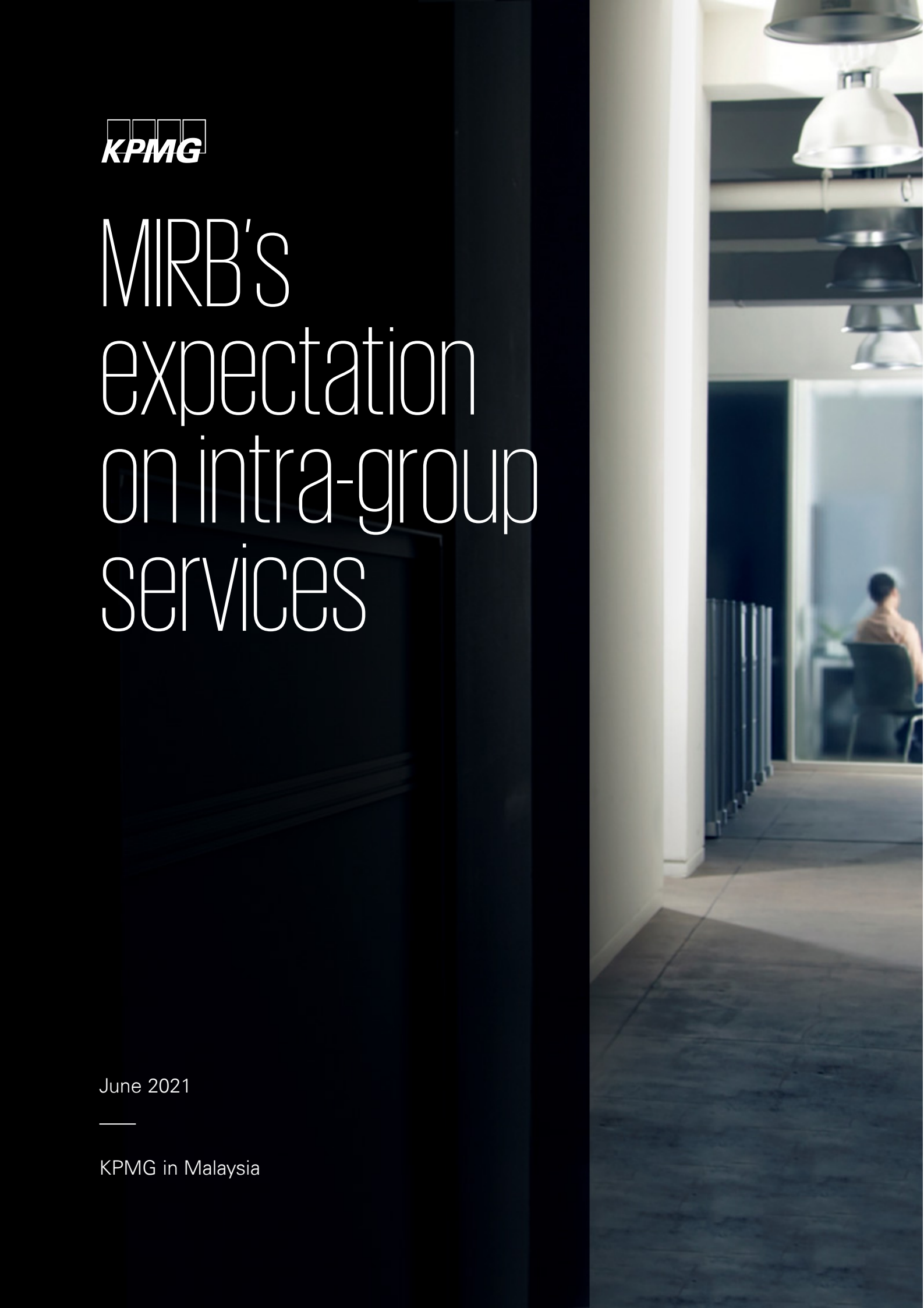

MIRB's expectation on intra-group services

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KPMG in Malaysia

On 17 June 2021, the Special Industry Branch of the Malaysian Inland Revenue Board ("MIRB") conducted a virtual discussion with taxpayers from the Banking, Insurance and Oil & Gas sector. Tax practitioners were also invited for this event organized by the MIRB. The main focus of the discussion is to discuss transfer pricing issues arising from the provision of intra-group services and what are the expectations of the MIRB from taxpayers.

Although this briefing was organized for taxpayers from the Banking, Insurance and Oil & Gas sectors, we feel the issues discussed are very relevant and applicable for taxpayers from all sectors who are involved in intra-group services transactions. We would therefore like to share the salient points of this discussion for everyone's benefit.

Common transfer pricing issues identified in relation to intra-group services:

1. Services received are shareholder or custodial activities, duplicative in nature, passive association benefits and on-call services

Very often, taxpayers do not consider whether the services received are shareholder type activities, or whether the services are duplicative of local efforts or whether the services generate a direct positive benefit to the recipient. As such, the associated costs are not quarantined and are recharged out to related parties. These costs should be isolated when determining the appropriate cost base to be charged out for the provision of intra-group services. In relation to on-call services, where there is no benefit to incur such costs, these should also be quarantined but if the taxpayer is able to substantiate there is a real business reason to incur costs for the service provider to be on stand-by, then arguably the costs should be chargeable.

2. Scope of services not clearly defined

Intercompany agreements and contracts that are in place do not have the scope of work clearly defined and more often than not, the actual services received is not reflected in the agreements or contracts. Another common issue is that the intercompany agreements are not updated.

3. Are the services really needed by the Service Recipient?

In the TP documentation, there is little or no analysis as to whether the taxpayer really need such services. Often, it seems that the taxpayer would just accept the charges by virtue of its relationship with the Service Provider. This is particularly the case where the charges are coming from the HQ where the taxpayer is unable to question or challenge.

4. Payment of intra-group charges resulted in continuous loss

There may be instances where the taxpayer is making losses after the payment of the intra-group charges and this is not limited to one year but continuously for a few years. It appears that the taxpayer is making profits only to then incur losses as a result of significant amount of charges from related parties.

5. Excessive charges for low value added services ("LVAS")

LVAS is defined by the OECD as services that are supportive by nature, not part of a core business of the group and do not contribute to economically significant activities, do not require the use of unique and valuable intangibles and do not lead to creation of unique and valuable intangibles and do not involve the assumption or control of substantial or significant risk for the Service Provider. This may include services such as human resource, accounting and audit activities, information technology or general and administrative services.

Taxpayers need to ensure that for LVAS, the charge is not excessive and it commensurate with the level of service received.

What is expected from taxpayers?

There are two major hurdles - first hurdle is to prove that services have been rendered and real economic benefits received. The second hurdle is to prove that the charge is arm's length. To overcome these two hurdles, taxpayers are expected to submit the necessary documentation to justify and support why the services received are necessary and how it is expected to benefit the business of the taxpayer, and the relevant computation schedules showing how the charge is determined. Some of the important information / documentation that taxpayers are expected to maintain are set out below:

1. A description of the (expected) benefits of each category of services.
2. Contracts or agreements for the provision of services and any amendments / addendum to those contracts.
3. Calculations showing the application of the specified allocation keys
4. Calculations showing the determination of the cost pool and the mark-up applied thereon
5. Charges must be consistent with the relative benefits intended from the services, based on the facts known at the time the services are provided
6. Any documents (i.e emails, minutes, memo) to substantiate the services rendered. Section 138 ITA 1967 applies.

This informal discussion is a very good initiative by the MIRB as it sets out clearly what is expected of taxpayers during a tax audit on intra-group services. With this, we hope that it will smoothen the tax audit process and prevent unnecessary dispute between the MIRB and taxpayers.

However, there are still some issues that remain and we hope that the MIRB is able to provide clarity in their next session. Some of the issues are:

1. Documentation requirements that the MIRB expects does not differentiate between a large Multinational Company ("MNC") where transaction amounts are in millions compared to Small Medium Enterprises ("SME") where transaction amounts are in thousands.

   We would like to suggest that the MIRB consider setting certain threshold where, for example, if a taxpayer's turnover is RM100 million and the intra-group charges are less than 5% of turnover or RM1million (whichever is lower), the taxpayer will not need to prepare TP documentation to justify the arm's length nature of the transaction. This will help reduce the compliance cost for SMEs.

2. How much documentation is enough to satisfy the MIRB?

   The amount of evidence that is required to be kept can sometimes be very voluminous. It is also very difficult and unfair to expect that the MIRB can come up with guidelines on how much documentation is required. Instead, we would like to suggest that when the MIRB requests for information during a tax audit (which typically covers 5 to 7 years), the MIRB can consider requesting information for the more recent years first as these are relatively easier to extract. Where the review of these information is sufficient to satisfy the MIRB that there are no issues, then the benefit of doubt should be given to the taxpayer that there are also no issues for the earlier years.

3. In situations where the taxpayer is providing services to related parties in countries where there are safe harbor provisions in place, such as Singapore and Australia, we would like to suggest that the MIRB accept the same mark-up to be adopted for similar type of intra-group services provided. This will avoid the need for the taxpayer to prepare a separate local benchmarking.

We hope this summary provides greater clarity to all taxpayers involved in intra-group services arrangement and look forward to further guidance and clarity from the MIRB in the next discussion.

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