CHARTERED TAX INSTITUTE OF MALAYSIA

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CHARTERED TAX INSTITUTE OF MALAYSIA (225750-T)

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TO ALL MEMBERS

TECHNICAL

Income Tax (Transfer Pricing) Rules 2012 - [P.U. (A) 132/2012]

These Rules apply to controlled transactions for the acquisition or supply of property or services and stipulate the approaches in administering such transactions.

These Rules are deemed to have come into operation from 1 January 2009.

A. General Applications of Transfer Pricing Rules

a) *Method to determine Arm's Length Price* (Rule 5)

Rule 5 sets out the hierarchy to apply the five (5) transfer pricing methods in the determination of the arm's length price:

1) Priority is given to the application of one of the traditional transactional methods (TTM) –
    - Comparable Uncontrolled Price Method (CUP); or
    - Resale Price Method (RPM); or
    - Cost Plus Method (CPM).
2) If TTM cannot be reliably applied or cannot be applied at all, then apply one of the transactional profit methods (TPM) –
    - Profit Split Method (PSM); or
    - Transactional Net Margin Method (TNMM).
3) If both TTM and TPM cannot be applied at all, then the Director General (DGIR) may allow the application of other methods which provide the highest degree of comparability between the transactions.

b) *Transfer price for separate and combined transaction* (Rule 7)

A person shall determine an arm's length price for each controlled transaction separately. However, where a combination of controlled transactions are closely linked or continuous and cannot be evaluated separately, or that the normal industry practice is to set one transfer price for those transactions, the DGIR may allow the determination of the arm's length price based on the combination of those transactions.

c) *Comparability of Transactions* (Rule 6)

An uncontrolled transaction, i.e. a transaction carried on by an independent person dealing with one another at arm's length, shall be used as a comparable of a controlled transaction if

- The comparability factors of both transactions are sufficiently similar, or
- None of the differences in respect of the comparability factors between both transactions, or between persons entering into any of those transactions, are likely to materially affect the price or cost charged or paid or the profit arising from those transactions in the open market, or
- Reasonably accurate adjustments can be made to eliminate the material effects of such differences.

Comparability factors include:-

a) the characteristics of the property or services;
b) the functions performed, assets employed and the risk assumed by the respective persons in the transactions;
c) the contractual terms;
d) economic circumstances; and
e) business strategies of the persons in the transactions.

Further, to strengthen the level of comparability, the results of the controlled transaction shall be compared with the results of an uncontrolled transaction for the same basis year for a year of assessment. Multiple year data may be accepted by the DGIR if complete and accurate data are available to prove the effect of the life cycles or the business cycles of the products or services in the industry of the person.

d) *Contemporaneous Transfer Pricing Documentation* (Rule 4)

Contemporaneous transfer pricing documentation (CTPD) is the documentation established by a person when developing or implementing any controlled transaction. CTPD must be prepared for a person who enters into a controlled transaction and shall include records and documents that provide a description of the following:

a) organizational structure, including an organization chart covering persons involved in controlled transaction;
b) nature of the business or industry and market conditions;
c) the controlled transaction;
d) strategies, assumptions and information regarding factors that influenced the setting of any pricing policies;
e) comparability, functional and risk analysis;
f) selection of the transfer pricing method;
g) application of the transfer pricing method;
h) documents that provided the foundation for or otherwise support or were referred to in developing the transfer pricing analysis;
i) index to documents; and
j) any other information, data or document considered relevant by the person to determine an arm’s length price.

Where there are any material changes in the controlled transaction in a basis period for a year of assessment under review, the CTPD shall be updated before the due date for furnishing a return for that basis period for that year of assessment.

B. Specific Applications of Transfer Pricing Rules

The Rules also set out treatments with regards to intra-group services, cost contribution arrangement, intangible property, financial assistance and permanent establishment as follows:

a) *Intra-group services* (Rule 9)

A person, in determining the arm’s length transfer price in accordance with Rule 5, in respect of services rendered between companies in the same group, shall demonstrate that

- the intra-group services have been rendered and the provision of such services has conferred an economic benefit or commercial value to his business, and
- the charge is justified.

Any charge in respect of the intra-group services shall be disregarded if it involves:-

a) shareholder or custodial activities;
b) duplicate services;
c) services that provide incidental benefits or passive association benefits; or
d) on-call services.

b) Cost contribution arrangement **(CCA) (Rule 10)**

Where a person enters into a CCA with its associated person to share the costs and risks for acquisition or supply of property or services, he shall determine

- the allocation of costs for such arrangement, and
- the payment in respect of entry, withdrawal or termination by any person

in accordance with the allocation and payment that would have been made by an independent person dealing with each other at arm's length.

A person and its associated person shall be construed as:-

a) persons, one of whom has control over the other;
b) individuals who are relatives of each other; or
c) persons, both of whom are controlled by some other person.

c) Intangible property **(IP) (Rule 11)**

IP includes patent, invention, formula, process, design, model, plan, trade secret, know-how or marketing intangible. Marketing intangible includes an intangible that is concerned with marketing activities, which aid in the commercial exploitation of the property or has an important promotional value for the property concerned. A person shall be deemed to be an owner of an IP and is entitled to any income attributable to that IP if the expenses and risks associated with the development of the IP are borne by that person.

In a controlled transaction where an IP is sold or licensed out, the arm's length price shall be determined by CUP, or in the case of highly valuable or unique property, the residual profit split method (RPSM) or other method which can provide the highest degree of comparability between transactions, is allowed by the DGIR.

Where the legal ownership of the IP does not vest with the developer of that IP, such person shall receive an arm's length consideration for the development of such IP.

Where a person, who is not the owner, undertakes marketing activities and bears marketing costs of such trademark or trade name in excess of those of a comparable independent person, he shall be entitled to an arm's length consideration for undertaking such activities from the owner of the trademark or trade name.

d) Interest on financial assistance **(FA) (Rule 12)**

Any person in a controlled transaction provides or receives FA, directly or indirectly, to or from another person, with or without consideration shall determine the arm's length interest rate for such assistance. FA includes loan, interest-bearing trade credit, advance or debt and the provision of any security or guarantee. Interest includes finance charge, discount, premium or other consideration relating to controlled transaction.

e) Permanent establishment **(PE) (Rule 14)**

A PE shall be treated as a distinct and separate entity from its head office and related branches. PE shall have the same meaning assigned to it in the Double Taxation Agreement (DTA) or if there is no DTA, means a fixed place of business through which the business of a person is wholly or partly carried on, or a fixed place of business of another person, through which the particular person makes supplies.

C. Powers of DGIR

a) Re-characterization of transactions (Rule 8)

The DGIR may disregard any structure adopted by a person in entering into a controlled transaction if:-

a) the economic substance of that transaction differs from its form; or

b) notwithstanding that the form and substance are the same, the arrangements made in relation to the transaction, viewed in totality, differ from those which would have been adopted by independent persons behaving in a commercially rational manner and the actual structure impedes the DGIR from determining an appropriate transfer price;

and in doing so, shall make adjustment to the structure of that transaction as he thinks fit, having regard to the economic and commercial reality.

b) Adjustment by DGIR (Rule 13)

Notwithstanding any other provision of these Rules, where the DGIR has reason to believe that any price including the rate of interest imposed or would have imposed in a controlled transaction is not at arm's length, the DGIR may make an adjustment to reflect the arm's length price or interest rate for that transaction.

Any adjustment under these Rules in respect of an assessment made on one of the persons in a controlled transaction may be reflected by an offsetting adjustment on the assessment of the other person in that transaction upon request by that other person.

The Transfer Pricing Rules are important subsidiary legislation which warrants a careful study. Members are requested to provide your feedback to the Institute so that we may raise them to the MOF/IRB. You may email your suggestion/comments to kslim@ctim.org.my or kim@ctim.org.my.