Updated version of Transfer Pricing Guidelines 2012

(With effect from 15 July 2017)

CHAPTER XI

DOCUMENTATION

11.1 Retention Of Records

11.1.1 Taxpayers are required to keep sufficient records for a period of seven years from the end of the year to which income from the business relates, as provided under paragraph 82(1)(a) of the Act, to enable the DGIR to ascertain income or loss from the business. Subsection 82(8) further provides that all records relating to any business in Malaysia must be kept and retained in Malaysia. 'Records' under subsection 82(9) include books of accounts, invoices, vouchers, receipts and other documents necessary to verify entries in any books of accounts.

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 1.3, 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.

11.2 Transfer Pricing Documentation

11.2.1 Contemporaneous Transfer Pricing Documentation

A documentation is deemed "contemporaneous" if it is prepared:

(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.

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. Examples of changes in operational conditions include the following:

(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.

Examples of changes in economic conditions include the following:

(a) foreign exchange;

(b) economic downturn; or

(c) natural disaster.

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.

11.2.2 Duty to prepare Transfer Pricing Documentation

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.

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.

The types of controlled transactions may involve:

(a) sales or purchases of raw materials, stock in trade or other tangible assets;

(b) royalties/ license fees/ other types of considerations in connection with use of intangible assets;

(c) management fees including charges for financial, administrative, marketing and training services;

(d) research and development;

(e) any other services not previously mentioned;

(f) rents/ lease of assets;

(g) interests; or

(h) guarantee fees.

As long as the operational conditions remain unchanged, the comparable searches in databases supporting part of the Transfer Pricing Documentation should be updated every three years rather than annually. However, financial data and suitability of the existing comparable should be reviewed and updated every year

in order to apply the arm's length principle reliably.

11.2.3 Submission of Transfer Pricing Documentation

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.

11.2.4 List of Documentation

A transfer pricing documentation may consist of the following: (Documentations for specific transactions are listed in Appendix A.)

(a) Organizational Structure

(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

(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.

(b) Nature of the business/industry and market conditions

(i) outline of the taxpayer's business including relevant recent history, the industries operated in, analysis of the general economic and legal issues affecting the business and industry, the taxpayer's business lines and the property or services in the controlled transactions;

(ii) a detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation

of those aspects of such transactions affecting the local entity;

(iii) the corporate business plans to the extent of providing an insight into the nature and purpose of the relevant transactions between the associated persons; and

(iv) a description of the structure, intensity and dynamics of the relevant competitive environment(s) and key competitors.

(c) Controlled Transactions

(i) description of details of the property or services to which the international/domestic transaction relates; any intangible rights or property attached thereto, the participants, the scope, timing, frequency, type and value of the controlled transactions (including all relevant related party dealings in relevant geographic markets);

(ii) names and addresses of all associated persons, with details of the relationship with each such associated person;

(iii) the nature, terms (including prices) and conditions of international transactions (where applicable) entered into with each associated person and the quantum and value of each transaction;

(iv) an overview description of the business, as well as a functional analysis of all associated persons with whom the taxpayer has transacted;

(v) all commercial agreements setting forth the terms and conditions of transactions with associated persons as well as with third parties; and

(vi) a record of any forecasts, budgets or any other financial estimates prepared by the person for the business as a whole and for each division or product separately.

(d) Pricing Policies

Details of pricing policy for each type of controlled transaction shall

include:

(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

(e) Assumption, Strategies and Information regarding Factors that Influence the Setting of Pricing Policies

(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.

(f) Comparability, Functional and Risk Analysis

(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;

(iv) the data collected and the analysis performed to evaluate comparability of uncontrolled transactions with the relevant controlled transactions;

(v) criteria used in the selection of comparables including database screens and economic considerations;

(vi) identification of any internal comparables;

(vii) adjustments (details and reasons for those adjustments) made to the comparables; and

(viii) aggregation analysis (grouping of transactions for comparability).

(g) Selection of the Transfer Pricing Method

(i) description of data and methods considered, the analysis performed to determine the arm's length price and the rationale for the selection of this methodology including reasons for its use in preference to other transfer pricing methodologies; and

(ii) documentation of the process involved in the selection of particular

methodologies.

(h) Application of the transfer pricing method

(i) documentation of assumptions and judgments made in the course of determining an arm's length outcome (refer to the Comparability, Functional and Risk analysis section above);

(ii) a list and description of selected comparable uncontrolled transactions (internal or external), if any, and information on relevant financial indicators for independent enterprises relied on in the transfer pricing analysis, including a description of the comparable search methodology and the source of such information;

(iii) documentation of all calculations made in applying the selected method, and of any adjustment factors, in respect of both the tested party and the comparable;

(iv) a description of the reasons for concluding that relevant transactions were priced on an arm's length basis based on the application of the selected transfer pricing method;

(v) a summary of financial information used in applying the transfer pricing methodology; and

(vi) appropriate updates of prior year documentation relied upon in the current year to reflect adjustments for any material changes in the relevant facts and circumstances.

(vii) A list of advance pricing arrangements (unilateral and bilateral) entered into by members of the group with respect to transactions to which the taxpayer is a party.

(viii) Documents that provide the foundation for or otherwise support, or were referred to, in the development of the transfer pricing analysis.

(i) Financial Information

(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;

(ii) information and allocation schedule showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements; and

(iii) summary schedules of relevant financial data for comparables used in the analysis and the sources from which that data was obtained.

(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:

(i) official publications, reports, studies and databases;

(ii) reports of market research studies carried out by recognized institutions;

(iii) technical publications brought out by recognized institutions;

(iv) agreements and contracts entered into with associated persons or with unrelated persons, which may be of relevance to the cross-border transactions;

(v) letters and other correspondence documenting any terms negotiated between the person and its associated person;

(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:

details of experience;

educational qualifications;

areas of particular expertise;

job description and duties;

remuneration;

written statements provided by key staff and used by taxpayer in determining the functions, risks and asset of the company;

(vii) other relevant documents.

11.2.5 Preparation and the Submission of Master File

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.

In cases where the parent of the MNE Group prepares a Master File for the Group, a copy of the Master File should be submitted together with the Transfer Pricing Documentation by the subsidiary company. To the extent this functional analysis duplicates information in the Master File submitted, a cross-reference to the Master File is sufficient.

The following information should be included in the master file:

(a) Organizational structure

Chart illustrating the MNE Group's legal and ownership structure and geographical location of operating entities.

(b) Description of MNE Group's business(es)

General written description of the MNE's business including:

(i) important drivers of business profit;

(ii) a description of the supply chain for the group's five largest products and/or service offerings which are relevant to the taxpayer's controlled transactions by turnover, and any other products and/or services amounting to more than five percent of the group taxpayer's turnover (The required description could take the form of a chart or a diagram);

(iii) a list and brief description of important service arrangements between members of the MNE Group, other than research and development (R&D) services, including a description of the capabilities of the principal locations providing important services and transfer pricing policies for allocating services costs and determining prices to be paid for intra-group services;

(iv) a description of the main geographic markets for the group's products and services that are referred to in the second bullet point above;

(v) a brief written functional analysis describing the principal contributions to value creation by individual entities within the group, i.e. key functions performed, important risks assumed, and important assets used; and

(vi) a description of important business restructuring transactions, acquisitions and divestitures occurring during the financial year.

(c) The MNE's intangibles (as defined in Chapter VIII of the Guidelines)

(i) A general description of the MNE's overall strategy for the development, ownership and exploitation of intangibles, including location of principal R&D facilities and location of R&D management;

(ii) A list of intangibles or groups of intangibles of the MNE Group that are important for transfer pricing purposes and which entities legally own them;

(iii) A list of important agreements among identified associated enterprises related to intangibles, including cost contribution arrangements, principal research service agreements and license agreements;

(iv) A general description of the group's transfer pricing policies related to R&D and intangibles; and

(v) A general description of any important transfers of interests in intangibles among associated enterprises during the fiscal year concerned, including the entities, countries, and compensation involved.

(d) MNE's intercompany financial activities

(i) A general description of how the group is financed, including important financing arrangements with unrelated lenders;

(ii) The identification of any members of the MNE Group that provide a central financing function for the group, including the country under whose laws the entity is organized and the place of effective management of such entities: and

(iii) A general description of the MNE's general transfer pricing policies related to financing arrangements between associated enterprises.

(e) The MNE's financial and tax positions

(i) The MNE's annual consolidated financial statement for the fiscal year concerned if otherwise prepared for financial reporting, regulatory, internal management, tax or other purposes.

(ii) A list and brief description of the MNE Group's existing unilateral advance pricing agreements (APAs) and other tax rulings relating to the allocation of income among countries.

11.2.6 The Extent of Relevant and Adequate Contemporaneous Documentation

In complying with subsection 140A(2) of the Act, taxpayers should take into account the size and complexity of their business and transactions in determining the nature and extent of documentation appropriate to their particular circumstances. In view that the nature and amount of documentation depends on facts and circumstances of a particular transaction, every taxpayer should evaluate the significance of its transactions in reference to their own business and the additional administrative costs of preparing such documentation.

In general, it is advantageous for a taxpayer to maintain proper documentations on controlled transactions that are applicable to his circumstances and be prepared to provide additional information or documentation not listed in the Guidelines, but may be relevant for the determination of arm's length price.

11.2.7 Acceptability of Documentation

To ensure the acceptability of the contemporaneous transfer pricing documentation, reasonable efforts should be given to:

(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;

(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;

(c) prepare the documentation in accordance with the Rules and the Guidelines;

(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;

(e) prevent from providing vague, useless or inadequately founded information;

(f) apply a coherent and transparent approach in identifying uncontrolled transactions;

(g) provide detailed analysis of functions, assets, risks, market conditions and business strategies;

(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.

11.2.8 Language

Taxpayers are permitted to file their transfer pricing documentation in Bahasa Malaysia or English. Where supporting documents are in a language other than Bahasa Malaysia or English, a translation should be provided upon submission of the transfer pricing documentation.

11.3 Penalty

11.3.1 Section 140A of the Act imposed on the taxpayer an obligation to apply the arm's length principle to a controlled transaction. Section 140A(2) says, "..…. where a person in the basis period for a year of assessment enters into a transaction with an associated person for that year for the acquisition or supply of property or services, then, for all purposes of this Act, that person shall determine and apply

arm's length price for such acquisition or supply". Subsection 140A(3) gives the power to the DGIR to make adjustment if the income reported is not at arm's length. The application of Section 140A has to be read together with the Rules and Guidelines.

11.3.2 The above legal provisions place the burden of proof of an arm's length price in a transaction where a taxpayer transfers goods or services with its associated persons, on the taxpayer. The contemporaneous transfer pricing documentation has to be prepared based on the requirement of the Rules and Guidelines to justify their pricing is at arm's length. The facts presented in the transfer pricing documentation will be analysed and compared with the actual transaction and condition. In cases, such as, where the facts presented by the taxpayer in the transfer pricing documentation is different from the actual conduct of the taxpayer, the information provided will be considered as incorrect information and be subjected to the penalty under paragraph 113(2)(b) of the Act.

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 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.

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:

(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.

(b) Comparables selected by the taxpayer do not meet all of the economically relevant characteristics or comparability factors set out in the Rules.

(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.

11.3.5 Penalty will not be imposed in cases, where:

(a) transfer pricing documentation is submitted within 30 days upon request by the DGIR; and

(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.

11.3.6 The penalty rate is as listed in the Transfer Pricing Audit Framework.