Can you survive a transfer pricing audit?

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KPMG in Malaysia

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The Organisation for Economic Co-operation and Development ("OECD") is championing the reformation of international tax landscape around the world via the Base Erosion and Profit Shifting ("BEPS") initiative. Specifically, with the introduction of BEPS Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting), there is collaboration amongst tax authorities worldwide for mutual exchange of information and increased transfer pricing transparency. The burden to prove the economic substance of controlled transactions with the arm's length principle is now a greater responsibility for taxpayers.

Malaysia is NO exception as the Malaysian Inland Revenue Board ("MIRB") continues to mirror the same by gazetting various transfer pricing rules and regulations.

Amongst others,

- Introduction of Income Tax (Country-by-Country Reporting) Rules 2016, effective 1 January 2017;
- Update of Transfer Pricing Guidelines 2012 (Updated TPG 2012), effective 15 July 2017; and
- Revision of Transfer Pricing Audit Framework, effective 15 December 2019.

With these enforcements, there is a strong indication that the transfer pricing and audit scrutiny will persist to be a major focus of the MIRB.

It takes a carefully structured game plan to handle Transfer Pricing Audits, so how ready are you?

1. What is a Transfer Pricing Audit?

A Transfer Pricing Audit is an examination performed by the MIRB on the taxpayers' business records and financial affairs to ascertain the arm's length nature of their controlled transactions in accordance to Section 140A of the Income Tax Act 1967, Income Tax (Transfer Pricing) Rules 2012 as well as the Updated TPG 2012.

2. How do the taxpayers get selected for Transfer Pricing Audit?

Taxpayers with significant amount of controlled transactions and/ or, not limited to the following characteristics:

a) Consistently loss making;

b) Record low or fluctuating profit margins;

c) Transact with related parties enjoying tax incentives or located in "tax havens";

d) Recently underwent a business restructuring exercise; and

e) Indicated "No" transfer pricing documentation in the declaration contained in the company's tax return.

3. How do the taxpayers know that they are under Transfer Pricing Audit?

The taxpayers may receive letter/ email from various branches of the MIRB (i.e. *Cawangan Pembayar Cukai Besar / Cawangan Cukai Multinasional / Cawangan Industri Khas / Cawangan Siasatan,* etc.) requesting for documents and information. The letter/ email would not specify that the taxpayer is being selected for Transfer Pricing Audit. The letter/ email will contain the information requested by the MIRB to conduct further review and risk assessment.

4. What are the types of documents and information requested?

a) Audited financial statement;

b) Trial balance before and after audit adjustments;

c) Tax computation and tax return;

d) Chart of accounts;

e) Accounting ledgers (e.g. general, sales, purchases, receivables, payables, etc.);

f) Incentive(s) application, approval claim forms and relevant supporting documents;

g) Schedule of functions, assets and risk analysis;

h) Schedule of intercompany financing (i.e. include details such as nature, purpose, amount, interest, etc.);

i) Intercompany agreements (e.g. sales or purchases of goods, royalty, management services, intercompany financing, etc.);

j) Ownership structure, place and nature of business;

k) Business overview, model and strategy;

l) Organizational chart, number of employees, job description;

m) Supply chain analysis;

n) Industry outlook and key business drivers;

o) Details of controlled transactions (include details such as amount, nature, product details, invoices, payment records, etc.);

p) Intercompany pricing policy;

q) Details on significant events such as restructuring, merger & acquisition, change of product or operations, etc.; and

r) Transfer Pricing Documentation.

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5. Number of years of assessment covered under Transfer Pricing Audit?

The statute of limitation to raise additional assessments for transfer pricing issues is 7 years.

6. How much time does the taxpayers have?

Typically, information requested should be submitted within 14 days except for Transfer Pricing Documentation, which can be submitted within 30 days from the date of request.

7. Can the taxpayers request for extension of time?

Yes, taxpayers can request for an extension of time. However, higher penalties may be imposed should there be additional tax assessments. Refer to Question 10 for the penalty rates.

8. Will MIRB visit the taxpayers' premise(s)?

MIRB may opt to visit the taxpayers' premise(s) based on their preliminary assessment on the documents/ information provided by the taxpayers. This will be the commencement of a field audit and on the first day of visit, MIRB will expect the taxpayers to carry out a presentation covering business operations, functional analysis, intercompany transactions, amongst others.

9. What are the common transfer pricing issues raised?

a) Transfer of goods (e.g. sales or purchases of goods);

b) Provision of services (e.g. management services, technical support, research & development, etc.);

c) Use of intangibles assets (e.g. payment for licensing/ royalty fee for use of technology or marketing related intellectual property);

d) Intercompany financing arrangements; and

e) Fluctuating profitability, focusing on losses, etc.

10. What if the taxpayers' controlled transactions are not at arm's length?

Taxpayers will be subject to transfer pricing adjustments where additional tax assessments may be raised. Where there is additional tax payable, penalties would apply as follows:

Condition	Penalty rate
Taxpayers did not prepare Transfer Pricing Documentation	50%
Taxpayers prepared a comprehensive and good quality Transfer Pricing Documentation but failed to submit it **within 30 days** from the date of request from MIRB	30%
Taxpayer prepared a **comprehensive** and **good quality** Transfer Pricing Documentation in accordance to TPG 2012 and submitted within 30 days from the date of request from MIRB	0%

The goal is to walk through the Transfer Pricing Audit with confidence and score a CENTURY.

It is vital for taxpayers to maintain comprehensive documentation and evidences as a first line of defense given that Transfer Pricing Audits are by-and large conducted on historical transactions. Getting yourself well-equipped now is critical to set you up for success rather than getting a panic attack when you receive a letter from MIRB.

At KPMG, we share insights and provide solutions to navigate your transfer pricing and tax audit needs.

Author:
Nivashini Rayapay
Director, Global Transfer Pricing Services
KPMG Tax Services Sdn Bhd

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Contact Us

For more information on our core service offerings, please contact:

Bob Kee
Executive Director

: +60 (3) 7721 7029

: bkee@kpmg.com.my

Chang Mei Seen
Executive Director

: +60 (3) 7721 7028

: meiseenchang@kpmg.com.my

Ivan Goh
Executive Director

: +60 (3) 7721 7220

: ivangoh@kpmg.com.my

KPMG Tax Services Sdn Bhd
Level 10, KPMG Tower
8, First Avenue, Bandar Utama
47800 Petaling Jaya, Selangor

: +60 (3) 7721 3388

: +60 (3) 7721 7288 / 7388

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