



TRANSFER PRICING FLASH

20th November 2020

New Transfer Pricing Provisions from the Finance Bill 2020

Following the recently released Finance Bill 2020, new transfer pricing ["TP"] provisions have been proposed for introduction to the Income Tax Act 1967 ["ITA 1967"]. For your easy understanding, we have categorised the new proposed provisions into 3 different parts as highlighted below:-

New Provisions Proposed under the ITA 1967	Effective 1 st January 2021
Failure to furnish Contemporaneous TP Documentation ["TP Doc"]	<p>Section 113B(1):- With prosecution, fine between RM20,000 – RM100,000 or Imprisonment not more than six months or both; and</p> <p>Section 113B(2):- Burden of proofing that contemporaneous TP Doc has been furnished lies with taxpayer.</p> <p>Section 113B(3):- Court may order for the TP Doc to be submitted within 30 days or any other period deemed fit by the Court.</p> <p>Section 113B(4):- Where there is no prosecution, penalty between RM20,000 to RM100,000 to be imposed by Director General of Inland Revenue ["DGIR"] through notice in writing or notice of assessment.</p> <p>Section 113B(5):- Taxpayer may appeal to Special Commissioners of Income Tax within 30 days from the notice served by the DGIR under Section 113B(4) of the ITA1967.</p>

New Provisions Proposed under the ITA 1967	Effective 1 st January 2021
<p>Power to Disregard Structure in a Controlled Transaction</p>	<p>Section 140A(3A):- The DGIR may disregard any structure adopted by a person in entering a transaction if:- (a) The economic substance of that transaction differs from its form; or (b) The arrangement made in relation to the transaction differs from those which would have been adopted by independent persons behaved in a commercially and rational manner and the actual structure impedes the DGIR from determining an appropriate transfer price.</p> <p>Section 140A(3B):- The DGIR shall make adjustments 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.</p>
<p>Surcharge on TP Adjustment</p>	<p>Section 140A(3C):- The DGIR may by notice in writing require a person to pay a surcharge of not more than 5% of the amount of increase of any income or reduction of any deduction or loss.</p> <p>Section 140A(3D):- Any surcharge required to be paid by a person shall be collected by the DGIR as if it were tax payable by that person and the surcharge shall be treated as tax payable for purposes of Sections 103 to 106 of the ITA 1967.</p> <p>Section 124(3):- DGIR is empowered to abate/remit surcharge imposed under Sections 140A(3C) and 140A(3D) of the ITA 1967.</p>

We would highlight that presently, there is no specific provision in the ITA 1967 to provide for imposition of penalty for failure to furnish a contemporaneous TP Doc and imposition of surcharge on TP adjustment. Where a taxpayer's related party transactions are regarded as non-arm's length by the Inland Revenue Board ["IRB"] in the event of a TP audit, a TP adjustment will arise resulting in additional tax payable. A penalty on the additional tax payable for non-compliance of arm's length price will be imposed by the IRB based on the penalty rates set out in the TP audit framework ["TPAF"], latest being TPAF 2019. Please refer to our [TP Flash on TPAF 2019 dated 6th May 2020](#). It is now proposed that a new surcharge is imposed even though the TP adjustment does not result in any additional tax liability on the taxpayer; for instance, in the case of a company having unabsorbed business loss to shelter the tax exposure from the TP adjustments.

Case Study for Illustration Purposes

As the imposition of surcharge is a new area of tax collection, for ease of understanding, we will present a case study focusing on the calculation of surcharge on TP adjustments.

Background

AMSTC Sdn Bhd ["AMSTC" or the "Company"] is principally involved in exporting frozen fruits to its overseas related party customers. The Company procures the fruits from independent suppliers in Malaysia and Thailand. The Company will do the sorting, packing and labelling before selling abroad.

ASMTTC has reported revenue of RM50 million in financial year ended ["FY"] 2019 and recorded a slight profit in the same financial year. The only related party transactions in the said financial year are sales to its foreign related parties. It does not sell to any independent customers. The Company has unabsorbed business loss brought forward from preceding year of RM10 million such that the company has NIL tax payable for year of assessment 2019.

In year 2021, AMSTC receives a TP audit letter from the IRB to furnish its TP Doc for FY 2019 within 30 days from the date of the letter. As AMSTC did not prepare any TP Doc, it is unable to submit a TP Doc within the 30 days' timeline. After one year of discussions and negotiations, both the IRB and Company conclude and concur on the following at the end of the TP audit:-

- i. Profit level indicator: Operating profit margin ["OPM"]
- ii. Most appropriate TP methodology: Transactional net margin method ["TNMM"]
- iii. Arm's length margin: OPM of 3% (the median point of the interquartile range of comparables' results)
- iv. AMSTC's margin: OPM of 1%

Based on the facts and circumstances as laid out above, the potential additional tax liability, penalty and surcharge that could be imposed by the IRB are as follows:-

Computation of Penalty and Surcharge	
Arm's length margin [A]	3%
AMSTC's margin [B]	1%
TP adjustment [C = A – B]	2%
Revenue [D]	RM50 million
TP adjustment [E = C × D]	RM1 million
Tax liability before TP adjustment [F] (there is no tax payable as the Company has sufficient unabsorbed business loss to offset the statutory income)	Nil
Additional tax liability from TP adjustment [G] (there is still no tax payable as the Company has sufficient unabsorbed business loss to offset the additional statutory income from TP adjustment)	Nil
Penalty under Section 113(2) of ITA 1967 @ 50% on additional tax liability [G × 50%] (under the existing TPAF 2019)	Nil
New proposed penalty for failure to furnish TP Doc	RM20,000 – RM100,000
New surcharge on TP adjustment under Section 140A(3C) @ 5% [E × 5%]	RM50,000

The surcharge of 5% is the maximum rate used in this case study as the IRB can impose a rate from 0% up to a maximum of 5%. The figures and margins are for illustration purposes only. The above scenario is based on our interpretation of the new proposed transfer pricing provisions.

Key Takeaways

It is clear that the new TP provisions are proposed with the aim to increase the tax revenue of the IRB and without doubt we could foresee more and more TP audits to be carried out in the near future. Companies with related party transactions should review their level of TP compliance and readiness in the event of TP audit.

Entrust Us with Assisting Your Organisation

Please talk to us regarding your concern on TP matters. It is critical for your organisation 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 organisation.

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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