

# INCOME TAX (TRANSFER PRICING) RULES 2012

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IN exercise of the powers conferred by paragraph 154(1)(b) of the Income Tax Act 1967 [Act 53], the Minister makes the following rules:

## CITATION AND COMMENCEMENT

- 1(1) These rules may be cited as the **Income Tax (Transfer Pricing) Rules 2012**.
- 1(2) These Rules are deemed to have come into operation on 1 January 2009.

## SCOPE AND APPLICATION

- 2(1) These Rules shall apply to controlled transactions for the acquisition or supply of property or services.
- 2(2) For the purpose of subrule (1), a person shall determine and apply the arm's length price for the acquisition or supply of property or services in accordance with the method and manner provided in these Rules.

## INTEPRETATION

3 In these Rules—

**"controlled transaction"** means the transaction referred to in subsections 140A(2) and (5) of the Act;

**"property"** includes any goods, movable or immovable thing, or intangible property and beneficially owned property;

**"service"** includes any rights, benefits, privileges or facilities that are, or to be, provided, granted or conferred under an arrangement for or in relation to any work and assistance including financial assistance.

## CONTEMPORARANEOUS TRANSFER PRICING DOCUMENTATION

- 4(1) A person who enters into a controlled transaction shall prepare a contemporaneous transfer pricing documentation.
- 4(2) The contemporaneous transfer pricing documentation shall include records and documents that provide a description of the following matters:
- (a) organizational structure, including an organization chart covering persons involved in a 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 provide 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.

**4(3)** For the purpose of this rule—

**"contemporaneous transfer pricing documentation"** means transfer pricing documentation which is brought into existence—

- (a) when a person is developing or implementing any controlled transaction; and
- (b) where in a basis period for a year of assessment the controlled transaction is reviewed and there are material changes, the documentation shall be updated prior to the due date for furnishing a return for that basis period for that year of assessment.

## **METHOD TO DETERMINE ARM'S LENGTH PRICE**

**5(1)** A person shall apply the traditional transactional method to determine the arm's length price of a controlled transaction.

**5(2)** Where the traditional transactional method cannot be reliably applied or cannot be applied at all, the person shall then apply the transactional profit method.

**5(3)** Where both the traditional transactional method and transactional profit method cannot be applied at all, the Director General may allow the application of other methods which provides the highest degree of comparability between the transactions.

**5(4)** For the purpose of this rule—3

**"traditional transactional method"** means the comparable uncontrolled price method or the resale price method or the cost plus method;

**"transactional profit method"** means the profit split method or the transactional net margin method.

## **COMPARABILITY OF TRANSACTIONS**

**6(1)** For the purpose of rule 5, an uncontrolled transaction shall be used as a comparable in determining an arm's length price of a controlled transaction.

**6(2)** An uncontrolled transaction may be used as a comparable if—

- (a) the comparability factors of such uncontrolled transaction and the controlled transaction are sufficiently similar; or
- (b) none of the differences in respect of the comparability factors between such uncontrolled transaction and the controlled transaction, 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
- (c) reasonably accurate adjustments can be made to eliminate the material effects of such differences referred to in paragraph (b).

- 6(3)** The comparability factors referred to in subrule (1) 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;
  - (e) business strategies of the persons in the transactions.
- 6(4)** For the purpose of determining the arm's length price, 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.
- 6(5)** The Director General may allow for the basis period for a year of assessment the application of data from other years prior to or after that basis period 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 in the controlled transaction.
- 6(6)** For the purpose of this rule, "**uncontrolled transaction**" means a transaction carried on by an independent person dealing with one another at arm's length.

## **COMPARABILITY OF TRANSACTIONS**

- 7(1)** A person in a controlled transaction shall determine an arm's length price for each controlled transaction in accordance with these Rules.
- 7(2)** Notwithstanding subrule (1), where a combination of controlled transactions are closely linked or continuous and cannot be evaluated separately, or it can be shown that the normal industry practice is to set one transfer price for those transactions, the Director General may allow the determination of the arm's length price based on the combination of those transactions.

## **RE-CHARACTERISATION OF TRANSACTIONS**

- 8(1)** The Director General 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 of that transaction 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 Director General from determining an appropriate transfer price.
- 8(2)** Where the Director General disregards any structure adopted by a person in entering into a controlled transaction under subrule (1), the Director General shall make adjustment to the structure of that transaction as he thinks fit to reflect the structure that would have been adopted by an independent person dealing at arm's length having regards to the economic and commercial reality.

## **INTRA-GROUP SERVICES**

- 9(1)** A person in a controlled transaction shall apply the methods in accordance with rule 5 to determine the arm's length transfer price for intra-group services and in applying any of the methods he shall—
- (a) 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
  - (b) demonstrate that the charge for the intra-group services is justified.
- 9(2)** Any charge made by a person in a controlled transaction in respect of the intra-group services shall be disregarded if it involves—
- (a) shareholder or custodial activities;
  - (b) duplicative services;
  - (c) services that provide incidental benefits or passive association benefits; or
  - (d) on-call services.
- 9(3)** For the purpose of this rule, **"intra-group services"** means services rendered between companies in the same group.

## **COST CONTRIBUTION ARRANGEMENT**

- 10(1)** Where a person enters into a cost contribution arrangement with its associated person to share the costs and risks for acquisition or supply of property or services, the person shall determine the allocation of costs for such arrangement in accordance with the allocation that would have been undertaken by an independent person dealing with each other at arm's length in a similar arrangement.
- 10(2)** Where there is an entry, withdrawal or termination by any person in respect of the cost contribution arrangement referred to in subrule (1), any payment made to that person in respect of such entry, withdrawal or termination shall be determined in accordance with the payment that would have been made by an independent person dealing with each other at arm's length.
- 10(3)** For the purpose of this rule, 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.

## **INTANGIBLE PROPERTY**

- 11(1)** Where in a controlled transaction an intangible property is sold or licensed out—
- (a) the owner or licensee shall charge an arm's length price; and
  - (b) the value of that property to the purchaser or licensor shall be the benefit that the intangible property is expected to generate.
- 11(2)** For the purpose of subrule (1), the arm's length price for such sale or license shall be determined by applying the comparable uncontrolled price method, or in the case where the property is highly valuable or unique, the residual profit split method shall be applied.

- 11(3) Notwithstanding subrule (2), the Director General may allow the application of other methods if the method provides the highest degree of comparability between transactions.
- 11(4) Where the legal ownership of the intangible property does not vest with the person that has developed that property, such person shall receive an arm's length consideration for the development of such property.
- 11(5) Where a person who is not the owner of a trademark or trade name 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.
- 11(6) In this rule, a person shall be deemed to be an owner of an intangible property and is entitled to any income attributable to that property if the expenses and risks associated with the development of the intangible property are borne by that person.
- 11(7) For the purpose of this rule—

**"intangible property"** 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 aids in the commercial exploitation of the property or has an important promotional value for the property concerned.

## **INTEREST ON FINANCIAL ASSISTANCE**

- 12(1) Any person in a controlled transaction who provides or receives financial assistance, directly or indirectly, to or from another person with or without consideration shall determine the arm's length interest rate for such assistance.
- 12(2) For the purpose of this rule—

**"financial assistance"** 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.

## **ADJUSTMENT BY DIRECTOR GENERAL**

- 13(1) Notwithstanding any other provision of these Rules, where the Director General has reason to believe that any price including the rate of interest imposed or would have been imposed in a controlled transaction is not at arm's length, the Director General may make an adjustment to reflect the arm's length price or interest rate for that transaction by substituting or imputing the price or interest, as the case may be.
- 13(2) 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.

## **PERMANENT ESTABLISHMENT AS A SEPARATE ENTITY**

**14(1)** For the purpose of these Rules, a permanent establishment shall be treated as a distinct and separate entity from its head office and related branches.

**14(2)** In this rule, "**permanent establishment**" —

- (a) shall have the same meaning assigned to it in the arrangement made under section 132 of the Act; or
- (b) if there is no arrangement made under section 132 of the Act, 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.