



TRANSFER PRICING FLASH

15th July 2020

Bank Negara Malaysia Reduced Overnight Policy Rate for the Fourth Time in 2020

Unexpectedly, the Bank Negara Malaysia ["BNM"] on 7th July 2020 decided to reduce the Overnight Policy Rate ["OPR"] by 25 basis points ["BPS"] to 1.75 percent. The ceiling and floor rates of the corridor of the OPR are correspondingly reduced to 2.00 percent and 1.50 percent, respectively. This is the fourth cut and BNM has slashed 125 BPS in year 2020 subsequent to the COVID-19 outbreak. Consequently, this leads to the reduction in the base rates, base financing/lending rates and fixed deposit rates of all banks in Malaysia.

How does the OPR change impact transactions relating to intragroup financial assistance?

Borrowings from banks by taxpayers are examples of financial assistance granted in uncontrolled transactions with or between independent parties, which are considered arm's length borrowings. The present reduction in the rates means that it costs less for one to borrow from the banks and similarly, gets less in return if one places deposits with the banks.

Companies with intragroup financial assistance ["IGFA"] which includes loans, interest bearing trade credits, advance or debt, and the provision of any security or guarantee, should take into consideration changes in the OPR to ensure the pre-determined interest rate of their IGFA remains at arm's length.

What are the transfer pricing requirements?

Chapter IX - Intragroup Financing of the Malaysian Transfer Pricing Guidelines 2012 ["the Guidelines"] requires that taxpayers (both recipients and providers of financial assistance) should charge or pay its related entity at a rate which is consistent with the rate that would have been charged in a similar transaction between independent parties. The Guidelines also provide that KLIBOR, prime rates offered by bank and/or specific rates quoted by banks for comparable loans can be used as a reference point when ascertaining the arm's length interest rate. Adjustments are then made on the rates used as reference point based on the outcome of the comparability analysis to arrive at the arm's length interest rate in IGFA.

What if the interest rate is not arm's length?

IGFA would raise transfer pricing ["TP"] concern if:-

- i. the interest rate charge is lower than the arm's length rate of interest (for the lender);
- ii. the interest rate charge is higher than the arm's length rate of interest (for the borrower); or
- iii. there is no interest charge.

As stipulated under the Transfer Pricing Rules 2012, where the interest rate imposed or would have been imposed on a controlled financial assistance is not at arm's length, the Director General of Inland Revenue may make an adjustment to reflect the arm's length interest or impute interest on the IGFA. Therefore, taxpayers should revisit their intragroup's borrowing arrangement to avoid any potential tax audit, especially on cross-border financial assistance which is exposed to higher TP risk.

What should taxpayers do?

Companies with IGFA should review their intercompany agreements on a periodic basis to ensure that all terms and conditions, including the pre-determined interest rates, remain at arm's length. Taxpayers are required to substantiate and document that the terms of the IGFA are arm's length. A TP analysis could be done to set the correct level of underlying interest and to document the comparability factors of the financial assistance concerned.

Companies should update their TP documentation to reflect the arm's length terms and conditions of their existing IGFA or prepare a contemporaneous documentation for new financial assistance. Other supporting documents that should be reviewed include the TP policy and intercompany agreements.

Entrust Us with Assisting Your Organisation

Please talk to us regarding your concern on IGFA. It is critical for organisations to comply with the TP regulations in order to mitigate their TP risks. Knowledge and effort spent on complying with the TP rules and regulations is key to defend your TP position and will certainly enhance your cash position in the long-run.

Strive to protect your organisation's TP position by being tax compliant. Please feel free to contact us at tax@moore.com.my.

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