comparison of results between the tested party and the comparable companies must be performed for the same basis year in a YA. Taxpayers are expected to update the benchmarking study when the latest financial data of the comparable companies is available or in the event of an audit.
Comparable Period	To minimize the impact of practical issues on benchmarking analysis, comparable companies with financial year end six months prior to or six months after the tested party's financial year end may be used to determine the arm's length price. For instance, a tested party with financial year end 31 December 2024, may use comparable companies with financial year end from 1 July 2024 to 30 June 2025.
Selection Criteria for Potential Comparables	The Malaysian Guidelines have provided guidance in selecting good quality comparables based on qualitative and quantitative criteria: a) Qualitative criteria • Functional comparability • Other criteria, such as product portfolios, business strategies, geographical markets and independent business activity of comparables b) Quantitative criteria • Size of transaction in terms of sales (not less than 10% of tested party's revenue), assets or number of employees • Intangible ratio (i.e., net value assets or R&D activities) • Export sales • Inventories ratio • Other criteria for special situations

Kroll observations:

- The Malaysian Guidelines provide guidance on selecting high-quality comparables based on both qualitative and quantitative criteria, aligning with the Organization for Economic Cooperation and Development ("OECD") Transfer Pricing Guidelines 2022 ("OECD Guidelines"), which propose a nine-step process for a comprehensive comparability analysis. However, there are certain differences in preferences, such as the requirement that the comparison of results between the tested party and comparable companies must be performed on the same basis year in a given YA.
- With stricter qualitative and quantitative criteria for selecting comparables, taxpayers must reassess their existing benchmarking studies to ensure compliance with the new Malaysian Guidelines. Failure to meet these standards could lead to TP adjustments, increased scrutiny and potential disputes. To minimize risks, businesses should proactively review and refine their benchmarking approach in line with the updated guidelines.
- The requirement for taxpayers to update benchmarking studies when the latest financial data of comparable companies becomes available or during an audit increases the compliance burden on businesses. While the IRBM acknowledges the time lag in publicly available financial data and does not render the CTPD as non-contemporaneous, it introduces potential risks if the updated benchmarking results in material differences from the original analysis. If a TP adjustment is triggered, a surcharge of up to 5% may be imposed on that adjustment.

4 Intragroup services

Low Value-Adding Intragroup Services	Effective YA2023, the Malaysian Guidelines allow taxpayers to elect a simplified approach to determine the arm's length charges for LVAS. LVAS refers to services that one or more MNE group members provide on behalf of one or more other group members. The guidance does not apply to services that are also rendered to third-party customers of the members of the multinational group. In such cases, it is expected that reliable internal comparables would be available to determine the arm's length price. This simplified approach is only applicable to the Malaysian service providers and foreign service providers that have similarly adopted the simplified approach as outlined in the OECD Guidelines in their jurisdictions. The service provider applies a markup of 5% on all relevant costs (except pass-through costs). The markup under the simplified approach does not need to be justified by a benchmarking study (even for a full CTPD), but all relevant documentation on this simplified approach should be prepared.
Pass-Through Costs	Pass-through costs are third parties' costs incurred on behalf of group members when performing functions as an intermediary, during which the person neither performs any value-added functions nor assumes any risks. The IRBM will consider the cost of services obtained from third parties as pass-through costs (with no markup applied) based on specific requirements as set out in the updated Malaysian Guidelines. It is specified that eliminating the pass-through costs from the cost-based PLI is not warranted where no evidence on adjustments or no publicly available data on the breakdown of similar pass-through cost and value-added cost is provided to the IRBM.

Kroll observations:

- The LVAS offers the benefit of avoiding the need for a benchmarking study when applying the safe harbor of 5% cost markup. However, this does not necessarily mean that the fixed markup is always the most advantageous for taxpayers. Conducting a benchmarking study could reveal a higher or lower arm's length markup, potentially leading to better tax outcomes, depending on the specific circumstances.
- Taxpayers should consider that the counterparty jurisdiction is not obligated to accept the 5% markup as arm's length, which may result in cross-border TP disputes or double taxation risks. In such cases, the taxpayer may still need to prepare a benchmarking study to support their pricing and comply with the TP requirements of that jurisdiction.
- Malaysian service providers must ensure their services qualify as LVAS to benefit from the simplified approach. This means that the CTPD must clearly justify the benefits derived from each LVAS category for both the service provider and recipient, as inadequate documentation could lead to challenges and adjustments from the tax authority.
- A key challenge is adjusting pass-through costs for the tested party while ensuring consistency with external comparables. However, the lack of detailed cost breakdowns in audited financial statements makes this difficult, increasing the risk of scrutiny and TP adjustments. To mitigate these risks, taxpayers must carefully document their cost allocation, align their TP policies and ensure robust compliance to defend against potential audits.

5

Business restructuring and financial transactions

Business Restructuring	The Malaysian Guidelines expanded the guidance on business restructuring, providing more detailed explanation on realistic options available for business restructuring, pre- and post-functional analysis relevant to the restructuring, and arm's length compensation. It emphasized the reduction in profitability of the local entities, following a corresponding decrease in the functions performed, assets employed and risks assumed by the entity. Under Paragraph 5.5 of the Malaysian Guidelines, business restructurings require that any valuation for the supply, acquisition or transfer of property may be necessary to achieve an arm's length remuneration, which is in line with the OECD Guidelines.
Financial Transactions	The Malaysian Guidelines indicate that a separate guideline will be issued to address specific TP requirements related to intragroup financial transactions, considering the complexity and depth of analysis required for determining the arm's length price or condition for financial transactions. In the meantime, taxpayers could reference the OECD Guidelines for further guidance on the treatment and documentation of the intragroup financial transactions. Loan benchmarking generally remains valid until the loan matures or is refinanced, regardless of whether the interest rate is fixed or floating. However, for short-term loans that are rolled over annually, the interest rate (fixed or margin over a base rate) should ideally be reassessed at the start of each year. For long-term floating rate loans where the borrower can refinance annually without penalty, the loan margin should also be reviewed yearly to determine if an independent party would refinance at a lower rate if the difference is significant. In contrast, refinancing a fixed-rate loan before maturity usually incurs a penalty or break cost, offsetting any potential savings. Even when annual benchmarking is not mandatory, taxpayers are advised to conduct an annual review to ensure: a) Assessment of material changes – Confirming that there have been no significant modifications to the loan terms, no new debt issuance, and that the borrower remains capable of servicing the debt. b) Transfer pricing policy alignment – Ensuring that interest calculations align with the terms of the loan agreement.

Kroll observations:

- The expanded guidance on business restructuring provides clearer expectations for taxpayers undergoing restructuring, ensuring they apply the arm's length principle and properly document the transaction in their CTPD as outlined in Appendix A. While this guidance helps businesses align with compliance requirements, it also places an increased burden on taxpayers to thoroughly analyze, justify and document their restructuring activities. Failure to do so may result in heightened scrutiny, potential TP adjustments and disputes with the IRBM.
- For intragroup financial transactions, the guidelines reinforce the complexity of compliance by outlining specific documentation requirements in Appendix A, such as agreements, loan terms and conditions to support the arm's length nature of these transactions. However, since further details will be provided in a separate guideline, taxpayers face uncertainty and potential compliance risks in the interim. Businesses engaged in intragroup financing must be prepared for stricter regulatory oversight once the additional guidance is issued.

Transfer Pricing Tax Audit Framework 2024

The IRBM published the latest edition of the Transfer Pricing Tax Audit Framework 2024 ("TPTAF 2024") along with the Malaysian Guidelines 2024 on 24 December 2024. TPTAF 2024 supersedes the previous Transfer Pricing Audit Framework 2019 ("TPAF 2019"). TPTAF 2024 outlines the rights and responsibilities of audit officers, taxpayers and tax agents when a TP audit is carried out.

The key updates in TPTAF 2024 are:

1. Updates on the audit examination process
2. Updates on the YA covered and the basis of selection of audit cases
3. Further clarity on audit settlements and voluntary disclosure
4. Enhancement of the penalty regime for non-compliance

Audit Examination Process	The TP tax audit examination will be carried out as a comprehensive audit examination as follows: a) At the taxpayer's premises, the IRBM's office or any places agreed by both parties b) Applying the Tax Audit Framework comprehensive audit examination procedures, which involve examination of the taxpayer's business records with additional procedures, such as the submission of business information slides as well as the TP documentation before the audit visit The TP tax audit examination is no longer referred to as "field" and "desk" audit as set out in TPAF 2019.
Year of Assessment Covered	A comprehensive audit examination of a TP case can cover up to six years of assessment and may be extended to seven years of assessment depending on the audit findings. The limit for this coverage period does not apply to TP tax audit cases involving fraud, willful default or negligence. Negligence may include failing to prepare CTPD or submitting non-compliant CTPD, as inferred from TPTAF 2024, where taxpayers fail to exercise due care expected under similar circumstances.
Selection of Cases	TPTAF 2024 has further clarified the basis for the selection of TP tax audit cases as follows: a) Risk assessment criteria for controlled transactions*; b) Targeted review of companies that have undergone restructuring c) Information received from third parties, including foreign tax authorities
Audit Settlement	The TP tax audit case needs to be completed within 450 calendar days from the audit commencement date. For TP tax audits that only involve related companies in Malaysia, if there are any offsetting adjustments made to any of those related companies, the adjustment for the same amount will **not** be automatically given to the other related parties. A separate application for an offsetting adjustment must be made by the other related parties, and audits will be carried out on those other related parties to ensure the application may be considered under the provisions of the Act.
Voluntary Disclosure	TPTAF 2024 has further clarified that taxpayers can make a voluntary declaration after the deadline for submission of the tax return but before the audit commences for a voluntary disclosure. If the information and documents to be submitted by the taxpayer for the voluntary disclosure are incomplete, the IRBM may conduct an audit visit or issue a letter of inquiry.

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* The risk assessment criteria may include significant amount of related party transactions, persistent losses, low margins, fluctuation in profits/ margins, etc.

Penalties and Surcharge

For audit cases commencing before 1 January 2021, a penalty may be imposed in the event of an understatement or omission of income as a result of the audit findings, ranging from 15% to 45% of the amount of tax undercharged as clarified further in TPTAF 2024.

For audit cases commencing on or after 1 January 2021, a surcharge may be imposed at a rate of up to 5% (0% to 4% for voluntary disclosure) on the amount of adjustment in the event of a TP adjustment that results in an increase in income or a reduction of any deduction or loss.

The surcharge is levied on the adjustment, **not** the amount of any additional tax payable.

Penalties for Failure to Submit a Transfer Pricing Documentation

In line with the latest edition of the Malaysian Guidelines (effective YA2023), the failure to submit a transfer pricing documentation ("TPD") within 14 days from the date of request from the IRBM may give rise to a fine between RM20,000 and RM100,000, or imprisonment for not more than six months or both.

This penalty will be imposed at the final stage of the audit process for each YA involved separately if:

a) The TPD submitted to IRBM exceeds the 14-day period from the date of service of the written notice; or
b) The TPD submitted to IRBM does not comply with the requirements under P.U. (A)165/2023 (i.e., TP Rules 2023) and the Malaysian Guidelines that are currently in force.

The amount of penalty that will be imposed based on the period of delay in submitting the TPD after the 14-day time frame is as follows:

Period of delay (number of days)	Penalty amount (RM)
Up to 7 days	20,000
More than 7 days up to 14 days	40,000
More than 14 days up to 21 days	60,000
More than 21 days up to 28 days	80,000
More than 28 days	100,000

The IRBM may grant a concession on these penalties, but only for companies with a financial year that began before 29 May 2023, regardless of whether the TPD pertains to YA2023 or YA2024.

Kroll observations:

- Taxpayers who have neglected to prepare TPD must urgently reassess their TP requirements. The 14-day submission deadline in the event of an audit is likely insufficient to prepare TPD from scratch, especially given the requirement for contemporaneous documentation, which mandates completion by the tax return filing date.
- The IRBM's increased focus on domestic-related party transactions means taxpayers must stay vigilant, even with reduced TPD requirements for domestic entities. While domestic-related party transactions do not involve foreign tax authorities (which could potentially challenge the adjustment), any domestic adjustments can lead to double taxation, where one domestic entity's increased taxable income is not offset for the domestic counterparty.
- In light of the updated rules and guidelines in Malaysia, taxpayers should regularly review their TP policies and ensure comprehensive information and documents are readily available to support their position in the event of an audit. It is important for taxpayers to keep up-to-date with the latest regulations to ensure adherence and minimize potential audit risks.

Conclusion

The TPTAF 2024 reflects the tax authority's increasing focus on enforcement, risk-based selection, and stricter penalties for non-compliance. The refined audit examination process and penalty regime impose greater scrutiny on transfer pricing compliance, requiring taxpayer to maintain robust documentation and provide sufficient information to meet the regulatory expectations.

The Malaysian Guidelines introduce new compliance requirements, enhanced documentation standards, and greater scrutiny on comparability and pricing adjustments, reinforcing the IRBM's commitment to enforcing arm's length principles.

Taxpayers must proactively align their transfer pricing policies with the updated rules, ensure robust benchmarking and documentation, and mitigate audit risks by maintaining transparent and defensible transfer pricing practices.

With the Malaysian Guidelines effective from YA2023, a key question arises regarding the treatment of CTPD that was prepared and finalized before 24 December 2024, prior to the official issuance of the new guidelines. Specifically, how should taxpayers that completed their CTPD between July 2023 and 23 December 2024 ensure compliance with the updated requirements and address any potential alignment issues.

This raises concerns about whether taxpayers need to update or revise their previously prepared documentation to align with the new requirements. It remains to be seen whether the IRBM will enforce retrospective adjustments, require additional disclosures, or provide transitional relief for such cases.

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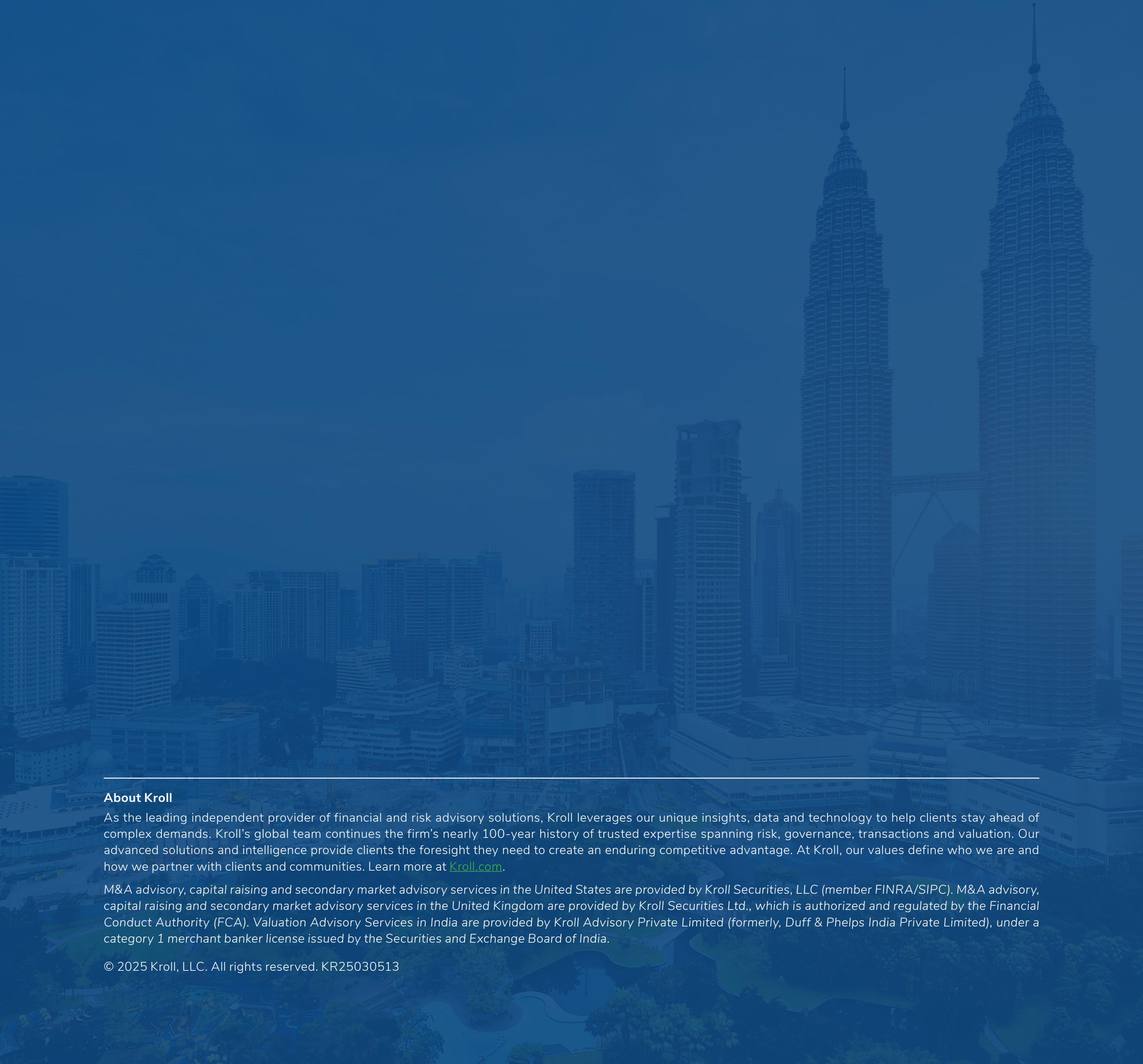

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