

GUIDELINE SHIFT: NAVIGATING MALAYSIA'S UPDATED TRANSFER PRICING LANDSCAPE

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The transfer pricing ("**TP**") framework in Malaysia has undergone significant reform with the issuance of the Malaysia Transfer Pricing Guidelines 2024 ("**TP Guidelines 2024**"), which apply from Year of Assessment ("**YA**") 2023 onwards. These developments are accompanied by key legislative changes, including the amendment to Section 140A of the Income Tax Act 1967 ("**ITA**"), the introduction of Section 113B of the ITA, and the revised Income Tax (Transfer Pricing) Rules 2023 ("**TP Rules 2023**").

Scope And Application

I. Scope and Application for the Preparation of Contemporaneous Transfer Pricing Documentation

Paragraph 1.3 of the TP Guidelines 2024 provides that contemporaneous transfer pricing documentation ("**CTPD**") must be finalised and dated before the submission of the taxpayer's income tax return for the year of assessment in which a controlled transaction takes place. The Guidelines introduce three categories of CTPD preparation: (i) Full CTPD, (ii) Exemption from CTPD, and (iii) Minimum CTPD.

With respect to full CTPD, the TP Guidelines 2024 revised the thresholds and conditions for mandatory full CTPD preparation:

TP Guidelines 2012 (YA 2022 & Prior YA)	TP Guidelines 2024 (YA2023 & Onwards)
Full CTPD was mandated under the following conditions (Paragraph 1.3.1 of the TP Guidelines 2012): • Turnover surpasses RM25 million and related party transactions exceeding RM15 million; or • Financial assistance exceeding RM50 million.	Full CTPD is mandated on the following conditions (Paragraph 1.7 of the TP Guidelines 2024): • Turnover surpasses RM30 million and cross-border related party transactions reach RM10 million annually; or • Receives or provides controlled financial assistance exceeding RM50 million annually.

Permanent establishments will be treated as a (hypothetically) distinct and separate enterprise from its head office or other related branches (Paragraph 1.3.4 of the TP Guidelines 2012).	Permanent establishments are now explicitly required to prepare full CTPD separately from their head offices or related branches, regardless of whether financial thresholds are met (Paragraph 1.4 of the TP Guidelines 2024).
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The interpretation of “cross-border related party transactions” remains contentious. Taxpayers generally argue that interest income and expenses should be included, while fixed asset transactions and dividends should be excluded. In contrast, the Inland Revenue Board of Malaysia (“IRB”) takes the opposite view, excluding interest income and expenses while including dividends and fixed asset transactions.

Secondly, with regard to exemptions from preparing TPD, the TP Guidelines 2024 expand the categories of exemption while concurrently imposing more stringent requirements:

TP Guidelines 2012 (YA 2022 & Prior YA)	TP Guidelines 2024 (YA 2023 & Onwards)
Individuals not carrying on a business (paragraph 1.3.1 of the TP Guidelines 2012)	- Individuals not carrying on a business (paragraph 1.5(a) of the TP Guidelines 2024); - Individuals carrying on a business (including partnerships) engaging solely in domestic controlled transactions (paragraph 1.5(b) of the TP Guidelines 2024); - Persons entering into controlled transactions amounting to not more than RM1 million annually (paragraph 1.5(c) of the TP Guidelines 2024); or - Individuals involved exclusively in domestic controlled transactions where neither party receives tax incentives; both parties are subject to the same headline tax rate; and neither party has incurred losses for two consecutive years preceding the transaction (paragraph 1.5(d) of the TP Guidelines 2024).

Notably, the IRB maintains that the conditions set out under paragraph 1.5(d) must be satisfied collectively in order to qualify for an exemption. However, an exemption from preparing CTPD does not absolve taxpayers from the obligation to demonstrate compliance. Taxpayers are still required to maintain sufficient documentation to substantiate adherence to the arm’s length principle (“ALP”).

Although failure to submit the analysis within the prescribed timeline does not attract penalties under Section 113B of the ITA, a surcharge may still be imposed under Section 140A(3C).

Thirdly, minimum CTPD as provided under paragraph 11.12 of the TP Guidelines 2024. Taxpayers who do not qualify for an exemption and are not required to prepare a full CTPD may opt to prepare either a full or minimum CTPD. The minimum documentation must include the worldwide group structure, organisational structure, details of controlled transactions and pricing policy. Despite its simplified format, minimum CTPD must still demonstrate compliance with the ALP. Financial transactions, previously excluded from minimum documentation, are now explicitly required to be documented under the minimum CPTD. While individuals not carrying on a business are exempt from CTPD obligations, the Guidelines remain silent on whether dormant companies are similarly excluded.

Supplementary Factors: Tax Incentives and Headline Tax Rates

The TP Guidelines 2024 expressly disqualify taxpayers from exemption eligibility if they benefit from tax incentives, including approvals under Section 127 of the ITA or incentives granted under the Promotion of Investments Act 1986, such as Pioneer Status or Investment Tax Allowance. Mutual exclusivity applies throughout the exempt period, specifically in the year of assessment in which claims are made either under Schedule 7A (Reinvestment Allowance) or Schedule 7B (Investment Allowance for the service sector), both of which are applicable only to companies.

Remarkably, the exemption is denied even if taxpayers do not utilise an approved incentive. A taxpayer claiming for RA during the relevant year is considered to enjoy an incentive and therefore is not exempt from preparing CTPD.

Additionally, the Guidelines require that both parties to a domestic controlled transaction be subject to the same headline tax rate, thereby excluding those benefiting from preferential rates under incentive schemes. For example, under Section 6(1)(m) and (n) of the ITA, a capped rate of 20% may apply to qualifying activities approved by the Minister, as prescribed in Part XVII (for businesses) and Part XVIII (for non-citizen employees) of Schedule 1. Similarly, SMEs taxed under paragraphs 2A and 2D of Part I of Schedule 1 and Labuan entities governed by the LBATA, are considered to operate under distinct headline tax regimes, unless the Labuan entity irrevocably elects to be taxed under the ITA via Section 3A.

II. Controlled Transaction

Initially governed by Section 139 of the ITA, “control” was traditionally based on clear ownership or entitlement thresholds, such as holding the majority of share capital, voting power, or rights in the event of distribution or winding up.

However, since 1.1.2019, Section 140A(5A) further extends this definition by providing that a person holding at least 20% but less than 50% of a company’s share capital is now considered to exert control if any of the following conditions

are satisfied: (a) the person depends on proprietary assets by another party; (b) its pricing or business decisions are influenced by the other party; or (c) one or more directors or members of the board of director are appointed by the other party. Accordingly, Section 139 must now be read together with Section 140A(5A) when assessing whether a transaction qualifies as a controlled transaction.

The Arm's Length Principle

I. Arm's Length Range ("ALR")

Under Rule 13(5) of the TP Rules 2023, the arm's length range is defined as the interquartile range, specifically between the 37.5th and 62.5th percentiles of a data set. Any result falling within this range is acceptable to the Director General of Inland Revenue ("**DGIR**"). However, if comparability defects are identified, such as where relevant economic differences cannot be quantified or adjusted, the DGIR may adjust the transfer price to the median or a point above it within the arm's length range.

II. Re-Characterisation of a Transaction

Under Rule 8 of the TP Rules 2012, which is in pari materia to Sections 140A(3A) and 140A(3B) of the ITA, the DGIR is empowered to recharacterise or disregard the form of a transaction. This power may be exercised where: (i) the economic substance of a transaction differs from its legal form; or (ii) the transaction, although aligned in form and substance, differs from arrangements that would have been adopted by independent parties acting in a commercially rational manner. Where such conditions are met, the DGIR may disregard the actual structure and substitute it with one that better reflects economic reality.

This substance over form doctrine recognises that associated persons often enter into arrangements that are not typical of third-party transactions. These arrangements may include relaxed or absent contractual terms, flexibility in altering contracts and transactions driven by group-level strategies. For instance, in example 2.12, a Malaysian entity secured an intra-group loan without providing security or covenants, resulting in a high interest rate. The DGIR determined that no independent lender would extend financing under such terms, concluding that the loan was not structured at arm's length. Accordingly, the transaction was disregarded under Section 140A(3A)(b) and the interest expense was disallowed.

Determination Of The Net Profit

According to paragraph 3.42 of the TP Guidelines 2024, when computing profit-level indicators such as operating margins, it is essential to exclude non-operating items that do not reflect business operations. As outlined in paragraph 3.45 of the TP Guidelines 2024, these typically include interest income, interest expenses, taxes and extraordinary items. While audited financial statements report operating profit as a subtotal, finance costs or income below the line may include trade and non-trade elements. When the financial statements separate operating interest income or expenses from non-operating ones, and the taxpayer can substantiate that such items are trade in nature, they may be included in the computation of

the net profit indicator. Proper documentation is essential to justify this inclusion during an audit.

Comparability Analysis

I. Comparable Period

The arm's length price must be determined by comparing controlled transactions with uncontrolled transactions conducted within the same basis year. This requirement is grounded in the principle that transfer pricing must be applied contemporaneously and assessed on a year-by-year basis. A contemporaneous comparison provides the most reliable benchmark as it reflects similar economic and market conditions.

To address practical challenges in benchmarking, paragraph 4.7 of the TP Guidelines 2024 allows comparison with companies whose financial year ends ("**FYE**") fall within a 6-month window before or after the tested party's FYE. Further, as illustrated in Example 4.2 of the said Guideline, comparables with FYEs up to 7 months before or 5 months after may also be used, provided the taxpayer can demonstrate that the periods reflect similar economic environments relevant to the controlled transaction.

II. Multiple Year Data

Under paragraph 7(6)(b) of the TP Rules 2023, taxpayers are prohibited from using multi-year averages to determine the arm's length price. However, multi-year data may still be referenced to identify trends. Paragraph 4.10 of the TP Guidelines 2024 requires that the most current, reliable data be used at the time of documentation. If updated during audit, such revisions will not affect the contemporaneity of the original CTPD and do not attract penalties under Section 113B of the ITA.

III. Losses

Where a tested party incurs losses, paragraph 4.10 of the TP Guidelines 2024 requires the taxpayer to demonstrate that such losses are commercially rational. This includes providing evidence of external non-transfer pricing factors such as economic downturns, strategic missteps, or natural disasters to justify the losses in the context of the arm's length principle.

Intragroup Services

Paragraph 6.1 of the TP Guidelines 2024 defines Intragroup Services ("**IGS**") as services provided within an MNE group for the benefit of other group members, including management, administrative, technical, marketing, and procurement functions.

I. Payment for IGS

Under rules 9(1) and 9(2) of the TP Rules 2023, IGS payments are deductible only if

the taxpayer can prove the following conditions:

- **Service Rendered:** The taxpayer must prove the service was rendered. If not, the payment is disallowed under Section 39 of the ITA.
- **Economic Benefit or Commercial Value:** If the service does not confer an economic benefit or commercial value to the recipient, it will be disregarded under Section 140A(3A) of the ITA.
- **Arm's Length Charge:** If the charge is not at arm's length, the DGIR may adjust under Section 140A(3) to reflect arm's length pricing.

Where a transaction is disregarded under Section 140A(3A), the DGIR is obliged under Section 140A(3B) to substitute the original structure with one that reflects commercial and economic reality.

II. Simplified Approach for Low Value Adding Intragroup Services ("LVAS")

For qualifying LVAS, the IRB permits a simplified mark-up of 5% on costs, provided the services involve no significant risks, do not use or develop valuable intangibles, and are not core profit-generating activities. Pass-through costs must be excluded from the cost base unless it can be reliably demonstrated that comparable margins similarly exclude them.

Conclusion

The TP Guidelines 2024 represent a significant evolution in Malaysia's transfer pricing framework, offering enhanced clarity and practical guidance for taxpayers. With the introduction of expanded thresholds, exemptions and the use of LVAs, the Guidelines aim to streamline the compliance process and reduce the burden on business. However, it is crucial for taxpayers to adhere to these requirements, as failure to provide contemporaneous transfer pricing documentation within the specified timeframe can result in severe penalties, including fines or imprisonment under Section 113B of the ITA. As Malaysia's transfer pricing landscape continues to evolve, businesses must remain vigilant in ensuing compliance to mitigate risks and avoid penalties.

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