



BOB KEE

Enhancing transfer pricing regulations

Comment

IN May 2023, Malaysia took a significant step towards fortifying its tax system with the introduction of the Income Tax (Transfer Pricing) Rules 2023 (TP Rules 2023).

Amidst a backdrop of other tax reforms such as the introduction of e-invoicing and the Capital Gains Tax, changes to the transfer pricing regime in Malaysia through the introduction of the TP Rules 2023 has tightened compliance surrounding how transactions with related parties should be addressed.

From a policy perspective, the TP Rules 2023 was timely as improvements were much needed to shield Malaysia's revenue base from potential profit shifting practices, as well as to align with global transfer pricing standards.

Looking towards Budget 2025, the question now is: How can Malaysia further strengthen its transfer pricing regime without overburdening taxpayers with administrative complexities?

> Introduce safe harbour rules to simplify compliance.

Complying with transfer pricing rules can be a resource-intensive process for both taxpayers and tax authorities.

The Organisation for Economic Cooperation and Development (OECD) has long acknowledged this challenge, and one effective solution is the introduction of safe harbour rules.

A safe harbour rule is a provision within transfer pricing regulations that allows taxpayers to make use of simplified transfer pricing methods to determine the arm's length price for related party transactions (RPTs).

These "safe harbours" provide an avenue for taxpayers to apply specific transfer pricing rules that are acceptable by tax authorities.

Tax authorities will also be able to set their expectations regarding what they would like to see from taxpayers with respect to pricing of certain RPTs.

By prescribing a certain profit margin or mark-up to certain types of RPTs via safe harbour rules, taxpayers would be able to refer to such guidance and apply them in appropriate circumstances without the need for a detailed transfer pricing analysis.

Run-up to



For example, in some jurisdictions, a 5% safe harbour profit mark-up is acceptable for transactions related to the provision of low value adding services.

By implementing safe harbour provisions for straightforward and routine transactions (such as provision of support services by a holding company to its subsidiaries), Malaysia could significantly reduce the compliance burden for taxpayers, particularly for smaller businesses.

For the tax authority, these rules would enable resources to be focused on more complex cases.

> Exclude domestic-related party transactions from transfer pricing compliance.

Another aspect that could be considered is the area of domestic transfer pricing.

It is worth noting that the prevailing arm's length provision under Section 140A of the Income Tax Act 1967 as well as the TP Rules 2023 does not exempt any class of taxpayer from complying with its requirements.

This uniform approach places an unnecessary burden on small and medium enterprises (SMEs) as they are required to conduct detailed analyses to prove compliance, despite the fact that they may have low levels of revenue or transactions with related parties that are based only in Malaysia (for example, domestic transactions).

Further, SMEs are also required to comply with the timeline requirements under TP Rules 2023, which adds further administrative burdens.

The compliance requirements placed on SMEs with domestic transactions are no different from those applicable to large multinational enterprise groups.

The OECD rightly acknowledges that transfer pricing compliance is complex, time consuming and costly.

By implementing safe harbour provisions for straightforward and routine transactions (such as provision of support services by a holding company to its subsidiaries), Malaysia could significantly reduce the compliance burden for taxpayers, particularly for smaller businesses.

Therefore, the requirement for taxpayers with domestic RPTs to fully comply with Section 140A should be re-examined.

To alleviate the strain on SMEs, consideration should be given to exempt certain classes of domestic taxpayers from the burden of complying with Section 140A and by extension the TP Rules 2023.

Malaysia's Inland Revenue Board (IRB) could also consider exempting taxpayers with turnover or RPTs below a certain threshold or whose RPTs as a percentage of overall revenue that is below a certain value.

This would not only reduce the administrative load on smaller businesses but also allow tax authorities to better focus its resources.

> Harmonise tax and transfer pricing audit requirements.

In practice, the IRB typically conducts its audits of corporate income tax and transfer pricing issues on a concurrent basis.

However, two separate frameworks currently govern the conduct of these audits, for example, the Tax Audit Framework and the Transfer Pricing Audit Framework.

This dual-framework approach can create confusion and inefficiencies for taxpayers trying to navigate two sets of expectations.

It would be beneficial for the IRB to consider harmonising the contents of the audit frameworks into a single, cohesive document.

A unified framework would clarify the audit process, particularly with regard to the years of assessment under scrutiny.

For instance, harmonisation could help standardise the period of coverage of audits to five years of assessment as per the latest tax audit framework.

In addition, consideration can also be given for a wider voluntary disclosure provision to be included in the harmonised framework.

This is where taxpayers who voluntarily disclose any corporate income tax or transfer pricing issues before an audit begins are not penalised.

This will encourage taxpayers to be more proactive in their approach to tax and transfer pricing compliance, which should lead to greater revenue collection in the long run on the part of the tax authority.

> A balanced and fair approach.

Overall, the introduction of the TP Rules 2023 is a commendable step forward to enhance on-going efforts by the IRB to safeguard the country's revenue from profit shifting practices.

Whilst these efforts are necessary, we hope Budget 2025 will introduce further enhancements of the transfer pricing rules to strike a balance between robust enforcement and manageable compliance requirements, so that the cost of compliance does not outweigh its benefits.

The taxation system should be supportive of both tax authorities and taxpayers so that new reforms would not only strengthen compliance but also contribute to a fairer and more efficient tax system for all.

Bob Kee is the head of transfer pricing services for KPMG in Malaysia. The views expressed here are the writer's own.