



Transfer Pricing – Updates and practical challenges

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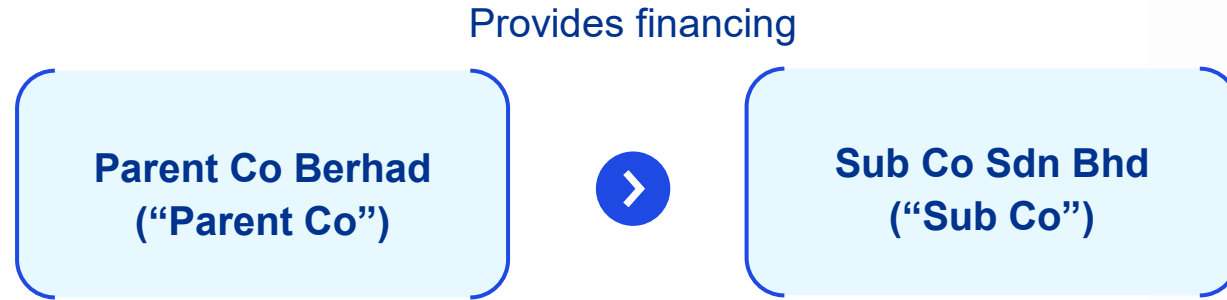


Malaysia Transfer Pricing Guidelines on Controlled Financial Transactions: Intra-Group Loans (“MFTIL”)

- ✓ Aimed at addressing specific transfer pricing requirements for intra-group loans as mentioned in Chapter 9 of the Malaysia Transfer Pricing Guidelines 2024 (“MTPG 2024”)
- ✓ Requirements in the MFTIL are effective for loans entered into on or after 31 July 2026
- ✓ Taxpayers can apply the MFTIL in reviewing existing controlled financial transactions and make voluntary disclosures where necessary



Intercompany financing



- ✓ Parent Co is the holding company of Sub Co.
- ✓ Parent Co provides financing to Sub Co in August 2026.

What are the arm's length considerations?

- ✓ An agreement should be in place.
- ✓ What is the arm's length interest rate?
- ✓ Is that all?



Key developments

01

Increased focus on
debt vs. equity
analysis

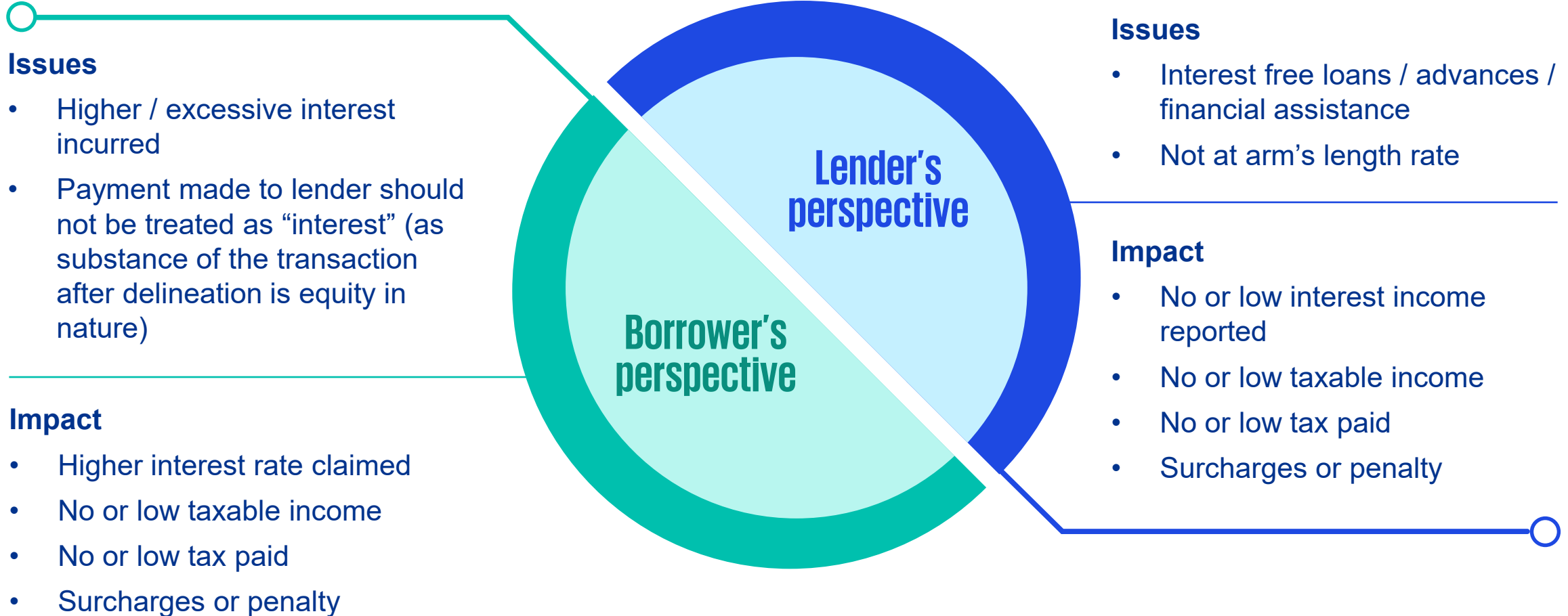
02

Determining arm's
length interest
rate

03

Stronger
documentation
expectations

Why controlled financial transactions may create tax issues?



Increased focus on debt vs. equity analysis

Increased focus on debt vs. equity analysis

- ✓ In order to determine the arm's length interest rate for a controlled financial transaction, the taxpayer must first accurately delineate the financial transaction.
- ✓ Delineation is important to determine whether the financial transaction is a debt or equity transaction.
- ✓ This is to ensure that substance prevails over form.

Where the purported loan does not exhibit characteristics of a genuine loan, the Inland Revenue Board of Malaysia ("MIRB") may recharacterise the transaction as an equity contribution, resulting in disallowance of interest deductions and additional tax payable / surcharge.

Increased focus on debt vs. equity analysis

Debt vs. equity analysis

- ✓ Debt vs. equity assessment is the first step in assessing intra-group financing
- ✓ Largely align with the OECD recommendations, with expanded requirements to include accounting and tax treatment
- ✓ Consideration of the borrower's financial background and credit risk in assessing the economic substance of the loan
- ✓ Common criteria (non-exhaustive) for comparing debt and equity are set out in the following slides. The existence of any single criterion is insufficient to classify a financial transaction as either equity or debt. It is important to weigh the combination of criteria together with other relevant facts and circumstances.

Criteria for comparing debt vs. equity

MFTIL	OECD TP Guidelines	Case Law	Hybrid Instrument Guidelines*
Existence of a legal obligation to repay	Failure of the purported debtor to repay on the due date or to seek a postponement	Failure of the debtor to repay on the due date or to seek a postponement	-
Fixed maturity date	Presence/absence of a fixed repayment date	Presence/absence of a fixed maturity date	Presence of maturity date of instrument
Expectation of return	Obligation to pay interest; Source of interest payments	Source of payments; Source of interest payments	Benefit to the instrument holder; Source from which the principal/distributions will be repaid/paid, and the order in case of liquidation or dissolution

Criteria for comparing debt vs. equity

MFTIL	OECD TP Guidelines	Case Law	Hybrid Instrument Guidelines*
Ranking upon liquidation or dissolution	Status of the funder in comparison to regular corporate creditors	Status of the fund in relation to regular corporate creditors	-
Participation in management or control	-	Participation in management; Identity of interest between creditor and stockholder	Involvement in the management
Intent of the parties	-	Intent of the parties; The names given to the certificates evidencing the indebtedness	-

Criteria for comparing debt vs. equity

MFTIL	OECD TP Guidelines	Case Law	Hybrid Instrument Guidelines*
Right to enforce repayment	Right to enforce payment of principal and interest	Right to enforce payment of principal and interest	Right to enforce payment/repayment of distributions/principal; Right to recover principal/accumulated distributions in the event of default or existence of step-up feature
Treatment in accounting and financial reports	-	-	-
Tax treatment under the relevant tax laws	-	-	-

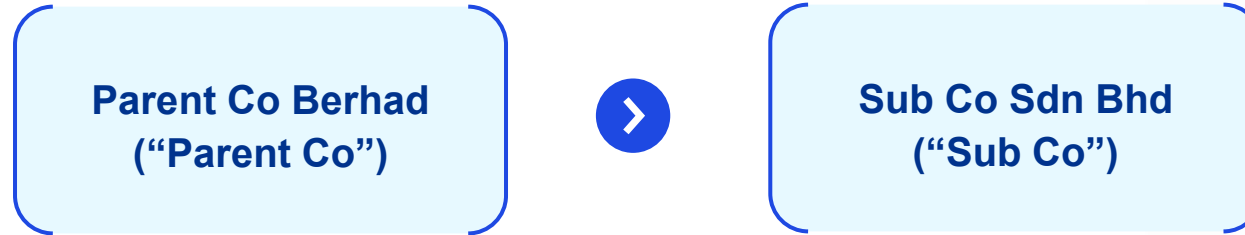
Criteria for comparing debt vs. equity

MFTIL	OECD TP Guidelines	Case Law	Hybrid Instrument Guidelines*
-	Ability of the recipient of the funds to obtain loans from unrelated lending institutions	Ability of the corporation to obtain loans from outside lending institutions; "Thin" or adequate capitalisation	Ability of the issuer to obtain loan and make payment on an arm's length transaction
-	Extent to which the advance is used to acquire capital assets	Extent to which the advance was used to acquire capital assets	-
-	Existence of financial covenants and security	-	-

*Not arranged in order of priority here

Intercompany financing

Provides financing



- ✓ Parent Co is the holding company of Sub Co
- ✓ No agreement available hence no enforceable obligations and rights
- ✓ No documentation on the intention of the parties at the onset
- ✓ Amount due from is classified as assets in Parent Co's balance sheet
- ✓ Amount due to is classified as liabilities in Sub Co's balance sheet

Determining arm's length interest rate

Determining arm's length interest rate

Generally, there are two methods:

01

**Comparable
Uncontrolled Price
("CUP") method**

02

**Cost of funds
method**

Determining arm's length interest rate

CUP Method

- Arm's length interest rates determined based on the facts and circumstances of the transaction: borrower's credit rating, loan-specific terms and conditions, and other relevant comparability factors.
- Possible benchmarks*:
 - Publicly available bond yields
 - Loan market data
 - Interbank lending rates
 - Commercial loans obtained by the taxpayer or its related group entities from independent lenders

* with necessary comparability adjustments

Determining arm's length interest rate

Cost of Funds Method

- Lender's borrowing expenses in acquiring the capital for lending, including:
 - costs associated with borrowing funds
 - expenses to arrange and service the loan
 - relevant risk premium or profit margin
- Appropriate for external funding via associated intermediaries, with observable borrowing rates
- Internal funds carry opportunity cost (e.g. fixed deposit)
- Agency / intermediary functions should exclusively reflect their own costs and risks

Determining arm's length interest rate

A simplified method was introduced to reduce the compliance burden of taxpayers

Simplified method

- Simplified method is not mandatory
- Election of applying either of the following prescribed rates published by Bank Negara Malaysia ("BNM") in pricing intercompany loans:
 - Deposit Rate – refers to average fixed deposit rate ("FD rate")
 - Average Lending Rate ("ALR")
- Eligibility criteria
 - Capital of an intra-group loan is not borrowed from one entity and transferred from the original borrower to the ultimate borrower
 - Specific criteria for each prescribed rate

Determining arm's length interest rate

Simplified method – eligibility criteria

Deposit Rate (FD rate)

- a. The taxpayer is not in the business of borrowing and lending
- b. The interest income from the intra-group loan is taxed under paragraph 4(c) of the ITA
- c. The source of the loan is from taxpayer's internal funds
- d. The loan is denominated in Ringgit Malaysia
- e. The aggregate amount of intra-group loan in the YA does not exceed RM50million; and
- f. The taxpayer only engages in intra-group loan with associated person resident in Malaysia.

Average Lending Rate (ALR)

- a. The taxpayer is not in the business of borrowing and lending
- b. The interest income from the intra-group loan is taxed under paragraph 4(c) of the ITA
- c. The loan is denominated in Ringgit Malaysia; and
- d. The aggregate amount of cross border intra-group loan in the YA does not exceed RM50million.

Practical Challenges 1A

Provides RM30 million loan

Parent Co Berhad
("Parent Co")



Sub Co Sdn Bhd
("Sub Co")

Internal funds



Meets the criteria to apply the Simplified Method

Which rate can be applied under the Simplified Method?

- A. FD rate
- B. ALR
- C. Can choose either FD rate or ALR

Practical Challenges 1B

Provides RM30 million loan

Parent Co Berhad
("Parent Co")



Sub Co Sdn Bhd
("Sub Co")

Internal funds

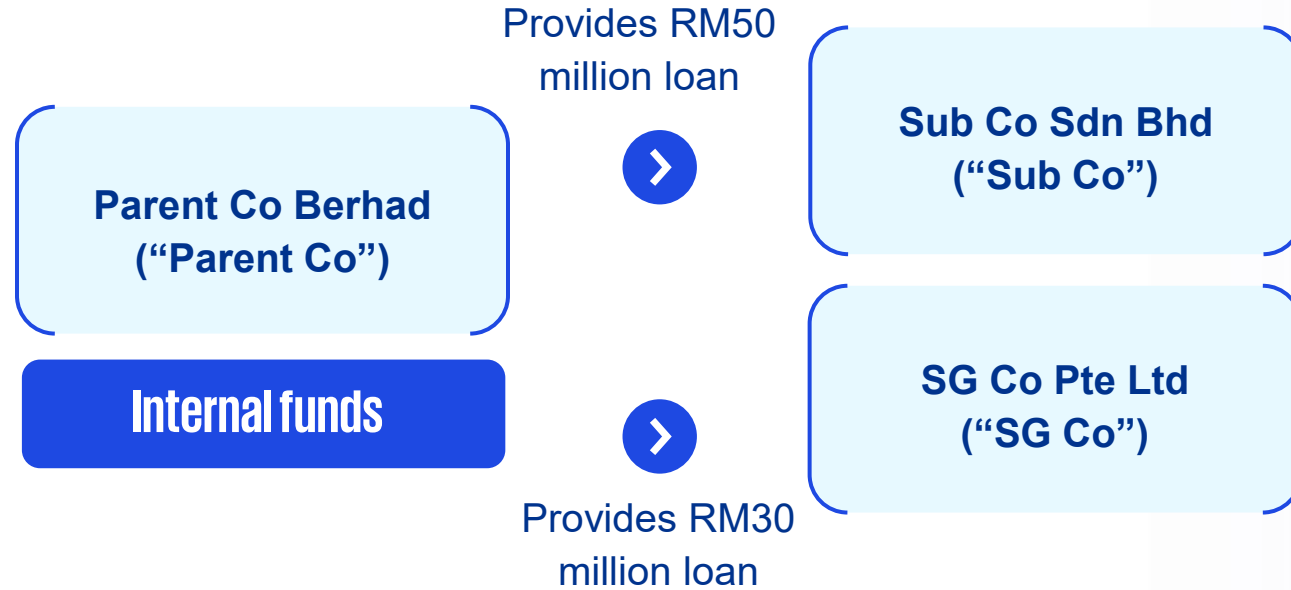


Parent Co is a **listed** investment holding company filing 60FA return, and the interest income from the intra-group loan is taxed under paragraph 4(a) of the ITA.

Can the Simplified Method be applied?

- A. Yes
- B. No

Practical Challenges 2A

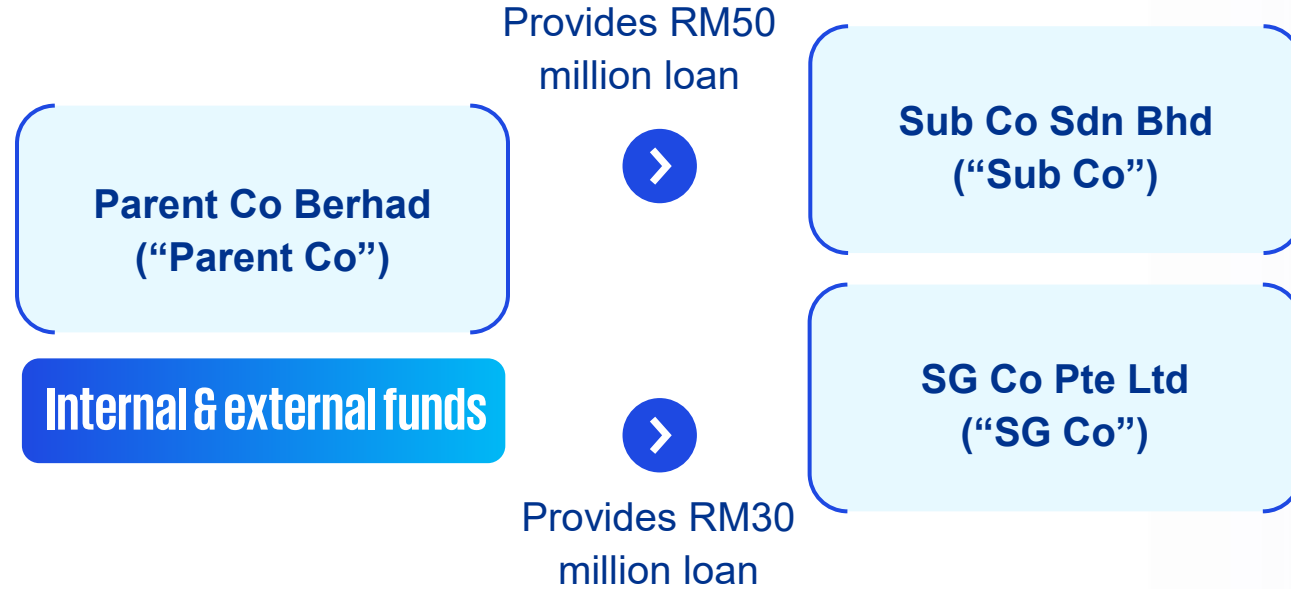


✓ Meets the criteria to apply the Simplified Method

Which rate can be applied under the Simplified Method?

- A. ALR
- B. FD rate

Practical Challenges 2B



✓ Meets the criteria to apply the Simplified Method

Which rate can be applied under the Simplified Method?

- A. ALR
- B. FD rate

Practical Challenges 3



Can the Simplified Method be applied?

Loan from Parent Co to	Fund origin	Which rate?
Sub Co	Internal	A. FD B. ALR
Sub Co 2 (intention?)	External	A. ALR B. Not eligible



Practical Challenges 4



Can the Simplified Method be applied?

Loan from	Parent Co to Sub Co	Sub Co to SG Co
	Yes	No
		Yes



Stronger documentation expectations

Stronger documentation expectations

- ✓ Supporting evidence for intra-group loans, including loan agreements, credit assessments, comparability analyses and evidence supporting the chosen pricing
- ✓ Arm's length interest rates established through the most appropriate pricing method, other than simplified method, are allowed to be reviewed once every three years, provided that all facts and circumstances remain unchanged
- ✓ Documentation to demonstrate eligibility to elect the simplified method:
 - a. A copy of the agreement
 - b. Confirmation that the source of intra-group loans is from the company's internal funds
 - c. Confirmation of currency, amount and loan terms
 - d. Confirmation that the company is not in the business of borrowing and lending
 - e. Proof that the loan is denominated in Ringgit Malaysia and, where applicable, that the loan amount does not exceed the stipulated threshold
 - f. Proof that the interest rates applied, either the deposit rate or the ALR, are based on the official publication of BNM or MIRB website.

Key Takeaways

Key takeaways for the way forward

Transfer Pricing is forward-looking, not a year-end outcome

- ✓ **Plan:** Establish an appropriate transfer pricing policy to accurately delineate the intra-group loan and determine the arm's length interest rate at the time of entering into the transaction
- ✓ **Implement:** Consistently apply the transfer pricing policy
- ✓ **Document:** Prepare and maintain relevant supporting documentation and analyses
- ✓ **Review:** Test outcomes against the policy and make adjustments where appropriate



Q&A





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