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Issue. 2

TRICOR INSIGHTS

**FINANCE ACT 2020 –
TRANSFER PRICING PROVISIONS**

Based on the 2021 Malaysian Budget Proposals which were announced by the Finance Minister on 6 November 2020, various changes to the Malaysian transfer pricing (TP) legislation were proposed. This included the introduction of additional TP penalties and surcharge.

In this regard, the Finance Act 2020 which sets out these legislative amendments, amongst others, has been gazetted on 31 December 2020 and came into operation on 1 January 2021. In addition, the 2012 Malaysian Transfer Pricing Guidelines (TP Guidelines) were recently updated to reflect a reduced timeframe for companies to submit the TP documentation upon request by the Inland Revenue Board (IRB).

As such, this Issue of Tricor Insights highlights the recent changes to the Malaysian TP legislation and TP Guidelines. These changes impact Malaysian businesses which transact with related parties in the course of their business operations.

1. Penalty for failure to furnish contemporaneous TP documentation

In the past, there were no specific penalties imposed for failure to furnish contemporaneous TP documentation.

A new Section 113B has now been inserted in the Income Tax Act 1967 (ITA), where the penalty for failure to furnish contemporaneous TP documentation is summarised as follows:

On conviction	<ul style="list-style-type: none"> • Fine of between RM20,000 – RM100,000, and/or prison term up to 6 months • Taxpayers are required to furnish TP documentation within 30 days / period decided by the court
No prosecution has been instituted	<ul style="list-style-type: none"> • Fine of between RM20,000 – RM100,000

We also understand that the penalty of RM20,000 to RM100,000 under Section 113B would be applied to **each year of assessment** even though the request for the TP documentation for more than one year of assessment may be made at the same time.

Taxpayers may appeal to the Special Commissioners of Income Tax within 30 days to reduce / waive the penalty.

Under the new Section 113B, the burden of proof is on the taxpayer to demonstrate that contemporaneous TP documentation has been furnished to the IRB.

2. Power to disregard structure in a controlled transaction

Previously, the specific provision empowering the Director General of IRB (DGIR) to disregard and re-characterise the structure adopted in a controlled transaction only appeared in the subsidiary legislation, the Income Tax (Transfer Pricing) Rules 2012 [TP Rules] (under Rule 8).

The said provision has now been inserted in the principal legislation i.e. the ITA. Sections 140A(3A) and 140A(3B) therefore empower the DGIR to disregard and re-characterise any structure adopted by a person in a controlled transaction under the following circumstances:

- the economic substance of the transaction differs from its form; or
- the arrangement made in relation to the transaction differs from those which would have been adopted by third parties behaving in a commercially rational manner and the structure impedes the DGIR from determining an appropriate transfer price.

3. Surcharge on TP adjustment

Prior to 1 January 2021, taxpayers were only subject to a penalty under Section 113(2) if TP adjustments made by the DGIR resulted in additional tax payable. In short, penalty is not imposed for non-taxable cases (i.e. loss making, tax incentive cases, etc.) notwithstanding that TP adjustments have been made.

A new Section 140A(3C) has now been inserted in the ITA, whereby a **surcharge** is imposed regardless of whether TP adjustments result in additional tax payable. This new section empowers the DGIR to impose a surcharge of not more than 5% of total TP adjustments on all cases (whether taxable or non-taxable). The DGIR is empowered to abate or remit the surcharge.

The following examples illustrate the impact of the surcharge on companies, for non-taxable and taxable cases respectively:

Illustration 1: Non-taxable case

Description	Prior to 1 January 2021 (RM'000)	w.e.f. 1 January 2021 (RM'000)
Adjusted income	100,000	100,000
Add: TP adjustment [A]	40,000	40,000
	140,000	140,000
Less: Capital allowance	(70,000)	(70,000)
Less: Investment tax allowance	(80,000)	(80,000)
Chargeable income	NIL	NIL
Additional tax assessed	NIL	NIL
Surcharge @ 5% (Note) on TP adjustment [A x 5%]	-	2,000
Total additional tax + surcharge	NIL	2,000

Illustration 2: Taxable case

Description	Prior to 1 January 2021 (RM'000)	w.e.f. 1 January 2021 (RM'000)
Adjusted income	100,000	100,000
Add: TP adjustment [A]	40,000	40,000
	140,000	140,000
Less: Capital allowance	(70,000)	(70,000)
Chargeable income	70,000	70,000
Tax payable @ 24%	16,800	16,800
Additional tax assessed	9,600	9,600
Surcharge @ 5% (Note) on TP adjustment [A x 5%]	-	2,000
Total additional tax + surcharge	9,600	11,600

Note: A maximum surcharge rate of 5% is used for the purpose of the above illustrations.

We also understand that whilst the surcharge will be imposed on any TP adjustments made under Section 140A, a penalty under Section 113(2) of the ITA will not be applied on the same adjustments.

4. Timeframe for TP documentation submission during a transfer pricing audit

Paragraph 11.2.3 of the TP Guidelines has now been updated to reflect that the TP documentation should be made available **within 14 days upon request by the IRB**. In the past, companies were given a period of 30 days to submit the TP documentation. The new 14-day timeframe is also expected to be reflected in the TP audit framework which will be updated in due course.

This change will apply to TP audit cases which commenced **on or after 1 January 2021**. Failure to submit the TP documentation within 14 days of the IRB's request would mean that the penalty under the new Section 113B would be applicable.

Paragraph 11.3.5, which outlines the circumstances whereby penalties will not be imposed, has also been updated in line with the above change. As such, penalties will not be imposed in the following cases:

- a) TP documentation is submitted within 30 days upon request by the DGIR for TP audit cases which have commenced **before 1 January 2021**
- b) TP documentation is submitted within 14 days upon request by the DGIR for TP audit cases which have commenced **on or after 1 January 2021**

Key comments

- The various amendments made to the Malaysian TP legislation demonstrates the IRB's continued focus on TP as a core area of taxation. These changes may also be due to the perceived lack of TP compliance and transparency by Malaysian taxpayers, from the IRB's perspective.
- In the past, many taxpayers have taken a more reactive approach to TP such as postponing the preparation of TP documentation until an audit is triggered by the IRB, particularly where the risk of additional tax payable is low (e.g. loss making companies, companies which enjoy tax incentives, etc.).
- However, given the above legislative and administrative changes, taxpayers no longer have the luxury of time to prepare the TP documentation. Instead, the TP documentation must be **contemporaneously prepared**, i.e.:
 - a. When the taxpayer is developing or implementing any controlled transaction; and
 - b. Where there are material changes to the controlled transaction, the TP documentation shall be updated prior to the due date for the submission of the tax return.
- Where TP documentation has been maintained on a contemporaneous basis, the taxpayer theoretically should have sufficient time to produce the documentation when requested by the IRB.
- Companies which fail to produce robust TP documentation are inevitably exposed to higher risk of TP adjustments during an audit. TP adjustments in turn result in higher compliance costs for companies, due to the imposition of penalties and surcharge. Hence, a proactive approach is required in mitigating TP risks.

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