



# New Requirements under the Income Tax (Transfer Pricing) Rules 2023

# Income Tax (Transfer Pricing) Rules 2023

The new Income Tax (Transfer Pricing) Rules 2023 (“TP Rules 2023”) have been released and gazetted on May 29, 2023. The TP Rules 2023 are effective from the Year of Assessment (YA) 2023, while the Income Tax (Transfer Pricing) Rules 2012 will continue to be applicable prior to YA2023.

The key changes in the TP Rules 2023 are set out below:

## Key Changes:



### Definition of Contemporaneous Transfer Pricing Documentation (TPD)

Contemporaneous TPD shall be brought into existence prior to the due date for furnishing a return.



### Date of Completion of TPD

The date on which completion of the TPD is required to be documented



### Content of Contemporaneous TPD

Additional information includes:

1. Schedule 1 – Multinational Enterprise Group Information
2. Schedule 2 – Taxpayer’s Business Information
3. Schedule 3 – Cost Contribution Arrangement Information

An indication of non-applicability of information, data or documents in the TPD is required (the checklist approach).

## Our Observations:



Taxpayers must ensure that contemporaneous TPD is readily available prior to the due date of filing the tax return, i.e., seven months after the financial year end.



The Inland Revenue Board of Malaysia (IRB) is now able to ensure that the TPD is prepared prior to the due date of tax return filing. Failing to comply may result in penalties ranging from RM20,000 to RM100,000 per YA.



The inclusion of the additional information from Schedule 1 is mainly covered in the master file. Taxpayers who are part of a group but do not meet the master file requirements, would also be required to furnish this information if they meet the full TPD requirements.

Failure to indicate the non-applicability of information results in non-completeness of the TPD and may be subject to the same penalties as above (even if the TPD was submitted within 14 days of a request).

## Key Changes:



### Selection of the best method

A taxpayer shall determine the arm's length price for a controlled transaction by applying the most appropriate method, supported with an explanation and reason for the method selected.



### Application of data

An arm's length price shall be determined based on the most recent information available publicly.

The use of prior years' data is allowed for the purpose of reviewing the impact of life cycle/business cycle of the property or services in selecting the comparables, but comparison of results between the tested party and the comparable companies for the same basis year in a YA is still required.

## Our Observations:



Taxpayers can now select the most appropriate/best method that provides the highest degree of comparability instead of applying the hierarchy of methods under the Income Tax (Transfer Pricing) Rules 2012. However, it is also necessary to consider the other methods and explain why the selected method is the best or most appropriate in preference to other methods.



The latest year of financial data of comparable companies may not be available at the point when the benchmarking study is performed and before the due date of tax return filing. This means that when the tax return is due for filing, the single year performance of the taxpayer is benchmarked against the previous year's profitability of the comparable companies. Taxpayers are expected to update the financial data of the selected comparables periodically as the IRB has the right to refer to the year-on-year results of the comparable data in assessing the benchmarking study. In practice, this is an additional compliance burden for taxpayers.

It would be more reasonable to benchmark the single year performance of the tested party against the multiple year average profitability of the comparable companies in order to ensure a more reliable estimation of the arm's length range.

## Key Changes:



### Arm's length range

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

The median is the value at the mid-point of the arm's length range.



### Adjustment to the median

The IRB may adjust the arm's length price to the median or any other point above the median if the transfer price falls outside the (tighter definition of) arm's length range.

## Our Observations:



The TP Rules 2023 have defined the arm's length range to be much narrower than the interquartile range (i.e., 25th to 75th percentile). In practice, this means that the IRB will be able to raise additional adjustments as the (single year) profitability of more taxpayers may fall below the narrower arm's length range. Taxpayers will need to monitor their financial performance more closely and proactively in order to ensure that the transfer price falls within this tighter range of acceptable results.



Taxpayers should review carefully the comparability of the selected comparables to ensure reliability of the arm's length range of results, as the IRB still has the right to adjust the transfer price to the median (or above median) of the arm's length range. In this regard, the IRB can seek to reject certain companies or introduce new companies in the set of comparables, which leads to a change in the arm's length range of results, and the IRB can exercise its discretion to make an adjustment. Even though the burden of proof lies with the IRB to justify any amendments to the selection of comparable companies, taxpayers should certainly dedicate more time and resources to ensure the comparables selected are as reliable, robust and strong as possible.

## Key Changes:



### Emphasis on DEMPE analysis

Notwithstanding the legal ownership, the person who contributes to the value of the intangible property (IP) through development, enhancement, maintenance, protection and exploitation (DEMPE) is entitled to an arm's length consideration. The owner of IP is not entitled to any income attributable to that IP if the legal owner is not involved in DEMPE.



### Offsetting adjustment

The provision of the offsetting adjustment has been removed under the TP Rules 2023.

## Our Observations:



Taxpayers who contribute to the value of the IP (regardless of legal ownership) must document the detailed information relating to DEMPE of the IP in the TPD and/or reassess any existing DEMPE of the IP. This is an additional compliance burden for the taxpayers to include such extensive information in the TPD.



No offsetting adjustment will be made on the assessment of the other party in a transaction for any transfer pricing adjustment that is made by the IRB. The IRB is also empowered to impose a surcharge of up to 5% on the transfer pricing adjustment based on Section 140A(3C) of the Income Tax Act 1967. It is also important to note that double taxation may occur due to adjustments made to the pricing of transactions taking place between Malaysian related parties (domestic transfer pricing).

## Conclusion

The key developments in the TP Rules 2023 have substantial implications for taxpayers in Malaysia. These changes significantly enhance the IRB's ability to impose transfer pricing adjustments on taxpayers by introducing a more stringent definition of the arm's length range, codifying a single year period of review, and providing for the application of adjustments to the median. In addition, the financial impacts of a transfer pricing adjustment are amplified due to the introduction of a 5% surcharge on the adjustment amount instead of on the tax arising on the adjustment itself, without any possibility of offsetting adjustments. Furthermore, for cross-border transactions, the 5% surcharge does not fall within the scope of "tax," rendering the mutual agreement procedure (MAP) unavailable for resolving double taxation. MAP may only potentially apply to the tax paid on the adjustment, subject to the provisions of the relevant double tax treaty, if applicable. However, in practice, pursuing MAP is challenging, costly, and carries an uncertain chance of success.

The key takeaway for taxpayers is to proactively seek to avoid transfer pricing adjustments on controlled transactions by ensuring that they are in full compliance with the Malaysian transfer pricing documentation rules and by diligently monitoring their financial performance relative to the now more stringent definition of "arm's length range."



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