

DEPARTMENT OF INTERNATIONAL TAXATION
 Dialog Session with CTIM Technical Committee on Transfer Pricing (TC-TP)
 Transfer Pricing Guidelines (Updated Version) – Chapter II and Chapter XI

A. General Comments		
Topic/ Issues	CTIM Comments	IRBM's Response
Effective Date	<p>We noted that the effective date for the updates to the Transfer Pricing Guidelines (TPG) 2012 is 15 July 2017. In this respect, we would suggest that the updated TPG 2012 be applied to transfer pricing (TP) documentation prepared for the year of assessment (YA) 2017 onwards and not prior to YA 2017.</p>	<ul style="list-style-type: none"> - The effective date refers to the taxpayer's financial year period and the date when the TP Documentation has been prepared. - For the financial year 2017 which started from 01/01/2017 and ended at 31/12/2017, the new updated guideline will be not applicable to them since the TP Documentation should be prepared before 15/07/2017. - For the financial year 2018 which started from 01/01/2018 and ended at 31/12/2018, the new updated guideline will be applicable to them since the TP Documentation should be prepared before 01/01/2018. - In situation for the financial year period for FYE2018 (01/08/2017 – 31/07/2018) where the TP Documentation has been prepared before 15/07/2017, they will not be subjected to this new updated TPG 2012. - In situation where TP Doc for any financial years has been prepared after 15/07/2017, they should be subjected to this new updated TPG 2012.

B. Comments on Updated Chapter II – The Arm’s Length Principle

Topic/ Issues	CTIM Comments	LHDNM Comments
<p>2.2 Guidance In Applying The Arm’s Length Principle</p> <p>2.2.2 The taxpayer need to ensure that:</p> <ul style="list-style-type: none"> (a) actual business transactions undertaken by them are identified, and transfer pricing is not based on contractual arrangements that do not reflect economic reality; (b) contractual allocations of risk are respected only when they are supported by actual decision-making; (c) capital without functionality will generate no more than a risk-free return, assuring that no premium returns will be allocated to cash boxes without relevant substance; and 	<p>Please confirm that the term “cash boxes” is defined based on the OECD/G20 BEPS Project 2015 Final Reports on Actions 8-10 Aligning Transfer Pricing Outcomes with Value Creation whereby “cash boxes” is referred to as “capital-rich entities without any relevant economic activities”. If otherwise, kindly clarify the meaning of “cash boxes”.</p>	<p>Yes. It refers to the same definition. (BEPS Action 8-10, page 11)</p> <p><u>OECD Website - FAQ</u></p> <p>64. How will the profits of “cash-boxes” be determined?</p> <p>Capital-rich entities without any other relevant economic activities (“cash boxes”), and therefore unable to exercise control over investment and other risks, will not be entitled to any premium returns. The profits that the cash box is entitled to retain will be equivalent to no more than a risk-free financial return. Moreover, if this return qualifies as interest or an economically equivalent payment, then those already marginal profits will also be targeted by the interest deductibility rules of Action 4.</p> <p>http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm</p>

B. Comments on Updated Chapter II – The Arm’s Length Principle

Topic/ Issues	CTIM Comments	LHDNM Comments
<p>2.2.4 Identifying the commercial and financial relations</p> <p>The typical process of identifying the commercial or financial relations between the associated persons and the conditions and economically relevant circumstances attaching to those relations requires:</p> <p>(a) a broad-based understanding of the industry sector (e.g. mining, pharmaceutical, luxury goods) in which the associated persons operates and the factors affecting the performance of any business operating in that sector. The understanding is derived from an overview of that particular MNC Group which outlines how they respond to the factors affecting performance in the sector, including its business strategies, markets, products, its supply chain, the key functions performed, material assets used, and important risks assumed. This information shall be provided by the taxpayer in support of the taxpayer’s analysis of its transfer pricing and provides useful context regarding the commercial or financial relations between members of the MNC Group.</p> <p>(b) identification of how each MNC operates within the group, analysis of each MNC’s activities (e.g. a production company, a sales company) and identification of its commercial or financial relations expressed in transactions between them. The accurate delineation of the actual transactions between the associated persons requires analysis of the economically relevant characteristics of the transaction.</p>	<p>Although operating as part of a Multi-National Company (MNC) Group, in most cases the local taxpayer does not have full transparency of the entire supply chain (i.e. how each MNC operates within the group and their respective economic activity). Therefore, it makes it difficult to identify the commercial or financial relations in transactions between members of the MNC Group. For example, the Malaysian operations may be small in the context of the entire supply chain. In order to prepare a comprehensive local file for the taxpayer, information in respect of the supply chain may not be available. Hence, would the IRBM deem the local file to be inadequate?</p>	<p>- Towards the global implementation of BEPS Action 8-10, MNE Group should be aware of the importance of the process in identifying the commercial and financial relations between associated persons. Therefore, documentation such as supply chain information is crucial in ascertaining the contribution and position of local taxpayer within global MNE Group.</p> <p>- Efficient supply chain management is an important aspect of business operations of any MNE group. Thus irrespective of whether an entity is huge or small, its role in the supply chain will be dictated by its Principal. Hence its size/its functionality should not be the determinative factor whether certain information can be provided. It’s the responsibility of the local entity to provide such information. Thus, MNE Group should provide such information to its subsidiary in Malaysia.</p> <p>- The attribution of income among between entities in the MNE Group should reflect their respective FAR and this significantly overlaps with the supply chain structure of the MNE Group. The supply chain structure based on FAR is also acceptable by IRBM.</p>

B. Comments on Updated Chapter II – The Arm’s Length Principle

Topic/ Issues	CTIM Comments	LHDNM Comments
<p>2.2.8 Tested Party</p> <p>The determination of a controlled transaction leads to the determination of the tested party. As a general rule, the tested party is the one to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found. In the Malaysian scenario, the IRBM gives priority to the availability of sufficient and verifiable information on both tested party and comparables. As such, IRBM does not accept foreign tested parties where information is neither sufficient nor verifiable.</p>	<p>Based on past experiences with the IRBM, it appears that the IRBM does not accept foreign related parties as tested parties. Under the above paragraph, the IRBM gives priority to the availability of sufficient and verifiable information on both tested party and comparables. Further, the local benchmarking analysis is time consuming and significant costs are incurred which is burdensome for the taxpayer.</p> <p>The principles prescribed by the OECD Transfer Pricing Guidelines whereby the tested party is selected based on the least complicated entity and where the transfer pricing method can be most reliably applied should be adopted.</p> <p>We would like to seek clarification in what circumstance information would be considered as sufficient and verifiable. For example, if audited financial statements of the foreign tested party can be provided, is this sufficient?</p> <p>Also, with respect to comparable companies in what circumstances would regional comparable companies be considered?</p> <p>We would recommend that additional guidance should be provided on the above.</p>	<p>- Generally, IRBM applies by the principles prescribed by the OECD Transfer Pricing Guidelines whereby the tested party is selected based on the least complicated entity and where the transfer pricing method can be most reliably applied should be adopted. The local subsidiaries of foreign MNE are predominantly contract manufacturers or routine distributors, hence in most cases the tested parties selected are the local entities.</p> <p>- If audited financial statements of the foreign tested party can be provided and other documentation or analysis to support the use of foreign tested party or comparables is available and verifiable, the foreign tested can be accepted.</p> <p>- If a foreign tested party is used it must be of simpler functions compared to the local entity and verifiable documents provided to IRBM to include :-</p> <ul style="list-style-type: none"> • transfer pricing documentation of the foreign tested party, • financial statements and detailed accounts of the tested party, • financial statements of comparables used in the TP documentation or screen shot of the financial and background information extracted from the database used.

		<ul style="list-style-type: none">- Foreign comparables can be similarly considered if annual reports, financial statements and background information of the comparables can be provided for verification by the IRBM.- Verifiable documents may include Transfer Pricing Documentation of the foreign tested party, financial statements of comparables used in the TP analysis and screen shot of the financial information extracted from the database used.- Foreign comparables can be similarly considered if annual reports, financial statements or source of financial information can be provided and verified by IRBM.
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B. Comments on Updated Chapter II – The Arm’s Length Principle

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<p>2.2.9 Selection and application of Transfer Pricing Methodologies (TPM) – NEW PARA</p> <p>The Rules have prescribed for specific methods to be used in arriving at the arm’s length price as discussed in Chapter III of the Guidelines. In determining the arm’s length price, a taxpayer will have to apply the <u>most appropriate</u> method based on the facts and circumstances of each particular transaction.</p> <p>OLD PARA in TPGL2012 7.5 Selection and application of Transfer Pricing Methodologies (TPM) The Rules have prescribed for specific methods to be used in arriving at the arm’s length price as discussed in section 11 of the Guidelines. (TPM)</p>	<p>Based on Rule 5 of the Income Tax (Transfer Pricing) Rules 2012 (“TP Rules 2012”), a person shall apply the traditional transactional method to determine the arm’s length price of a controlled transaction. Where the traditional transactional method cannot be reliably applied or cannot be applied at all, the person shall then apply the transactional profit method (i.e. hierarchy basis).</p> <p>With the updated TP Guidelines stating that taxpayers will have to apply the <u>most appropriate method</u> based on the facts and circumstances of each particular transaction when determining the arm’s length price, we would assume that the TP Rules 2012 will be revised in due course. <u>Can the IRBM confirm on this?</u></p>	<p>- The application of Para 2.2.9 should be read together with the current Para 1.1 of Chapter III (Methodologies). Thus Rule 5, TP Rules 2012 is still applicable.</p> <p>- Taxpayer should justified why the method selected is the most appropriate method in determining the arm’s length price of a controlled transaction.</p>

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Topic/ Issues	CTIM Comments	LHDNM Comments
<p>2.5 Comparability Adjustment</p> <p><u>CTIM Comments:</u></p> <p>In analyzing the results of the taxpayers on a year by year basis, there are inconsistencies in adjusting for one off items such as <u>gain/losses on disposal of assets</u>, non-trade related interest expense and foreign exchange. This has resulted in significant transfer pricing adjustments to taxpayers as the comparable companies may be reporting higher than normal margins (i.e. pushing the median up) due to gains from <u>disposal of assets</u>.</p> <p>While it is appreciated that disposals of assets are part and parcel of a normal operations of business, the analysis of the results on a year by year basis and the non-adjustment of one off items seem to imply that all companies should dispose of assets in the same year which is an impossible assumption to make.</p> <p>In order to ensure that the results of the taxpayer and the comparable companies are compared on a level playing field, <u>we would suggest that adjustments of one off or exceptional items should be made</u> before the operating margins of the tested party and the comparable companies are examined.</p>		<ul style="list-style-type: none"> - Items such as gain/losses on disposal of assets, non-trade related interest expense and foreign exchange’ provided above are not ‘one-off items’. Such items are recurring year-by-year and are found in both tested party and comparables. According to global practice, they are considered to be normal business transactions - IRBM is consistent in the treatment ‘gain/losses on disposal of assets, non-trade related interest expense and foreign exchange’ in benchmarking analysis. - However, for exceptional one-off adjustments IRBM will consider the merits for such adjustments on a case by case basis - In the range comparables selected, there are possibility of certain comparables having gain in disposal of assets and others may suffered losses. In term of global practices, such transactions are a normal business transactions. - The IRBM may consider the merits for such adjustments on a case by case basis especially where it can be proven that a non-adjustment can have a significant impact on the results of TP analysis.

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<p>2.5.4 Working capital adjustments should only be considered when the reliability of the comparables will be improved and reasonably accurate adjustments can be made. They should not be automatically made and would not be automatically accepted by IRBM. These adjustment make minor differences to the result when reliable comparables have been selected. In cases where significant difference is calculated, it will raise concern as whether the differences resulted from other issue.</p>	<p>We would like to seek clarification on the circumstances in which working capital adjustments are allowed and when will it be allowed. If working capital adjustments are allowed, what formula should be adopted? Will the IRBM follow the guidance/calculation process as provided in the OECD Guidelines (Annex to Chapter III)?</p>	<p>- Annex III OECD TPGL 2010 state “they should not be automatically made and would not be automatically accepted by tax administrations”</p> <p>- Taxpayer should first justify on how WCA can increase the reliability of the analysis. The ratio of WCA on controlled transactions of tested party should not be applied to comparables.</p>

C. Comments on Updated Chapter XI – Documentation		
Topic/ Issues	CTIM Comments	LHDNM Comments
<p>11.1 Retention Of Records</p> <p>11.1.2 For transfer pricing purposes, a taxpayer who has entered into a transaction with an associated person in the basis year for a year of assessment is required to not only maintain the above records, but also prepare and keep contemporaneous documentations. Notwithstanding the exclusions under paragraph 3 of the Guidelines, the taxpayer is required to maintain contemporaneous documentation to assist in demonstrating whether the taxpayer’s transfer pricing policy is appropriate for tax purposes. At the same time, this alleviates the risk of transfer pricing adjustment and has relevance to penalty consideration during a transfer pricing audit.</p>	<p>It is stated that ‘Notwithstanding the exclusions under paragraph 3 of the Guidelines, the taxpayer is <u>required</u> (rather than <u>encouraged</u>, as referenced in Para 3.2 of the 2012 Malaysian TP Guidelines) to maintain contemporaneous documentation to assist in demonstrating whether the taxpayer’s transfer pricing policy is appropriate for tax purposes.’ Please clarify if this revision is intentional as it implies that transfer pricing documentation would need to be prepared by the taxpayer if it is engaged in controlled transactions, regardless of whether it falls within Para 3 of the 2012 Malaysian TP Guidelines.</p> <p>Please clarify whether contemporaneous TP documentation is now mandatory.</p>	<p>- Taxpayer under the scope of Para 3.1 of Chapter I should prepared its documentation contemporaneously.</p> <p>- For others, they are still <u>encouraged</u> to prepare the full TP Doc or the simple TP Doc.</p>

Topic/ Issues	CTIM Comments	LHDNM Comments
<p>11.2 Transfer Pricing Documentation 11.2.1 Contemporaneous Transfer Pricing Documentation</p> <p>A documentation is deemed “contemporaneous” if it is prepared:</p> <ul style="list-style-type: none"> (a) at the point when the taxpayer is developing or implementing any arrangement or transfer pricing policy with its associated person; or (b) if there are material changes when reviewing these arrangements prior to preparing the relevant tax return of his income for the basis year for a year of assessment. <p>Material changes are significant changes that would give impact to the functional analysis or transfer pricing analysis of the tested party. Material changes include changes to the operational and economic conditions that will significantly affect the controlled transactions under consideration.</p> <p>Examples of changes in operational conditions include the following:</p> <ul style="list-style-type: none"> (a) changes in shareholding; (b) changes in business model and structure; (c) changes in business activities (e.g. changes in group business activities that give impact to local business activities); (d) changes in financial/financing structure; (e) changes in TP policy; or (f) merger & acquisition. <p>Examples of changes in economic conditions include the following:</p> <ul style="list-style-type: none"> (a) foreign exchange; (b) economic downturn; or (c) natural disaster. 	<p>Since the contemporaneous TP documentation has already been prepared, there is no necessity to update it at the year end.</p>	<ul style="list-style-type: none"> - Where there are material changes, taxpayer should updated it accordingly (at the year-end). - As for the comparables information for benchmarking analysis, they should be updated if the data is available at the end of the relevant year of assessment

<p>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 available 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.</p>		
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C. Comments on Updated Chapter XI – Documentation		
Topic/ Issues	CTIM Comments	LHDNM Comments
<p>11.2.2 Duty to prepare Transfer Pricing Documentation</p> <p>Taxpayers who are involved in controlled transactions are generally required to maintain a contemporaneous transfer pricing documentation. This includes taxpayers involved in domestic controlled transactions where at least one party enjoys tax incentives or suffers from continual losses, or is taxed at a different rate, such that the effect of that transaction would result in adjustments that alter the total tax payable.</p> <p>For a person that is assessable but not chargeable to tax in Malaysia due to tax incentive, or losses; or is transacting with a related party that is assessable but not chargeable to tax in Malaysia due to the same factors, that person is encouraged to prepare Transfer Pricing Documentation if the criteria in paragraph 1.3.1 is fulfilled.</p>	<p>It is stated that ‘For a person that is assessable but not chargeable to tax in Malaysia due to tax incentive, or losses; or is transacting with a related party that is assessable but not chargeable to tax in Malaysia due to the same factors, that person is encouraged to prepare Transfer Pricing Documentation if the criteria in paragraph <u>1.3.1</u> is fulfilled. Please confirm if the reference is to paragraph 3.1 and not paragraph 1.3.1.</p>	<p>It has been changed in the website with the following text :</p> <p>“... that person is encouraged to prepare Transfer Pricing Documentation if the criteria in paragraph 3.1 of Chapter I is fulfilled.”</p>

C. Comments on Updated Chapter XI – Documentation

Topic/ Issues	CTIM Comments	LHDNM Comments
<p>11.2.3 Submission of Transfer Pricing Documentation</p> <p>The Transfer Pricing Documentation is not required to be submitted with the annual Return Forms. However, the documentation should be made available within 30 days upon request by the IRBM.</p>	<p>In any cases, for the request letter sent by IRBM to taxpayers, it is often that taxpayers receive them after 2 weeks from the date of the letter. If IRBM gives 30 days for taxpayers to submit TP documentation, then it should be from the date of receipt instead of date of the letter. In this case where the date of receipt is 2 weeks after the date of the letter, if the IRBM has given an additional 2 weeks for the response, it shouldn't be regarded as an extension but should be considered as part of the 30 days and the TP documentation should still be considered as contemporaneous.</p> <p>We would also suggest that the IRBM's request for TP documentation should be sent by email in addition to the hardcopy so that the receipt of the request is on a timely basis.</p>	<p>- IRBM officer will call and confirm with person in charge or tax agent informing them about the request of TP Documentation. It will followed by official email and the attachment of formal request letter (softcopy). The formal letter (hardcopy) will be posted to taxpayer.</p>

C. Comments on Updated Chapter XI – Documentation

Topic/ Issues	CTIM Comments	LHDNM Comments
<p>11.2.4 List of Documentation</p> <p><u>CTIM Comments:</u></p> <p>As this paragraph provides a list of documents/information which <u>may</u> be covered in the transfer pricing documentation to be prepared/maintained by taxpayers, please confirm that the documentation prepared by the taxpayer would not be regarded as invalid or that it <u>does not fully meet the requirements</u> as set out in the 2012 Malaysian TP Guidelines if certain documents/information (as contained within this paragraph) are not covered in the documentation.</p> <p>A transfer pricing documentation may consist of the following: (Documentations for specific transactions are listed in Appendix A)</p> <p>(a) Organizational Structure</p> <p>(i) the taxpayer’s worldwide organizational and ownership structure (including global organization chart and significant changes in the relationship, if any), covering all associated persons whose transactions directly or indirectly affect the pricing of the documented transactions; and</p> <p><u>CTIM Comments:</u></p> <p>The information required above is too wide. It should be limited to the relevant related persons transacting with the taxpayer. Other related persons will not be relevant as they may be located in other geographical locations and carry on other business activities.</p>		<p>- Such documentation or information is required by IRBM and it should be provided accordingly. Failure to provide any information will render the TP documentation not fully meet the requirements as set out in 2012 Malaysian TP Guidelines. However all TP Doc prepared on or after 15.7.2017 should meet the requirement of the updated TPGL.</p> <p>- Global organizational chart or structure is important to ascertain how the MNE Group operates globally and how it will affect local taxpayer. Certain related person might carry out on other business activities which is not connected to local taxpayer but as a Group, it will reflect in the Group financial information.</p> <p>- IRBM agreed to give the flexibility to taxpayer on providing the structure of the global organizational chart in the form of a list or chart. Submitting a list of subsidiaries is acceptable (with an adequate reason) if the organizational and ownership structure cannot be provided.</p>

C. Comments on Updated Chapter XI – Documentation

Topic/ Issues	CTIM Comments	LHDNM Comments
<p>(ii) a description of the management structure of the local entity, a local organization chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.</p> <p><u>CTIM Comments:</u> The above paragraph states that the documentation should include ‘a description of the management structure of the local entity, a local organization chart, and a <u>description of the individuals</u> to whom local management reports and the country(ies) in which such individuals maintain their principal offices.’ Please confirm if this refers to the <u>designation of the individuals to whom local management reports or alternatively, please clarify the description required for the individuals.</u></p> <p>(d) Pricing Policies</p> <p>Details of pricing policy for each type of controlled transaction shall include:</p> <ul style="list-style-type: none"> (i) the formula adopted, including anticipated profit margin/mark-up and cost component; (ii) how the formula is applied; (iii) who determine the pricing policy; (iv) how often is the policy being revised; (v) sample of documents to support the pricing policy; and (vi) comparability study to ensure the arm’s length price <p><u>CTIM Comments:</u> Since the comparability study has already been done when the taxpayer determines the TP policy, there is no need to review and update the outcome. There is only a need to check whether the prices are set at arm’s length i.e. whether the taxpayer has complied with what they said they would do. Furthermore, where the TP policy is concerned, it is at arm’s length and adjustments should not be made.</p>		<ul style="list-style-type: none"> - Organizational structure in term of local structure and reporting line (if it’s different from local reporting or if there is reporting to foreign management), should be addressed in this Organizational Structure. - Designation of the individuals to whom local management reports should be provided. - TP policy should be provided by taxpayer. If there are no pricing policy and company only relied on comparability study, taxpayer should justified the use of such approach.

C. Comments on Updated Chapter XI – Documentation

Topic/ Issues	CTIM Comments	LHDNM Comments
<p>(e) Assumption, Strategies and Information regarding Factors that Influence the Setting of Pricing Policies</p> <ul style="list-style-type: none"> (i) relevant information regarding business strategies and special circumstances at issue, for example, intentional set-off transactions, market share strategies, distribution channel selection and management strategies that influenced the determination of transfer prices; (ii) assumptions and information regarding factors that influenced the setting of prices or the establishment of any pricing policies for the taxpayer and the related party group as a whole; and (iii) documentation to support material factors that could affect prices or profits in arm’s length dealings. <p>CTIM Comments: Taxpayers would expect the IRBM to give due consideration to the above-mentioned factors in an audit.</p> <p>(f) Comparability, Functional and Risk Analysis</p> <ul style="list-style-type: none"> (i) a description of the characteristics of the property or service transferred, functions performed, assets employed, evaluation on management, allocation and assumption of risks (refer to the RISK Analysis Framework), terms and conditions of the contract, business strategies pursued, economic circumstances and any other special circumstances; (ii) information on functions performed (taking into account assets used and risks assumed) of the related party involved in the controlled transaction as well as a description of the functions, assets and risks of group of the companies to the extent that they affect or are affected by the controlled transactions carried out by the taxpayer; (iii) details of comparables including for tangible property: its physical features, quality and availability; for services: the nature and extent of the services; and for intangible property: the form of the transaction, the type of intangible, the rights to use the intangible that are assigned and the anticipated benefits from its use; 		<ul style="list-style-type: none"> - Information on how taxpayer set their transfer price is required by IRBM (especially the auditor), however these are generally not included in TP Documentation. Such information includes: <ul style="list-style-type: none"> ✓ Details of controlled purchase transactions embedded with other related party cost. ✓ Market penetration strategy might affect taxpayer sales prices to third party customer. - Documentation that has been prepared should outline the supply chain and also indicate the assumptions to support the basis of the price setting. Taxpayers who make those price setting assumptions have to review their assumptions based on the market conditions.

C. Comments on Updated Chapter XI – Documentation

Topic/ Issues	CTIM Comments	LHDNM Comments
	<p>(iv) the data collected and the analysis performed to evaluate comparability of uncontrolled transactions with the relevant controlled transactions;</p> <p>(v) criteria used in the selection of comparables including database screens and economic considerations;</p> <p>(vi) identification of any internal comparables;</p> <p>(vii) adjustments (details and reasons for those adjustments) made to the comparables; and</p> <p>(viii) aggregation analysis (grouping of transactions for comparability).</p> <p><u>CTIM Comments:</u></p> <p>1. Year on year requirement and unavailability of comparable data</p> <p>The updated TPG does not address how to deal with unavailability of comparable data to carry out a year on year analysis. There should be some consideration to allow for weighted average data for comparable companies to be used. It is not practical to have a year on year requirement when the data is not available at the time the documentation is prepared (on a contemporaneous basis).</p> <p>2. Adjustment to the median</p> <p>The TPG refers to arm’s length range but it is not very clear whether the inter-quartile range will satisfy the requirement. In practice the IRBM uses the median as a point of comparison but the TPG does not make reference to median. There is a need to address what happens in TP Audits and what is contained in the TPG.</p>	<p>- When preparing TP Documentation and selecting comparables and compilation of its financial data, the previous year or average year data of comparables can be used for the purposed of contemporaneous documentation. But when audit takes place, the comparison will be make on year on year basis.</p> <p>- The latest available comparable data is acceptable and date of comparable search must be stated in the TP documentation. Adjustments will be made on comparables based on year to year comparison of financial information i.e. data available at the time of the TP audit. No penalty will be imposed if the TP documentation is prepared according to the TPG, but there may be additional tax payable if there is an adjustment.</p>

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	<p>In all transfer pricing audit cases conducted by the IRBM, adjustments to the median of the inter quartile range (IQR) are always applied when applying the transactional net margin method on the basis that the median is the sole arm's length reference point in the IQR. This is notwithstanding that the results of the taxpayer may be within the range for that year. While the median is used as the sole arm's length reference point, no downward adjustments are given when the results are above the median of the IQR in any given year.</p> <p>However, the IRBM has stated in writing that they would consider a downward adjustment to the median only if the taxpayer pursues the case via a Mutual Agreement Procedure.</p> <p>The application of the median by the IRBM is based on the reading of only a portion of paragraph 3.62 of the OECD's Transfer Pricing Guidelines.</p> <p>In reading paragraphs 3.55 to 3.62 (arm's length range) in its entirety, it is clear that any point within the IQR should be regarded as an arm's length result as using a single reference point i.e. the median when analyzing the results on a year by year basis is implying that all companies should earn the same net margin in any given year which we believe is theoretical at best.</p> <p>As such our suggestion would be as follows:-</p> <ul style="list-style-type: none">• If the results of the taxpayer are within the IQR (computed using the comparable companies accepted by the IRBM) no adjustment should be made.• If for any given year, the results are below the IQR, then an adjustment to the median can be proposed.• This should be formalized in the Malaysian TP Rules and/or Guidelines to provide certainty to taxpayers.	

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<p>3. Placement in the arm’s length range</p> <p>Publicly available information, such as information available from audited accounts lodged with the Companies Commission of Malaysia, company websites, search/ trade databases, etc., which is used in benchmarking searches in arriving at the arm’s length range often do not contain sufficient information in order for the comparable companies detailed function, asset and risk profiles to be discernible.</p> <p>In this regard, as a corollary to the IRBM allowing placement in the arm’s length range in determining arm’s length pricing, we would ask that the IRBM recognize the limitations in publicly available information and that the arm’s length range compiled may be based on results of comparable companies with slightly differing function, asset and risk profiles. The taxpayer, would be expected to earn between the median and upper quartile or between the median and the lower quartile depending on its function, assets and risk profile relative to the comparable companies.</p> <p>4. Use of information not publicly available</p> <p>The arm’s length interquartile range is usually compiled from results of companies deemed comparable to the tested taxpayer based on publicly available information such as information available from audited accounts lodged with the Companies Commission of Malaysia, company websites, search/ trade databases, etc. in analysis utilizing transfer pricing methods comparing tested party margins against those of said comparable companies. In this regard, taxpayers may be expected to be guided by said publicly available information in setting and/or monitoring arm’s length pricing in its intercompany transactions.</p> <p>In order to ensure that the taxpayer is not unduly penalized for not having access to information not in the public domain, we would suggest that the tax authorities be confined to making accept or reject decisions on potentially comparable companies based on information that is publicly available. If the IRBM does intend to persist with the use of information not in the public domain, at the very least no penalties should be applied on the balance of tax undercharged as a result of adjustments made arising from information not publicly available.</p>		<p>- The details of the arm’s length range will be covered under Chapter IV – Comparability Analysis.</p> <p>- Currently, IRBM has been accepting results of comparable companies with slightly differing function, asset and risk profiles, so this should not have been as issue.</p> <p>- It is the policy of IRBM of not using any secret comparables or any comparables where its information can’t be access publicly.</p>

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Topic/ Issues	CTIM Comments	LHDNM Comments
<p>5. Multiple year data The Guidelines did not provide further guidance for situations where abnormal factors have been identified. Would such situations then warrant the use of multiple year average?</p> <p>6. Use of local comparable companies</p> <p>The IRBM currently insist in almost all cases that benchmarking studies should only be undertaken using local or Malaysian comparable companies even though this is not provided for in the TP Rules.</p> <p>The IRBM should consider the use of Pan Asian comparable on the following basis:-</p> <ul style="list-style-type: none"> • The Multi-National Enterprises (MNEs) that are examined by the IRBM are significantly larger in size than the possible local comparable companies. The difference in size of operations for example turnover and working capital levels will result in different levels of margin earned. • No suitable local comparable companies are available and as such taxpayers end up using “potentially comparable companies” and since the IRBM does not accept any comparability adjustments such as working capital, one off, functional intensity adjustments etc. we are not making a fair comparison of margins. • While Pan Asian companies may operate under different economic circumstances as Malaysia, in applying the TNM method this should not pose any issue as we are comparing the net margin in percentages and not values. As such any differences in the economic environment would have been factored in the cost and operating expenses level resulting in a comparable net margin in percentage terms. • With the introduction of Action 13 of the OECD BEPS project, compliance costs are expected to increase significantly for companies. The use of Pan Asian comparable companies will help to alleviate costs as a single search could be used across the MNE group for companies having comparable FAR profiles. In fact this will also assist the IRBM in assessing whether other companies within the Group that have a similar FAR profile as the Malaysian entity is allocated similar levels of profits thus ensuring that Malaysia receives its fair share of profits. 		<ul style="list-style-type: none"> - Multiple year data is for the purposes of analysing the case and taxpayer financial information or performance over a period of time. Year on Year comparison or adjustment is still applicable (as current practices) - IRBM may accepted the use of foreign comparables where there are no local comparables can be found. - Financial statements of the foreign comparables can be provided and other documentation or analysis to support the use of foreign comparables must be available and verifiable.

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<p>7. Comparability Analysis We would like to highlight that publicly available information is very limited, and that the quality of such publicly available information is usually not good enough to perform an in depth comparability analyses. Given the limitations, a more flexible approach should be allowed when determining comparability. We would like to enquire to what extent the IRBM would expect the conditions for comparability to be analysed. We would like to seek clarification whether the IRBM’s confirmation that any analyses on comparability must be based on objective and publicly available information, and not on information or data which are privy to the IRBM.</p>		<p>- Comparability analysis are not based on information or data which are privy to the IRBM</p> <p>- No secret comparables are used.</p>
<p>(i) Financial Information</p> <p>(i) annual local entity financial accounts for the fiscal year concerned, if audited statements exist, they should be supplied and if not, existing unaudited statements should be supplied;</p>	<p>This paragraph states that the documentation should include ‘annual local entity financial accounts for the fiscal year concerned, if audited statements exist, they should be <u>supplied</u> and if not, existing unaudited statements should be <u>supplied</u>’. Please confirm if the <u>accounts are required to be attached as an appendix to the documentation</u> or whether the accounts should <u>only be submitted to the IRBM upon request</u>.</p>	<p>For local entity and comparables financial accounts :</p> <p>The accounts should be submitted to the IRBM <u>upon request</u>.</p>

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<p>(j) Taxpayers should keep readily available documents and information that were used in preparing the transfer pricing documentation as they are necessary to support the transfer pricing analysis. This may include:</p> <p>(vi) supporting documents for the economically significant activities and functions undertaken by the taxpayer. For example, where skilled and experienced staff constitute human resource assets for the taxpayer, documentation pertaining to these staff which may be relevant here including:</p> <ul style="list-style-type: none"> • written statements provided by key staff and used by taxpayer in determining the functions, risks and asset of the company; 	<p>Please elaborate on what depth of detail is required in the written statements and the form that this statement should take.</p>	<p>- The depth of detail required in the written statements include what they do daily, the decisions that they make, who they liaise with (e.g. with other companies) and the written statement should be signed off by the key person. Other information to be provided include the name, designation, background and qualification of the key person.</p> <p>- Alternatively, the information provided by the key person can be documented in the TP documentation. Such information should be verified and confirmed as correct by the taxpayer. It should include the details of the person interviewed and when the interview was conducted. The person interviewed can sign off in the TP documentation.</p>
Topic/ Issues	CTIM Comments	LHDNM Comments
<p>11.2.5 Preparation and the Submission of Master File</p> <p>Taxpayers that are obliged under the Income Tax (Country-by-Country Reporting) Rules 2016 to prepare the Country-by-Country Report shall prepare the Master File and submit it together with the Transfer Pricing Documentation when requested.</p>	<p>The Master File should be ready not later than 12 months after the last day of the reporting financial year (FY) [in line with several countries and similar to CbCR] and be submitted to the tax authorities not later than 30 days after the date of receipt of the written request for the Master File by the tax authorities. Please confirm that the check the box for TP documentation (Item R4) in the Form C excludes the Master File as the deadline for submitting the Form C is within 7 months after the last day of the basis period.</p>	<p>Form C (Item R4)</p> <ul style="list-style-type: none"> • Exclude the Master Files

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Topic/ Issues	CTIM Comments	LHDNM Comments
<p>11.2.7 Acceptability of Documentation To ensure the acceptability of the contemporaneous transfer pricing documentation, reasonable efforts should be given to:</p> <p>(a) undertake a transfer pricing analysis to ascertain that transfer prices comply with the arm’s length principle and reflect commercially realistic outcomes for all controlled transactions;</p> <p>(b) maintain documents that are applicable to the circumstances and be prepared to provide additional information or documentation not contained above, but which may be relevant for the determination of the arm’s length price;</p> <p>(c) prepare the documentation in accordance with the Rules and the Guidelines;</p> <p>(d) implement and review the arm’s length transfer pricing policies and redesign the transfer pricing policy to accommodate any changes in the business environment;</p> <p>(e) prevent from providing vague, useless or inadequately founded information;</p> <p>(f) apply a coherent and transparent approach in identifying uncontrolled transactions;</p> <p>(g) provide detailed analysis of functions, assets, risks, market conditions and business strategies;</p>	<p>The updated chapter requires information of the other party of the controlled transactions (especially foreign entity) and other entities within the MNC Group. Such information is often not available locally and time consuming to obtain. To what extent does the Inland Revenue Board of Malaysia (IRBM) expect such information to be incorporated into the TP documentation? (Note: information may be available where the MNC has prepared the Master File).</p> <p>Further, to what extent does the IRBM expect the preparer of the TP documentation to verify the accuracy of the information obtained when preparing the TP documentation?</p>	<p>- Taxpayers should provide a broad based understanding of the industry sector and identification of how each entity operates within the group (see paragraph 2.2.4 of Chapter 2 – The Arm’s Length Principle). Such information should be incorporated in the TP Documentation.</p> <p>- Failure to comply with this requirement will result in the TP Documentation provided being considered as incomplete and one sided adjustments being made subject to penalty.</p>

- (h) apply a transfer pricing method in accordance with the Rules and these Guidelines;
- (i) ensure that the factual, economic and empirical representations in transfer pricing documentation are company, product and market specific;
- (j) ensure that the transfer pricing documentation is accurate and precise, and matches the accounting, financial and benchmarked data/comparables;
- (k) highlight and document any specific event that may have hindered the MNE's performance so that appropriate fact-based adjustments can be considered;
- (l) avoid from preparing documentation which is of relatively limited use, incomplete and does not properly support the transactions; and
- (m) maintain adequate background documents and full records containing particulars about the factual assumptions and relevant factors that have been taken into account in working out the arm's length price.

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Topic/ Issues	CTIM Comments	LHDNM Comments
<p>11.3 Penalty</p> <p>11.3.3 Paragraph 113(2)(b) provides that where a person gives any incorrect information in relation to any matter affecting his own chargeability to tax or the chargeability to tax of any other person, then, if no prosecution was made under subsection 113(1) in respect of the incorrect return or incorrect information, the Director General may require that person to pay a penalty equal to the amount of tax which has been undercharged in consequence of the incorrect return or incorrect information or which would have been undercharged if the return or information had been accepted as correct.</p>	<p>If a duty of care has been exercised in conducting a functional, risk and assets analysis (FRA) and in preparing the TP documentation, please confirm that the FRA and TP documentation are not considered as incorrect information if they differ from the information given by the taxpayer to the IRBM.</p>	<p>- Taxpayer should provide a correct information pertaining to any disclosure in their TP Documentation including FAR analysis. Therefore, when a FAR analysis provided in a TP Documentation is different from the actual conduct of the business, penalty under 113(2) may applied.</p> <p>- Based on the circumstance of the case, taxpayer will be given an opportunity to explain on how the incorrect information has been provided in TP Documentation.</p>
<p>11.3.4 Below are some of the issues and conditions which may lead to a penalty being imposed when an adjustment is made to the reported income:</p> <p>(a) Form and substance is not the same; i.e. where the agreement does not reflect the actual conduct between the taxpayer and its associated person.</p> <p>(b) Comparables selected by the taxpayer do not meet all of the economically relevant characteristics or comparability factors set out in the Rules.</p> <p>(c) Inaccurate or misleading explanation of function, assets and risk; e.g. where a taxpayer claims that it does not bear the foreign exchange risk but in substance it does, and this is reflected in its accounts.</p>	<p>For paragraph 11.3.4 (b), in most of the cases, the comparability analysis is carried out based on publicly available information. However, as publicly available information is often not in good quality, hence it is difficult or merely impossible to consider all of the economically relevant characteristics or comparability factors set out in the Rules.</p> <p>If that is the case, they will always be a penalty to be imposed. However in reality, public available information is usually lacking and it is not possible to consider all the comparability factors. We suggest that paragraph 11.3.4 (b) should not be included as an issue/condition on which penalty should be imposed as it would be impossible to comply.</p>	<p>- In selecting comparables, taxpayer should look into the all the economically relevant characteristics or comparability factors before it's been selected as comparables.</p> <p>- But if the selected comparables does not meet all the economically relevant characteristics or comparability factors, it should be addressed and justify why such comparables are chosen despite not having met all the economically relevant characteristics in the TP Documentation.</p>

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Topic/ Issues	CTIM Comments	LHDNM Comments
<p>11.3.5 Penalty will not be imposed in cases, where:</p> <p>(a) transfer pricing documentation is submitted within 30 days upon request by the DGIR; and</p> <p>(b) the transfer pricing documentation prepared fulfils the requirement of the Rules and these Guidelines, wherein reliable and correct information is provided by the taxpayer.</p>	<p>As transfer pricing is not an exact science, we would recommend that penalties should not be imposed in the following situations even though the IRBM may not agree with the conclusions arrived at by the taxpayer and proposed adjustments:-</p> <ul style="list-style-type: none"> • The taxpayer has taken reasonable care to prepare transfer pricing documentation in accordance with the requirements of OECD and IRBM rules and guidelines. • In preparing documentation, taxpayer would have used latest available financial data of comparable companies. For example for FY15, taxpayer may have compared their results with that of comparable companies of 2014 or an average. When an audit is conducted in the future, there should not be any penalties in respect of contemporaneous TP documentation as there should not be any TP adjustments to it. Furthermore, there is no need to update the contemporaneous TP documentation. 	<p>- No penalty if TP Documentation is submitted within stipulated time and complete (fulfils the requirement)</p> <p>- The penalty imposed is under Section 113(2) of the Income Tax Act 1967 is for incorrect return. The IRBM will provide reasons for imposing such penalties in letters to the taxpayers.</p>

C. Other Matters

Topic/ Issues	CTIM Comments	LHDNM Comments
Notification as Reporting Entity or Non-Reporting Entity for Country-by-Country Reporting Purposes	<p>We refer to the sample proforma letter (attached in Appendix I) which has been given by the IRBM to taxpayers who have requested for it for the purpose of notifying the Director General of Inland Revenue as the Reporting Entity / Non-Reporting Entity for County-by-Country Reporting purposes in Malaysia.</p> <p>We seek the IRBM's consent to release the sample proforma letter to our members so that they can take the appropriate action where applicable.</p>	Updated version of the notification letter is on the IRBM's website.