



TRANSFER PRICING FLASH

16th August 2022

Additional Disclosure on Transfer Pricing in Year of Assessment 2022 Form C

Calling all taxpayers with related party transactions read on to find out what the Inland Revenue Board ["IRB"] wants from you!

The IRB has released the updated *YA 2022 Form C* with additional Transfer Pricing ["TP"] disclosure on *Item F8*. Generally, Item F8 of the Form C consists of two parts, namely Part A on company information and Part B on value of the controlled transactions. As there are no changes on Part B of the Form C for Year of Assessment ["YA"] 2022 compared to the previous year, we will focus on this article the new requirement disclosure of Part A of the YA 2022 Form C.

i) Company characterization

The taxpayer is required to describe its characterization pertaining to its business activities, i.e. manufacturing or distribution or service activities, as illustrated below:

INFORMATION ON CONTROLLED TRANSACTIONS			
PART A: COMPANY INFORMATION			
1. Are you required to prepare a Transfer Pricing Documentation?	1 = Yes	2 = No	
2a. Manufacturing activities performed	1 = Yes 2 = No (if yes, fill in 2b)		
2b. Characterization of manufacturing activity	1 = Toll manufacturer 4 = Others	2 = Contract manufacturer	3 = Full-fledge manufacturer
3a. Distribution activities performed	1 = Yes 2 = No (if yes, fill in 3b)		
3b. Characterization of distribution activity	1 = Full-fledge distributor 4 = Limited risk distributor	2 = Commissionaire distributor 5 = Licensed distributor	3 = Agent distributor 6 = Others
4a. Service activities performed	1 = Yes 2 = No (if yes, fill in 4b)		
4b. Characterization of service activity	1 = Management service provider 4 = Others	2 = IT service provider	3 = Treasury

The characterization of the taxpayer requires accurate delineation of actual transaction and allocation of risk related to the controlled transaction. It is determined through the analysis of functions, assets and risks ["FAR analysis"], which is an integral process of a TP study to identify the economically significant activities and responsibilities undertaken, assets used or controlled and risks assumed by the taxpayer to support the value it creates for its group of companies.

Depending on the business activities undertaken by the taxpayer, it is possible to have more than one characterizations; i.e. a company can be both a full-fledged manufacturer and a limited risk procurement agent. The characterization would reflect the basis in which a taxpayer is rewarded for its value creation in the contractual arrangement with its related entities. Technically, the compensation a taxpayer receives should be commensurate with its FAR profile. Without preparing a TP documentation ["TP Doc"], the taxpayer would not know with certainty its characterization for TP purposes.

ii) Business restructuring

Business restructuring poses as one of the red flag indicators for the IRB in selecting TP audit targets, especially when it results in the reduction of profitability after the restructuring, or when it occurs after the expiry of tax incentives. Business restructuring that takes place after the Covid19 pandemic will likely attract the IRB's attention, especially if it leads to a change in the taxpayer's characterization (for instance, from a full-fledged manufacturer to a toll manufacturer) with a drastic drop in profitability. Business restructuring must be done with careful consideration of the FAR profile before and after the change.

The type of restructuring that the IRB is interested to know is as follows:

5a. Business restructuring during the basis period	<input type="checkbox"/> 1 = Yes <input type="checkbox"/> 2 = No (If yes, fill in 5b)
5b. State the nature of business restructuring	<input type="checkbox"/> 1 = Conversion of full-fledge manufacturer into contract/toll manufacturer <input type="checkbox"/> 2 = Conversion of contract/toll manufacturer into full-fledge manufacturer <input type="checkbox"/> 3 = Conversion of full-fledge distributor into limited risk/commissionaire/agent/licensed distributor <input type="checkbox"/> 4 = Conversion of limited risk/commissionaire/agent/licensed distributor into full-fledge distributor <input type="checkbox"/> 5 = Transfer of intellectual property rights to foreign associated person <input type="checkbox"/> 6 = Other

iii) Research and development ["R&D"] activity

Taxpayers engaging in R&D activities must ensure that the actual activities carried out are aligned with the terms of the intercompany agreement. The entity that carries out the R&D work may or may not have ownership of any intangible of which the results or outcome arising from the R&D activities may ultimately belong to another related entity. This includes entities that contribute to the development and/or enhancement of the manufacturing intangibles, including the products and/or process which are shared among the associated enterprises. Generally, entities that perform R&D activity would be a potential TP audit target, including those which no longer enjoy tax incentives where a sharp plunge in profit margin is obvious. The compensation should be commensurate with the FAR profile or characterization of the entity involved in the R&D activities.

The disclosure of R&D activity would be interrelated with the other disclosures in Item F8, such as business restructuring, ownership of intangibles or/and participation in cost contribution arrangements. The types of the R&D activity that taxpayer is required to disclose are as illustrated below:

6a. Performed any research and development activity?	<input type="checkbox"/> 1 = Yes <input type="checkbox"/> 2 = No (If yes, fill in 6b)
6b. State the types of R&D activity	<input type="checkbox"/> 1 = Systematic, investigative and experimental study that involves novelty <i>Technical risk carried out in the field of science or technology with the object of acquiring new knowledge</i> <input type="checkbox"/> 3 = Study for the production or improvement of materials, devices, products, produce, or processes <input type="checkbox"/> 4 = Others

iv) Ownership of trade/ brand name/ Intellectual Property ["IP"]

TP intangible refers to something that is capable of being owned/controlled for use in commercial activities, whose use or transfer will be compensated had it occurred in transaction between independent parties in comparable transaction. It is not necessarily an intangible based on legal or accounting definitions. Tradename, brand name and intellectual property are examples of TP intangibles. Ownership of intangibles, for TP purposes, whether legal and economic ownerships, is generally determined based on the involvement of development, enhancement, maintenance, protection, and exploitation functions on the intangibles by the associated enterprises within the value chain. The YA 2022 Form C requires disclosure on ownership of intangibles as follows:

7. Do you own any trade/ brand name/ intellectual property?	<input type="checkbox"/> 1 = Yes <input type="checkbox"/> 2 = No
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v) Cash pooling

Cash pooling is a centralized cash management strategy to consolidate and manage the group's cash position at one designated entity to form the central account for the group. This designated entity being the cash pool leader will coordinate and monitor all the cash balances of the entities (i.e. cash pool participants) via a master account for the group where all the cash is pooled. Cash pool participants deposit cash to the pool (or withdraw cash from the pool), and not to (or from) a particular cash pool member. It is the responsibility of the cash pool participants to apply the arm's length principle to the cash pool transactions.

Taxpayers are required, in items 8a and 8b of the Form C, to disclose if they participate in any cash pooling arrangement and if so, whether they function as cash pool leader or member (i.e. their characterization in the intercompany cash pooling arrangement) based on their respective FAR profile:

8a. Are you involved in any cash pooling activities?	1 = Yes 2 = No (if yes, fill in 8b below)
8b. Role in the cash pooling activity	1 = cash pool leader 2 = cash pool member

vi) Other disclosures

The other disclosures in Item F8 of the Form C relate to dividend declaration/payment; permanent establishment; interest, royalties and service payments; and cost contribution arrangement as shown below:

9. Has the company declared or paid any dividend?	1 = Yes 2 = No
10a. Are you a PE as defined under the TP Rules?	1 = Yes 2 = No (if yes, fill in 10b)
10b. Do you make any interest, royalties and service payments to your head office?	1 = Yes 2 = No (if yes, fill in B17 below)
11. Are you involved in any Cost Contribution Arrangement (CCA)	1 = Yes 2 = No (if yes, fill in B15 below)

What happen if the Form C disclosure is incorrect?

To complete the Form C accurately, taxpayers must understand that they are required, by law, to prepare TP Doc if they have controlled transactions and the outcome of the analysis in the TP Doc must now be reported in the Form C. As such, taxpayers will have no choice but to prepare and update their TP Doc yearly as required by the TP rules and regulations. Where the taxpayer gives any incorrect information in Form C for matters affecting his own chargeability to tax or the chargeability to tax of any other person, upon conviction, a fine between RM1,000 and RM10,000 and a special penalty of 200% of tax undercharged may be imposed.

It should also be noted that under the TP provisions, taxpayers are required to furnish the TP Doc within 14 days upon request by the IRB in accordance with Section 113B of the Income Tax Act 1967 failing which a penalty of between RM20,000 and RM100,000 may be imposed by the IRB and it may come with/without imprisonment of up to 6 months.

Entrust Us with Assisting Your Organization

Please talk to us regarding your concern on TP matters. It is critical for your organization to comply with the TP regulations in order to mitigate the TP risks. Knowledge and effort focused on complying with the TP rules and regulations is key to defend the TP position of your organization.

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

Stay Safe, Stay Compliant.

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