

Scrutiny of Transfer Pricing Compliance Increases as Changes Take Effect (19 April 2021 - The Edge)

Scrutiny of transfer pricing compliance increases as changes take effect

BY ESTHER LEE

Companies in Malaysia have increasingly come under the scrutiny of the Inland Revenue Board (IRB) where transfer pricing practices are concerned. Industry experts highlight that the number of transfer pricing desk audits have increased significantly since the beginning of the year.

Transfer pricing audits, once mainly focused on multinational corporations with cross-border related-party transactions, are now being expanded to larger Malaysian conglomerates with domestic related-party transactions, says Sockalingam Murugesan, EY Asean transfer pricing leader and partner at Ernst & Young Tax Consultants Sdn Bhd.

This comes following the Finance Act 2020 that was gazetted on Dec 31, 2020, and took effect on Jan 1 this year. The act introduced three landmark changes to the transfer pricing compliance and audit regime in Malaysia.

Deloitte Malaysia national transfer pricing leader Subhabrata Dasgupta points out that these changes will have an effect on corporate income tax returns for 2021 and subsequent years. "It will also affect the transfer pricing compliance strategy of companies as well as cause implications for open years of assessment."

The three major changes that have garnered the most attention include the introduction of a RM20,000 to RM100,000 penalty per year of assessment for failure to furnish contemporaneous transfer pricing documentation upon request.

Previously, there were no specific penalties imposed on documentation non-compliance. Penalties were only imposed if a tax adjustment or transfer pricing adjustment was made whereby taxpayers would be subject to additional tax and penalties for the submission of an incorrect tax return under Section 113(2) of the Income Tax Act 1967.



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BakerTilly Malaysia international tax and transfer pricing executive director Yohan Francis Xavier says the steep penalty for failure to provide transfer pricing documentation upon request indicates such documentation is in fact compulsory for all companies, from multinational corporations to small and medium enterprises, as long as related-party transactions are involved.

"While the rules and guidelines on transfer pricing documentation have been in place for many years, many taxpayers have adopted the 'wait and see' approach when it comes to actually preparing their documentation. They wait until an audit is triggered by the IRB, and often find themselves caught unprepared. This also follows a lackadaisical attitude to complying with the arm's length principle," explains Yohan.

The timeline to furnish contemporaneous transfer pricing documentation has also been more than halved to 14 days from 30 days previously.

Yohan says it would be impossible to prepare comprehensive transfer pricing documentation from scratch even with 30 days, so the shortened time frame of 14 days means that the IRB expects



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taxpayers engaging in controlled transactions to have up-to-date transfer pricing documentation for each year of assessment.

The second major change is the introduction of a surcharge of up to 5%, which will be imposed on the transfer pricing adjustment amount. This has a much wider impact, the tax consultants point out.

Sockalingam says that previously, companies not subject to income tax because of tax incentives may not have reviewed their transfer pricing position adequately because there was no tax impact. However, this will not be the case anymore as the surcharge will be applied on the amount of adjustments made, regardless of whether the company's tax incentives put it in a no additional tax position.

Finally, the amendment has given the tax authority the ability to disregard structures or transactions where the economic substance differs from its form that is adopted in controlled transactions, emphasising the "substance over form" principle.

"It also stresses the need for taxpayers to actively review their intercompany transactions as this would ensure that such transactions have economic substance



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that aligns with form for the transactions, and are supported by transfer pricing analyses demonstrating adherence to the arm's length principle," Yohan observes.

So, which companies are likely to come under transfer pricing audit scrutiny?

Usually, companies with significant related-party transactions and have low or fluctuating profits are the primary targets of such scrutiny.

"Historically, the focus of the IRB has been on the audit of transfer pricing of tangible goods and intra group service transactions. [But] there has been recent concentration on financial assistance arrangements," Subhabrata highlights.

Sockalingam notes there has been a greater focus by the IRB on services and intangible transactions as well. He adds that companies which have gone through internal supply chain restructurings are also being looked at to determine if their new transfer pricing policy reflects the changes in the functional and risk profiles.

Ultimately, with the changes made, companies with intercompany transactions need to put more thought into their transfer pricing compliance, be it when they

prepare their tax compliance documents or strengthen existing documentations.

Subhabrata suggests that companies start by preparing robust contemporaneous transfer pricing documentation for all open years of assessment in order to mitigate the risk of a flat penalty and surcharge.

Other recommendations by him include accurately delineating controlled transactions to align actual conduct with intercompany contracts, adopting arm's length practices even if the associated income is exempt and providing voluntary disclosure to the tax authorities, especially where a taxpayer has been subject to prior transfer pricing audits.

Sockalingam believes that transfer pricing should be looked at from a holistic point of view. "Transfer pricing should be looked at beyond just the finance or tax department, but by all stakeholders in the supply chain or organisation in determining and applying robust transfer pricing policies that are defensible from both a tax and commercial perspective."

"In addition, for certainty of their transfer prices, companies should look at advanced pricing arrangements (APAs) that are provided for under our existing laws have upfront certainty and agreement on their transfer prices with the tax authorities," he says.

That said, with such major changes made to the transfer pricing compliance, tax experts agree that this is evidence that companies can expect stricter enforcement by the tax authorities in the coming days and is in line with global momentum on the subject of transfer pricing since 2015.

"The expectation of the IRB would be to witness a significant increase in compliance, among both domestic group companies and foreign-owned multinational businesses, especially companies with tax attributes," says Subhabrata.