



# TRANSFER PRICING GUIDELINES

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2012

**This document replaces the 2003 Transfer Pricing Guidelines. Prepared by the IRBM Multinational Tax Department, the Guidelines are intended to help explain administrative requirements pertaining to Section 140A of the Income Tax Act, 1967 and the Income Tax (Transfer Pricing) Rules 2012. All enquiries may be directed to [ldn\\_jcm@hasil.gov.my](mailto:ldn_jcm@hasil.gov.my).**

**INLAND REVENUE BOARD OF MALAYSIA  
TRANSFER PRICING GUIDELINES  
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## **PART I PRELIMINARY**

### **1. INTRODUCTION**

Transfer pricing generally refers to intercompany pricing arrangements for the transfer of goods, services and intangibles between associated persons. Ideally, the transfer price should not differ from the prevailing market price which would be reflected in a transaction between independent persons. However, business transactions between associated persons may not always reflect the dynamics of market forces. These Transfer Pricing Guidelines (hereinafter referred to as the Guidelines) are largely based on the governing standard for transfer pricing which is the arm's length principle as set out under the Organization for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines. Although some parts of the Guidelines have been adopted directly from the OECD Transfer Pricing Guidelines, there may be areas which differ to ensure adherence to the Income Tax Act 1967 (the Act) and Inland Revenue Board of Malaysia (IRBM) procedures as well as domestic circumstances. In this regard, the Guidelines may be reviewed from time to time. Notwithstanding the aforementioned, the arm's length principle remains as the guiding principle throughout the Guidelines. Examples shown in the Guidelines are for illustrative purposes only. Thus, in dealing with actual cases, the facts and circumstances of each case must be examined before deciding on the applicability of any of the methods described in the Guidelines.

### **2. OBJECTIVE**

2.1 The purpose of the Transfer Pricing Guidelines is to replace the IRBM Transfer Pricing Guidelines issued on 2 July 2003, in line with the introduction of transfer pricing legislation in 2009 under section 140A of the Act, and the Income Tax (Transfer Pricing) Rules 2012 (hereinafter referred to as the Rules).

2.2 The Guidelines are concerned with the application of the law on controlled transactions. They provide guidance for persons involved in transfer pricing arrangements to operate in accordance with the methods and manner as provided in the Rules, as well as comply with administrative requirements of the IRBM on the types of records and documentations to maintain.

### 3. SCOPE

3.1 The Guidelines are applicable on controlled transactions for the acquisition or supply of property or services between associated persons, where at least one person is assessable or chargeable to tax in Malaysia. To ease compliance burden persons referred to do not include individuals not carrying on a business, further-

(a) for a person carrying on a business, the Guidelines apply wholly to a business with gross income exceeding RM25 million, and the total amount of related party transactions exceeding RM15 million.

(b) where a person provides financial assistance, the guidelines on financial assistance are only applicable if that financial assistance exceeds RM50 million. The Guidelines do not apply to transactions involving financial institutions.

3.2 Any person which falls outside the scope of 3.1 may opt to fully apply all relevant guidance as well as fulfil all Transfer Pricing Documentation requirements in the Guidelines; or alternatively may opt to comply with Transfer Pricing Documentation requirements under paragraph 25.4(a), (d) and (e) only. In this regard, the person is allowed to apply any method other than the five methods described in the Guidelines provided it results in, or best approximates, arm's length outcomes.

- 3.3 Notwithstanding the aforementioned paragraphs the Guidelines need not apply to transactions between persons who are both assessable and chargeable to tax in Malaysia and where it can be proven that any adjustments made under the Guidelines will not alter the total tax payable or suffered by both persons. Please also refer to paragraph 25.2.
- 3.4 The Guidelines are also applicable by analogy, in relation to transactions between a permanent establishment (PE) and its head office or other related branches. For the purpose of the Guidelines, the PE will be treated as a (hypothetically) distinct and separate enterprise from its head office or other related branches. Paragraph 3.1 does not apply to this category of taxpayers.

#### **4. RELEVANT PROVISIONS**

- 4.1 Section 140 of the Income Tax Act 1967 (ITA) empowers the Director General of Inland Revenue (DGIR) to disregard certain transactions which are believed to have the direct or indirect effect of altering the incidence of tax, and make adjustments as he thinks fit, to counter-act the effects of such transactions. Thus, Section 140 allows the DGIR to disregard transactions believed not to be at arm's length and make the necessary adjustments to revise or impose tax liability on the persons concerned. Under subsection 140(6), the said non arm's length dealings include transactions between persons one of whom has control over the other and between persons both of whom are controlled by some other person.
- 4.2 With effect from 1.1.2009, section 140A was introduced to specifically address transfer pricing issues. The section requires taxpayers to determine and apply the arm's length price on controlled transactions. This section further allows the DGIR to make an adjustment to reflect the arm's length price, or interest rate, for that transaction by substituting or imputing the

price or interest, as the case may be; and to disallow considerations for controlled financial assistance which are deemed excessive in respect of a person's fixed capital.

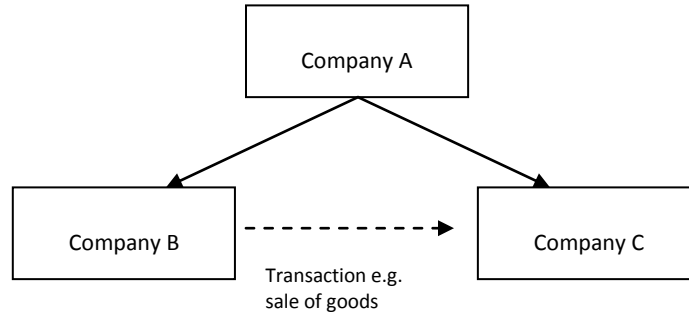
- 4.3 Paragraph 154(1)(ed), also introduced with effect 1.1.2009, empowers the Minister of Finance to provide for the scope and procedure relating to the implementation and facilitation of section 140A by way of the Income Tax (Transfer Pricing) Rules 2012.

## **5. MEANING OF CONTROL AND ASSOCIATED**

- 5.1 Section 139 of the ITA refers to 'control' as both direct and indirect control. The interpretation of related companies or companies in the same group (referred to in the context of holding and subsidiary companies) is provided for under subsection 2(4) of the same Act.
- 5.2 Under the Guidelines, two companies are associated companies with respect to each other if one of the companies participates directly or indirectly in the management, control or capital of the other company; or the same persons participate directly or indirectly in the management, control or capital of both companies.

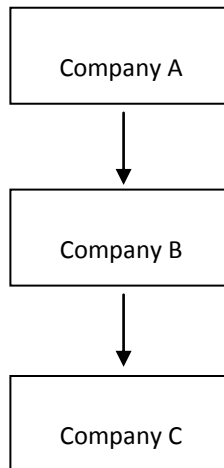
Examples of control and associated persons:

### Example 1

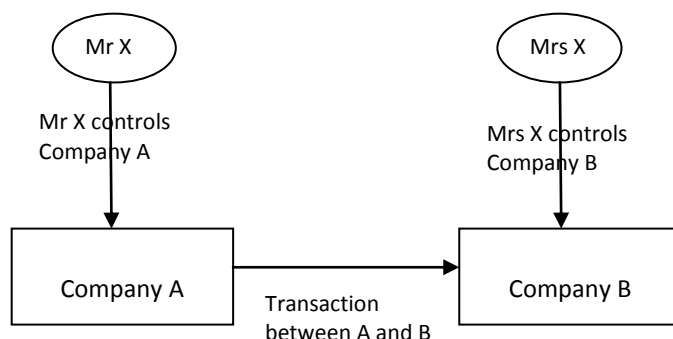


In this example, Company A controls Company B and Company C through share ownership. As Company A controls both Company B and Company C, Companies B and C are associated enterprises. Therefore, transfer pricing laws apply to transactions between the two.

### Example 2



Company A controls Company B, which in turn controls Company C. Company A thus indirectly controls Company C, transfer pricing laws thus apply to transactions between them.

**Example 3**

The Act provides that transactions between Company A and Company B are deemed controlled transactions due to the relationship between Mr X and Mrs X.

**PART II****THE ARM'S LENGTH PRINCIPLE****6. MEANING OF ARM'S LENGTH PRINCIPLE**

6.1 The arm's length approach, which is internationally accepted as the preferred basis for determining the transfer price of a transaction between associated persons, will be the basis adopted by IRBM. This is consistent with the objective of minimizing the possibility for double taxation. According to the arm's length principle, a transfer price is acceptable if all transactions between associated parties are conducted at arm's length price. Arm's length price is the price which would have been determined if such transactions were made between independent entities under the same or similar circumstances.



- 6.2 The arm's length principle is stated in paragraph 1 of Article 9 of the OECD Model Tax Convention as:

"Where . . . conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

- 6.3 When associated persons enter into a transaction, the element of control which one party has over the other may exist. Under this circumstance, bargaining power rarely come into play. Unlike independent companies, multinational enterprises (MNEs) usually operate based on its own set of conditions which normally do not reflect the market forces. While independent enterprises are concerned with maximising individual profits, by aiming for the lowest costs and highest returns, MNEs are concerned with overall group profits which may result in unequal distribution of profits within the group.
- 6.4 An example to illustrate the difference between controlled and uncontrolled transactions is as follows:

Company A purchases raw material to make furniture. Under an arm's length transaction, Company A would make the best effort to obtain its raw material at the lowest price possible in order to minimise its costs and maximise its profits. This will entail extensive bargaining between Company A and its suppliers.

However, there usually exist elements of control that dictate the price and manner in which raw material is to be purchased in a controlled transaction. The likelihood of bargaining for the best price is minimal, and Company A may be expected to accept the price as dictated by its controlling entity. It is not impossible to witness prolonged losses in cases like Company A that have little say in the price it is willing to pay for raw material.

6.5 In essence, the application of the arm's length principle:

- (i) treats associated persons not dealing at arm's length as if they operate as separate entities rather than as inseparable parts of a single unified business; and
- (ii) is generally based on a comparison of:
  - a. prices, margins, division of profits or other indicators of controlled transactions; with
  - b. prices, margins, division of profits or other indicators of uncontrolled transactions.

## **7. DETERMINATION OF ARM'S LENGTH PRICE**

The determination of an arm's length price involves the following steps which are interrelated and listed in no particular order:

### **7.1 Analysis of transactions and functions**

Functional analysis is an understanding of the related party transactions, business operations, functions performed, assets employed and risks assumed to determine the characterization of the taxpayer's business. A detailed discussion of this is in section 9.

## 7.2 Characterization of business

Characterization is an important element in the steps towards determining the arm's length price of a controlled transaction. The most common characterisations, based on the nature of activity as well as the complexity of the operations, are:

- (i) manufacturing: full-fledged, licensed, contract or toll;
- (ii) distribution: full-fledged, limited risk;
- (iii) service provider.

## 7.3 Identification of comparable transactions

As part of the exercise of establishing an arm's length price, it is important to decide the level at which transactions are compared. The level of transaction is determined based on what is being used to compare, whether:

- (i) to compare a single transaction (e.g. the sale price and terms of sale of particular product);
- (ii) to compare a bundle of transactions;
- (iii) to compare results at gross margin level;
- (iv) to compare results at net margin level; or
- (v) to compare results by reference to some other measures, such as return on capital, ratio of costs to gross margin, etc.

The most appropriate comparables should be selected in adherence to the five factors of comparability as discussed in sections 8 and 9 of the Guidelines.

## 7.4 Tested Party

The determination of a controlled transaction leads to the determination of the tested party. As a general rule, the tested party is the one to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found. In the Malaysian scenario, the IRBM gives priority to the availability of sufficient and verifiable information on both tested party and comparables. As such, IRBM does not accept foreign tested parties where information is neither sufficient nor verifiable.

## 7.5 Selection and application of Transfer Pricing Methodologies (TPM)

The Rules have prescribed for specific methods to be used in arriving at the arm's length price as discussed in section 11 of the Guidelines.

## 7.6 Profit Level Indicator (PLI)

7.6.1 In applying the TPM, due consideration must also be given to the choice of PLI which measures the relationship between profits and sales, costs incurred or assets employed. The use of an appropriate PLI ensures greater accuracy in determining the arm's length price of a controlled transaction. PLI is presented in the form of a ratio i.e. financial ratios or return on capital employed. Just as in the selection of transfer pricing methods, the choice of an appropriate PLI depends on several factors, including:

- (i) characterization of the business;
- (ii) availability of reliable comparable data; and
- (iii) the extent to which the PLI is likely to produce a reliable measure of arm's length profit.

7.6.2 Some of the more commonly used PLI include:

- (i) Return on costs: cost plus margin and net cost plus margin.
- (ii) Return on sales: gross margin and operating margin.
- (iii) Return on capital employed: return on operating assets.

## **8. COMPARABILITY ANALYSIS**

8.1 A comparability analysis is a pre-requisite in the application of all transfer pricing methods that conform to the arm's length principle. This involves comparing conditions in a controlled transaction with those in an uncontrolled transaction.

8.2 A controlled transaction in a comparability analysis is the transaction that has been identified as the transaction where pricing may not be arm's length. An uncontrolled transaction may be:

- (i) a transaction between the tested party and an independent party conducted under terms and circumstances similar to the controlled transaction (internal comparable); or
- (ii) a transaction between two independent parties under similar terms and circumstances (external comparable).

8.3 An uncontrolled transaction is deemed comparable if the following five factors of comparability of that transaction with that of a controlled transaction are sufficiently similar:

- (i) Characteristics of the property or services;
- (ii) Functions performed, assets employed and risks assumed by the respective persons;
- (iii) Contractual terms;

- (iv) Economic circumstances; and
- (v) Business strategies.

8.4 In order to be deemed comparable, the following conditions must be met where there are differences between an uncontrolled transaction and a controlled transaction:

- (i) none of the differences between the transactions being compared or between the enterprises undertaking those transactions could materially affect the margins in an open market; or
- (ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

## **9. FACTORS DETERMINING COMPARABILITY**

### **9.1 Characteristics of Property or Services**

Similarity in product characteristics is more relevant when comparing prices rather than profit margins between controlled and uncontrolled transactions. Comparison of product characteristics is used to a greater extent in the application of the Comparable Uncontrolled Price (CUP) method than any other method. Characteristics that are compared should include:

- (i) in the case of tangible property: the physical features, quality and the volume of supply of property;
- (ii) in the provision of services: the nature and extent of services; and
- (iii) in the case of intangible property: the form of transaction (e.g. licensing or sale), type of property (e.g. patent, trademark or know how), the duration and degree of

protection; and the anticipated benefits from the use of property.

## 9.2 Functional Analysis of Functions Performed, Risks Assumed and Assets Employed

A functional analysis is a crucial process in determining an arm's length price as it forms the basis for identifying comparables. It involves the determination of how functions, assets (including intangible property) and risks in a business are divided up between parties involved in the transactions under review. Thus, a functional analysis serves three important purposes:

- (i) to provide an overview of the organization and its business operations;
- (ii) to identify the functions performed, risks assumed and assets employed by both the associated and independent persons, and
- (iii) to assess important and economically significant functions, risks and assets undertaken by both the associated and independent persons.

### 9.2.1 Functions

(a) Functions are activities performed by each person in business transactions such as procurement, marketing, distribution and sales. The principal functions performed by the associated person under examination should be identified first. Any increase in economically significant functions performed should be compensated by an increase in profitability of the person.

(b) Usually, when various functions are performed by a group of independent persons, the party that provides the most effort and, more particularly, the rare or unique functions would earn the most profit. For example, a distributor performing additional marketing and advertising function is expected to have a higher return from the activity than if it did not undertake these functions.

(c) It is thus relevant to consider the relative importance of each function in a functional analysis. The sheer number of functions performed by a particular member of a multinational group does not necessarily mean that it should derive the greater share of the profit. A party performing the most, or more, economically significant functions of the group's operations, albeit fewer functions relative to the other associated person, should be entitled to the greater share of the profit.

### 9.2.2 Assets

In comparing functions performed, it is also important to identify and consider the assets (tangible and intangible) that are employed, or are to be employed, in a transaction. This includes the analysis of the type of assets used (e.g. plant and equipment and valuable intangibles) and the nature of the assets used (e.g. the age, market value, location, and property right protections available).

#### (a) **Tangible assets employed**

Tangible assets such as property, plant and equipment are usually expected to earn long-term returns that commensurate with the business risks assumed. Profitability of a company should rightfully increase with the increase in the amount, as well as the degree, of specificity of assets employed. Quantifying these amounts whenever



possible helps determine the level of risks borne and the level of profit a company should expect.

(b) **Intangible assets employed**

Intangible assets are also expected to generate returns for the owners by way of sales or licensing. It is thus essential to identify the parties to whom the returns generated are attributable.

9.2.3 **Risks**

Evaluation of risks assumed is crucial in determining arm's length prices with the economic assumption that the higher the risks assumed, the higher the expected return. Controlled and uncontrolled transactions are not comparable if there are significant differences in the risks assumed, for which appropriate adjustments cannot be made.

(a) **Types of risks include:**

- (i) Operational risk (including risks for manufacturing liability, systems failure, reliability of suppliers, inventory and carrying costs, environmental and other regulatory risks);
- (ii) Market risk (including industrial risks, country political risks, reliability of customers and fluctuation in demand and prices);
- (iii) Product risk (including product liability risk, warranty risk / costs and contract enforceability);
- (iv) Business risks related to ownership of assets or facilities;
- (v) Financial risk (including currency, commodity, interest rate and funding risks);

- (vi) Credit and debt collection risks (including delay or default in payment of trade receivables, default on guaranties, loans and other receivables); and
- (vii) Risks of the success or failure of investments in research and development.

(b) **Allocation of risks**

The allocation of risks between associated persons should be based on functions performed. A functional analysis helps identify important risks, as well as differentiate between the party which bears and controls the risks in the legal contractual terms and the party which bears the risks based on the economic substance of the transaction.

As previously mentioned, the assumption is that in an open market, an increased risk will be compensated by an increase in the expected return. However, this does not always mean that the actual return must necessarily also be higher, as it also depends on the degree to which the risk actually realizes.

**Example 4**

A distributor that serves merely as an agent, and is reimbursed on its expenses, would receive the income appropriate to that lower risk activity as opposed to one that takes on full marketing and advertising responsibilities to promote a product. Similarly, a contract manufacturer or a contract research provider that assumes minimal risk would be entitled to a smaller return than if it had assumed the full risk.

(c) **Consistency of risk allocation with economic substance**

Allocation of risk must also be consistent with the economic substance of a transaction. The best evidence, in determining whether a purported allocation of risk is consistent with the economic substance of a transaction, is in the parties' conduct.

An additional factor to consider in examining the economic substance of a purported risk allocation is the consequence of such an allocation in an arm's length transaction. In an arm's length dealing, it generally makes more commercial sense for one party to be allocated a greater share of those risks over which they have relatively more control and from which they can insulate themselves less costly than the other party.

**Example 5**

M enters into a contract to produce and ship components to S Co at the discretion of S Co. As a toll manufacturer, M is remunerated to carry out instructions given by S Co. In an independent situation, M would not assume inventory risk where it has no control over it. S Co, as the party that has control over the inventory should assume the risk.

**Example 6**

**(General Example of a functional analysis)**

P, a resident of country M, is responsible for the design and development of a branded audio product. P sets up a subsidiary, S, in country C which manufactures the product. S sells 100% to P, and the goods are warehoused by P until they are sold to independent parties.

A functional analysis, as demonstrated below, suggests that most of the profits should go to P as it performs the most important functions i.e. functions that actually generate profit. None of the functions performed by S Co is sufficiently significant in the overall operation to justify a larger share of the profit. Note that the number of functions performed is not a determining factor.

*The party performing a function is indicated by “✓”*

	<b>P</b>	<b>S</b>
<b>Functions performed</b>		
Design and development of product	✓	
Sourcing of material	✓	
Manufacturing and packaging		✓
Warehousing	✓	
Sales and marketing	✓	
Logistics	✓	✓
Provision of technical services	✓	
<b>Assets employed</b>		
Property, Plant and equipment	✓	✓
Intangibles	✓	
<b>Risks assumed</b>		
Product risk	✓	
Market risk	✓	
Credit and Collection risks	✓	
Operational risk	✓	✓
Forex risk	✓	✓

### 9.3 Contractual terms

Contractual terms are relevant in determining the comparability of a controlled and uncontrolled transaction as they may influence the price or margin of a transaction. Allocation of responsibilities, risks and benefits between enterprises are normally defined in a contract agreement. Any differences between the contractual terms of the transactions being examined would need to be adjusted in determining an arm's length price

for the controlled transaction. The terms and conditions in a contract may include:

- (i) the form of consideration charged or paid;
- (ii) sales or purchase volume;
- (iii) the scope and terms of warranties provided;
- (iv) rights to updates, revisions or modifications;
- (v) the duration of relevant licenses, contracts or other agreements, and termination or renegotiation rights;
- (vi) collateral transactions or ongoing business relationships between the buyer and the seller, including arrangements for the provision of ancillary or subsidiary services; and
- (vii) terms of credit and payment.

#### 9.4 Economic Circumstances

Arm's length prices vary across different economic circumstances. Factors that may affect the price or margin of a transaction include:

- (i) the geographic location of the market;
- (ii) the size of the market;
- (iii) the extent of competition in the markets;
- (iv) the level of supply and demand in the market as a whole and in particular regions;
- (v) customer purchasing power;
- (vi) cost of production including the costs of land, labour and capital, and transport costs;
- (vii) the level of the market (e.g. retail or wholesale);
- (viii) the date and time of transactions;
- (ix) the availability of substitute goods and services; and
- (x) the extent of government intervention e.g. whether goods compared are price controlled.

**Example 7**

An analysis of the local market in Country D indicates that gross margin paid to distributors of product X is 20%. However, this does not necessarily mean that 20% is also an appropriate gross margin for Malaysian distributors of product X. Margins in different markets are influenced by factors such as consumer preferences which would affect the retail price of the goods, and relative competitiveness of the distribution sector which would affect the margin received.

**9.5 Business Strategies**

Business strategies adopted by an enterprise influence the price charged for a product. In a comparability analysis, it is necessary to evaluate whether an independent person in the same circumstances as that of a controlled person would have adopted similar strategies and if so, what rewards would have been expected. Business strategies that are relevant in determining comparability include innovation and new product development, degree of diversification, market penetration schemes, distribution channel selection, market level and location.

**10. COMPARABILITY ADJUSTMENT**

10.1 Comparability adjustment is an important element of comparability analysis that, when applied appropriately, enhances the accuracy and reliability of comparison. Differences between the transaction of the comparables and that of the tested party must be identified and adjusted for, in order for the comparables to be useful as basis for determining the arm's length price.

10.2 Comparability adjustments are intended to eliminate the effects of differences that may exist between situations being compared and that which could materially affect the condition being examined in the methodology (e.g. price or margin). Logically, comparability adjustments should not be performed to correct differences that have no material effect

on the comparison. Thus, these adjustments are neither routine nor mandatory in a comparability analysis; rather, improvements to comparability should be shown when proposing an adjustment. Comparability adjustments include accounting adjustments and function/risk adjustments.

10.3 Adjustments need to be considered with much caution, on a case-by-case basis, and should only be applied to good quality comparables in light of information available in order to improve their accuracy. The following should be avoided as they do not improve comparability:

- (i) adjustments that are questionable when the basis for comparability criteria is only broadly satisfied;
- (ii) too many adjustments or adjustments that too greatly affect the comparable as it indicates that the third party being adjusted is in fact not sufficiently comparable;
- (iii) adjustments on differences that do not materially affect the comparability;
- (iv) highly subjective adjustments, such as on the difference in product quality.

## **PART III METHODOLOGIES**

### **11. TRANSFER PRICING METHODOLOGIES**

The following methodologies can be used in determining arm's length price:

- i. Comparable uncontrolled price method
- ii. Resale price method
- iii. Cost plus method
- iv. Profit split method
- v. Transactional net margin method

The first three methods are commonly known as 'traditional transactional methods'. Although the taxpayer is given the right to choose any method, the emphasis should be on arriving at an arm's length price. It is advised that methods (iv) and (v), commonly referred to as 'transactional profit methods', be used only when traditional transactional methods cannot be reliably applied or exceptionally cannot be applied at all. This will depend heavily on the availability of comparable data. The method that requires the fewest adjustments and provides the most reliable measure of an arm's length result is preferred by the IRBM as this will reduce the scope and nature of future disputes. Therefore, in deciding the most appropriate method, the following must be considered:

- (a) The nature of the controlled transaction, determined by conducting a functional analysis,
- (b) The degree of actual comparability when making comparisons with transactions between independent parties;
- (c) The completeness and accuracy of data in respect of the uncontrolled transaction;
- (d) The reliability of any assumptions made; and



- (e) The degree to which the adjustments are affected if the data is inaccurate or the assumptions incorrect.

Where both the traditional transactional method and transactional profit method cannot be applied at all, the Director General may allow the application of other methods provided the prices arrived at is in accordance with the arm's length principle.

### 11.1 Comparable Uncontrolled Price Method (CUP)

The CUP method is the most direct way of ascertaining an arm's length price. It compares the price charged for a property or services transferred in a controlled transaction to the price charged for a property or services transferred in a comparable uncontrolled transaction, in comparable circumstances. A difference between the two prices may be an indication that the conditions of the commercial and financial relations of the associated persons are not arm's length, and that the price in the uncontrolled transaction may need to substitute for the price in the controlled transaction.

The method is ideal only if comparable products are available or if reasonably accurate adjustments can be made to eliminate material product differences. Other methods will have to be considered if material product differences cannot be adjusted to give a reliable measure of an arm's length price.

#### 11.1.1 **Comparability Analysis**

A MNE using the CUP method to determine its transfer price must first identify all the differences between its product and that of an independent person. The MNE must then determine whether these differences have a material effect on the price, and adjust the price of

products sold by the independent person to reflect these differences to arrive at an arm's length price.

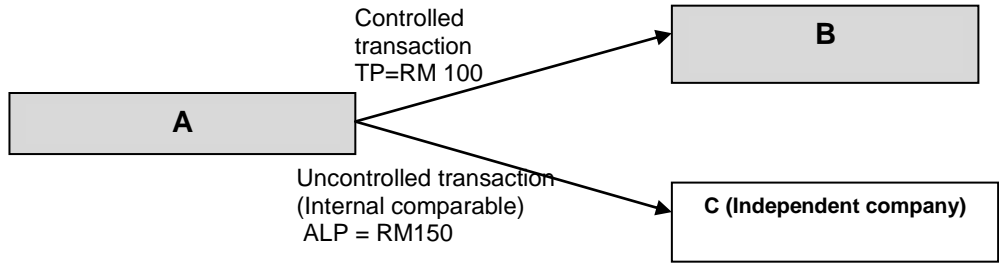
A comparability analysis under the CUP method should consider amongst others the following:

- (a) Product characteristics such as physical features and quality.
- (b) If the product is in the form of services, the nature and extent of such services provided.
- (c) Whether the goods sold are compared at the same points in the production chain.
- (d) Product differentiation in the form of patented features such as trademarks, design, etc.
- (e) Volume of sales if it has an effect on price.
- (f) Timing of sale if it is affected by seasonal fluctuations or other changes in market conditions.
- (g) Whether costs of transport, packaging, marketing, advertising, and warranty are included in the deal.
- (h) Whether the products are sold in places where the economic conditions are the same.

11.1.2 CUP may be identified from either an internal comparable transaction or an external comparable transaction as shown in the following examples:

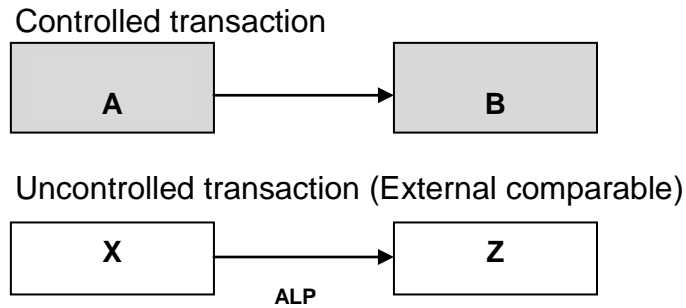
**Example 8**

Taxpayer A, a MNE, sells 60% of its product to an associated company B, at a price of RM100 per unit. At the same time, the remaining 40% of that product is sold to an independent enterprise C at RM150 per unit.



The products sold to B and C are the same, and the transaction between A and C may be considered as a comparable uncontrolled transaction. However, a functional analysis of B and C must first be carried out to determine any differences. If there are differences, adjustments must be made to account for these differences. Adjustments must also be made to account for product quantity discounts since volume of sales to B and C are different. Assuming there are no material differences that require adjustments to be made, the CUP method may be applied using the unit price of RM150 as a comparable arm's length price.

**Example 9**



Manufacturer A exports its product to associate company B. Manufacturer X exports the same product, in similar quantities and under similar terms to company Z, an independent party operating in similar markets as B. The uncontrolled sales price is a delivered price whereas the controlled sales are made FOB factory. These differences in terms of transportation and duties have an effect on price. Therefore, adjustments should be made on the uncontrolled transaction to eliminate the differences.

Selling price X to Z		RM 150
less:		
Adjustment for freight	RM 10	
Adjustment for duties	RM 5	
Total adjustments		<u>15</u>
Arm's length price A to B		RM <u>135</u>

### 11.2 Resale Price Method (RPM)

The resale price method is generally most appropriate where the final transaction is with an independent distributor. The starting point in the resale price method is the price at which a product that has been purchased from an associated enterprise is then resold to an independent enterprise. This price (the resale price) is then reduced by an appropriate gross margin (the resale price margin) representing an amount from which the reseller would seek to cover its selling and other operating expenses and in the light of functions performed (taking into account assets used and risks assumed), make an appropriate profit. An arm's length price for the original transaction between associated enterprises is obtained after subtracting that gross margin, and adjusting for other costs associated with the purchase of the product (e.g. custom duties). A typical adjustment may be represented as follows:

**Arm's length price** = Resale price – ( Resale price x Resale price margin )

Where:

\* Resale price margin =  $\frac{\text{Sales price} - \text{Purchase Price}}{\text{Sales Price}}$

\* Resale price margin must be comparable to margins earned by other independent enterprises performing similar functions, bearing similar risks and employing similar assets

As shown in the formula, the focus is on the resale price margin. This margin should ideally be established from comparable transactions between the reseller (involved in the controlled transaction) and other independent parties. In the absence of such transactions, the resale price margin may be determined from sales by other resellers in the same market. The resale price margin is expected to vary according to the amount of value added by the reseller. The factors that may be contributed to the value added depend on the level of activities performed by the reseller.

#### 11.2.1 Comparability Analysis

In making comparisons for purposes of RPM, the focus is more on functions performed compared to product characteristics. Factors which may influence the resale price margin and other considerations when performing a comparability analysis include:

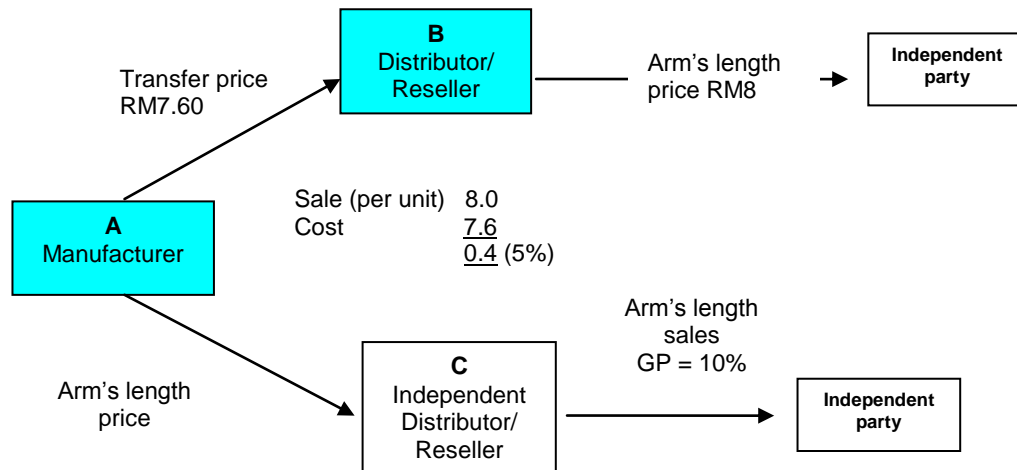
- (a) The functions or level of activities performed by the reseller: whether only performing minimal services to taking on full ownership and responsibility for the risk involved in the transactions e.g. whether the reseller is merely a forwarding agent or a distributor who assumes full responsibility for marketing and advertising the product by risking its own resources in these activities;
- (b) The degree of added value or alteration the reseller has done before the product is resold. The method is difficult to apply if the product has gone through a substantial number of processes;
- (c) Employment of similar assets in the controlled and uncontrolled transactions e.g. a developed distribution network;
- (d) Although broader product differences are allowed as compared to the CUP method, product similarities are still significant to

some extent particularly when there is a high value or unique intangible attached to the product;

- (e) If the resale price margin used is that of an independent enterprise in comparable transaction, differences in the way business is managed may have an impact on profitability;
- (f) A resale price margin will be more accurate if it is realized within a short time lapse between original purchase and the resale of the product as a longer time lapse may give rise to changes in the market, exchange rates, costs etc.;
- (g) Whether the reseller is given exclusive rights to resell the products;
- (h) Differences in accounting practices, where adjustments must be made to ensure that the components of costs in arriving at gross margins in the controlled and uncontrolled transactions are the same.

### **Example 10**

Taxpayer **B**, a **distributor**, is a Malaysian subsidiary of multinational **A**, which is located overseas. **B** distributes high quality product manufactured by **A**. **A** also sells similar product of a lower quality to an independent distributor **C** in Malaysia. The cost of product purchased from **A** by **B** is RM 7.60 per unit. **B** resells the product to independent party for RM8. A functional analysis shows that **B** and **C** perform similar functions. The gross profit ratio of **C** was found to be 10%.



In this example, it is noted that there are product (quality) differences when comparing the controlled and uncontrolled transactions. However, since the focus of comparison is on margins the differences are not as material as they would have been if the basis of comparison were on prices. Furthermore, **B** and **C** carry out similar functions (**C** being another reseller in the same market), thus the resale price margin of 10% will be used as a basis to determine the arm's length price for the original purchase by **B** from **A**.

$$\begin{aligned} \text{Arm's length price of product purchased (in RM)} &= 8 - (8 \times 10\%) \\ &= \text{RM } 7.20 \end{aligned}$$

### Example 11

Using similar facts in example 10, assume now that there are the following differences between the controlled and uncontrolled transactions:

- B bears warranty risk but C does not, as the risk is borne by A; and
- A provides samples and promotional materials to C free of cost while B produces its own promotional materials and bears the related costs.

The two margins are not comparable until an adjustment is made to account for these differences.

**Calculation of adjusted resale price margin:**

Distributor B net sales to independent customer	RM 8.00
Arm's length resale price margin of C (%) is	10%
Therefore,	
<b>Arm's length resale price margin for B (10% x RM 8.00) =</b>	<b>RM0.80</b>

Adjustments for functional and risk borne by B:

Promotional costs	RM 0.10
Warranty costs	RM 0.20
Total Adjustments	<u>RM0.30</u>
Adjusted resale price margin for B	<u><b>RM1.10</b></u>

**Calculation of Arm's Length Price of A to B**

Distributor B net sales to independent customer	RM	8.00
Less: adjusted resale price/gross margin		<u>1.10</u>
Arm's length transfer price of A to B	RM	<u><b>6.90</b></u>

11.3 Cost plus Method (CPM)

11.3.1 The cost plus method is often useful in the case of semi-finished goods which are sold between associated persons, or when different companies in a multinational group have concluded joint facility agreements or when the manufacturer is a contract manufacturer or where the controlled transaction is the provision of services.



11.3.2 The starting point in a cost plus method, in the case of transfer of products between associated persons, is the cost to the supplier. An appropriate mark-up is added to this cost to find the price that the supplier ought to be charging the buyer. The appropriate mark-up should ideally be established by reference to the mark-up earned by the same supplier from comparable uncontrolled sales to independent parties. This is due to the fact that similar characteristics are more likely found among sales of product by the same supplier, than among sales by other suppliers. If no such transactions exist, the appropriate mark-up may be determined based on comparable transactions by independent parties operating independently. If there are material differences between the controlled and uncontrolled transaction that could affect the gross profit mark-up, appropriate adjustments must be made on the gross profit mark-up earned in the uncontrolled transaction.

Formula for arm's length price in CPM:

**Arm's length price** = Costs + (Cost x Cost plus mark-up)

Where:

\*Cost plus mark-up =  $\frac{\text{Sales price} - \text{Costs}}{\text{Cost}}$

\*Cost plus mark-up must be comparable to mark-ups earned by independent parties performing comparable functions, bearing similar risks and using similar assets.

### 11.3.3 Comparability Analysis

Comparability when applying the cost plus method should take into account similarity of functions, risks assumed, contractual terms, market conditions, business strategies as well as any adjustments

made to account for the effects of any differences in the aforementioned factors between the controlled and uncontrolled transactions. As with the resale price method, fewer adjustments are needed to account for product differences compared to the CUP method.

#### 11.3.4 Cost Structure Consideration

- (a) The method used in determining costs and the accounting policies should be consistent and comparable between the controlled and uncontrolled transaction, and over time in relation to the particular enterprise. The costs referred to in the cost plus method is the aggregation of direct and indirect costs of production. Usage of other costs must be well justified and may be considered only if they result in a more accurate estimate of the appropriate margin. In computing costs, the practice must be in accordance with generally accepted principles or normal accounting standards in Malaysia.
- (i) Direct costs are costs identified specifically with a particular activity including compensation, bonuses, travelling expenses of employees directly engaged in performing such activity, or materials and supplies consumed in providing the activity. In determining the cost base incurred in providing an activity, costs that do not relate to the service under consideration must be excluded and the costs must be consistent with those incurred in comparable transactions.
- (ii) Indirect costs are costs not specifically attributable to a particular activity but nevertheless relate to direct costs or relate to the process of the activity. These include utilities, rental, supervisory and clerical compensation and other

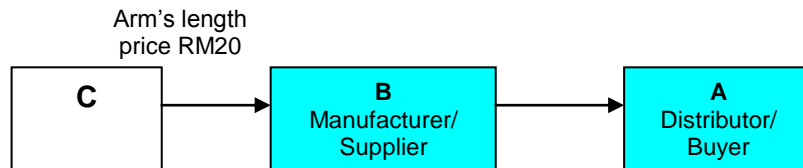
overhead costs of the department incurring the direct costs. Indirect costs also include an appropriate share of costs of the supporting units and departments (e.g. accounting and secretarial units etc).

- (b) The determination of costs is important in the application of CPM where the comparable mark up is to be applied to a comparable cost basis. For example, an independent supplier who leases its business assets may not be comparable to a supplier in a controlled transaction who owns its assets. Adjustments must be made to eliminate the differences in these costs.
- (c) It is also important to consider differences in the level and types of expenses (operating and non-operating expenses including financing expenditures) related to the functions performed and risks assumed by the parties or transactions being compared. Consideration of these differences may indicate the following:
  - (i) If expenses reflect a functional difference which has not been taken into account in applying the method, an adjustment to the cost plus mark-up may be required;
  - (ii) If the expenses reflect additional functions that are distinct from the activities tested by the method, separate compensation for those functions may need to be determined. Such functions may for example amount to the provision of services for which an appropriate reward may be determined. Similarly, expenses that are the result of capital restructures reflecting non-arm's length arrangements may require separate adjustment;

- (iii) If differences in the expenses of the parties being compared merely reflect efficiencies or inefficiencies of an enterprise, as would normally be the case for supervisory and general and administrative expenses, adjustments to the gross margin may be inappropriate.

**Example 12**

Taxpayer B is a Malaysian subsidiary of foreign multinational A. B manufactures electrical components which it exports to A. The electrical components are specially tailored to meet the requirements of A. All raw materials used in the manufacture of the product are purchased from an independent enterprise C, at RM20 per unit. The total cost per unit of manufactured product is RM80. B then sells the product to A at a price of RM100 per unit at a mark-up of 25%. An independent manufacturing company, performing the same functions, bearing similar risks and using similar assets, selling to another independent company is found to have a mark-up on cost of 40%.



Sales		100
Purchases	20	
Mfg Cost	50	
Overheads	<u>10</u>	<u>80</u>
G.P		<u>20</u>

Since B’s product is highly customised, there are no product comparables available. The mark-up of 40% of the other

independent manufacturing company can thus be used as a basis in arriving at arm's length price. Arm's length price of electrical component sold to A by B (in RM)

$$= 80 + (80 \times 40\%) = \mathbf{112}$$

### Example 13

Company A manufactures customised moulds for independent parties using designs supplied by independent parties earning a cost plus mark-up of 10%. Under these arm's length agreements, **costs** are defined as the sum of direct costs (i.e. labour and materials) plus estimated indirect costs (estimated to be 40% of the direct costs).

$$\begin{array}{l} \text{Cost} = \text{Direct} \quad + \text{Estimated} \quad (40\% \text{ Direct Costs}) \\ \quad \quad \text{Costs} \quad \quad \quad \text{Indirect Costs} \end{array}$$

Company A also manufactures moulds for an affiliate, F, using designs supplied by F. Under the agreement with F, **costs** are defined as the sum of direct costs plus actual indirect costs.

$$\begin{array}{l} \text{Cost} = \text{Direct} \quad + \text{Actual} \quad \text{Indirect} \\ \quad \quad \text{Costs} \quad \quad \quad \text{Costs} \end{array}$$

Calculation done based on this agreement shows that actual indirect cost is equivalent to 30% of direct cost for each project. In order to determine the appropriate mark-up for A's transaction with F, the cost base of its transaction with the independent parties need to be restated.

The transfer price is calculated as follows:

**Original calculation under the arm's length agreement:**

Direct costs	RM	1,000
Indirect costs (40% × RM1,000)		<u>400</u>
Total costs	RM	1,400
Mark-up 10%	RM	<u>140</u>
Price	RM	<u>1,540</u>

**Recalculation of mark-up under the arm's length agreements using restated costs:**

Direct costs	RM	1,000
Indirect costs (30% × RM1,000)		<u>300</u>
Total costs	RM	<u>1,300</u>
Price established above	RM	<b>1,540</b>
Mark-up based on restated costs (RM1,540 - RM1,300)	RM	240
Gross mark-up based on restated costs =RM240/RM1,300 = <b>18.5%</b>		

**Therefore, the arm's length transfer price between A and F:**

Direct cost	RM	900
Add:		
Indirect costs (30% × RM900)		270
Mark-up (18.5% × (RM900 + 270))		<u>216</u>
Arm's Length Price RM		<u><b>1,386</b></u>

This example illustrates how the cost base of a tested party and the comparable transaction must be expressed in equivalent terms. For purposes of this example, it has been assumed that the transactions between A and the independent parties are functionally comparable to the transactions between A and F. Under normal circumstances, there may be functional differences, such as marketing, that should be given consideration when determining the arm's length mark-up.

#### 11.4 Transactional Profit Method

Transactional profit methods examine profits that arise from controlled transactions among associated persons. The profit methods that satisfy the arm's length principle are those that are consistent with the **transactional profit split method** or the **transactional net margin method** (TNMM) as described in these Guidelines.

##### 11.4.1 Transactional Profit Split Method

- (a) The transactional profit split method provides an alternative solution for cases where no comparable transactions between independent parties can be identified. This would normally happen when transactions are highly integrated that they cannot

be evaluated separately. Profit split method is based on the concept that the combined profits earned in a controlled transaction should be equitably divided between associated persons involved in the transaction according to the functions performed. To arrive at an arm's length price, the value of the contributions that each associated person makes to the transaction is assessed based on how independent persons would split the profits among them under similar circumstances.

Two approaches for estimating the division of profits (projected or actual) are described in the following paragraphs. These approaches are neither exhaustive nor mutually exclusive:

(i) **Residual profit split approach**

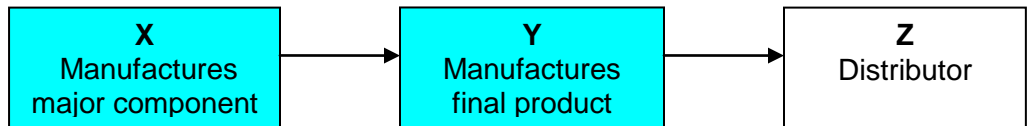
This approach is the most appropriate method in cases where both parties to a transaction contribute significant unique intangibles. There are two stages of profit division under this approach. First, the combined profit is apportioned according to basic returns assigned to each party to the transaction. These returns are based on the basic, non-unique, functions that each party performs, and are determined by reference to market returns obtained by independent parties in similar transactions. This basic return would generally not account for the return that would be generated by any unique and valuable assets owned by the participants. The next stage involves the allocation of the remaining residual profit/loss, also with reference to how independent parties in similar circumstances would have divided such residuals.



The following example demonstrates the application of the residual profit split approach:

**Example 14**

**X**, **Y** and **Z** are companies located in different countries. Company **X** designs and manufactures the major components of a high quality electrical product which it sells to its subsidiary **Y**. From these components, **Y** further develops and manufactures them into the final product which it exports to **Z**, an independent distributor.



The trading accounts of **X** and **Y** is as follows:

	<b>X</b>	<b>Y</b>
Sales	100	300
Purchases	15	100
Manufacturing cost	<u>20</u>	<u>35</u>
Gross profit	65	165
R&D	20	15
Other operating expenses	<u>15</u>	<u>10</u>
Net profit	30	140

The final product in the transaction happens to be a unique product for which there is no comparable. However, research indicates that there are several companies that carry out similar functions to that of **X** and **Y** involving similar semi-finished and final products, of a much lower quality. The average net mark-ups for these independent companies involved in transactions similar to **X** and **Y** is 30% and 20% respectively.

## Application of Residual Profit Split Approach

In the above example, the CUP method cannot be used due to the uniqueness of the final product. For the sake of simplicity, assume that there is insufficient data and information to apply the cost plus method, while the resale price method is inappropriate as the product has undergone substantial transformation at Y. The profit split method is adopted using the residual approach.

### (a) Residual analysis of the group profit

#### Calculation of total profit

Total Sales of transaction	300
Cost of goods sold (X)	35
Cost of goods sold (Y) [excluding purchases from X]	35
<b>Gross profit</b>	<b>230</b>
R&D	35
Other operating expenses	25
<b>Net profit</b>	<b>170</b>

#### Calculation of basic return

The mark-ups derived from external data will be used to calculate basic returns to X and Y.

i. Basic return to X = 30% of (COGS + Other operating expenses)

$$= 30\% \times (35+15) = 15$$

ii. The calculation of basic return to Y has to take into account the fact that the COGS for the comparable independent companies have included the purchase price for the semi-finished product. Since this is the

transfer price for Y, the basic return for Y will be a function of the transfer price i.e.

$$\begin{aligned}
 &= 20\% \text{ of } [(COGS - \text{purchase price}) + \text{other operating expenses} + \text{arm's length transfer price}] \\
 &= 20\% [(135 - 100) + 10 + TP] \\
 &= 20\% (35 + 10 + TP) \\
 &= 9 + 0.2TP
 \end{aligned}$$

(b) Residual profit split:

#### Calculation of residual profit

$$\begin{aligned}
 \text{Residual profit} &= \text{Net profit} - [(\text{Return to X}) + (\text{Return to Y})] \\
 &= 170 - [15 + (9 + 0.2TP)] \\
 &= 146 - 0.2TP
 \end{aligned}$$

Assume that in this case R&D is a reliable indicator of X and Y's relative contribution of an intangible asset, the residual profit may be split based on the relative R&D expenditure as follows:

	X	Y
R&D	20	15
Total R&D	35	35
R&D expenditure ratio	57%	43%

#### Calculation of residual profit split

$$\text{For X} = 57\% \text{ of } (146 - 0.2TP) = 83.22 - 0.114TP$$

$$\text{For Y} = 43\% \text{ of } (146 - 0.2TP) = 62.78 - 0.086TP$$

#### Net profit for X

$$\text{Basic return to X} = 15$$

$$\text{Residual return to X} = 83.22 - 0.114TP$$

$$\begin{aligned}
 \text{Total net profit for X} &= 15 + 83.22 - 0.114TP \\
 &= 98.22 - 0.114TP
 \end{aligned}$$

**Net profit for Y**

$$\text{Basic return to Y} = 9 + 0.2\text{TP}$$

$$\text{Residual return to Y} = 62.78 - 0.086\text{TP}$$

$$\begin{aligned} \text{Total net profit for Y} &= (9 + 0.2\text{TP}) + (62.78 - 0.086\text{TP}) \\ &= 71.78 + 0.114\text{TP} \end{aligned}$$

**Adjustment for transfer price between X and Y:**

Sales price of X (Assume X makes no profit)

$$= 100 - 30 = 70$$

Adjusted sales price (i.e. TP)

$$= 70 + \text{Adjusted net profit for X}$$

$$= 70 + 98.22 - 0.114\text{TP}$$

$$= 168.22 - 0.114\text{TP}$$

$$\text{TP} = 168.22/1.114 = 151$$

**Adjusted net profit:**

	<b>X</b>	<b>Y</b>
Sales	100	300
<b>Arm's length adjustment</b>	<b><u>51</u></b>	
Adjusted sales	<b>151</b>	
Purchases		100
	(15)	
<b>Adjustment</b>		<b><u>51</u></b>
<b>Adjusted purchases</b>		<b>151</b>
Manufacturing cost	(20)	(35)
<b>Adjusted gross profit</b>	<b>116</b>	<b>114</b>
R&D	20	15
Other operating expenses	15	10
<b>Adjusted net profit</b>	<b>81</b>	<b>89</b>

(ii) **Contribution analysis approach**

(a) The second approach under the Transactional Profit Method is the contribution analysis approach. Under this approach, combined profits would be divided between associated persons based on the relative value of functions (i.e. contribution) performed by each of the associated persons participating in a controlled transaction. To determine the relative value of contribution, it may be necessary to focus on the nature and degree of each party's contribution of differing types (e.g. provision of services, capital invested) and assign a percentage based on the relative comparison and external market data.

Unlike the residual approach, basic returns are not allocated to each party to the transaction before the profit split is made. Generally, the profit to be combined and divided is the operating profit. Where allocation of expenses to controlled transactions is impossible, a split of gross profits may be considered, after which expenses attributable to the relevant enterprises will be deducted accordingly.

However, it is difficult to determine the relative value of contribution that each of the participants makes to the controlled transactions, and the approach will often depend on the facts and circumstances of each case. Thus, the approach requires careful judgment and the criteria should always include what adds value to the transaction and how economically important were the functions carried out by each party in earning the profits.

(b) The division of combined profits under the transactional profit split method is achievable by the use of allocation keys. The choice of allocation keys by which profits are split largely depends on the facts and circumstances that surround a case. An allocation key can be in the form of a figure (e.g. a percentage) or a variable (e.g. specific expenses). Some of the more common types of allocation keys are:

- Asset-based: useful where the controlled transaction demonstrates strong correlation between assets and the creation of value;
- Cost-based: where there is clear indication of correlation between cost and value created;
- Time spent by employees performing intragroup services;
- Units produced or sold;
- Number of employees;
- Space used.

### **11.5 Transactional Net Margin Method (TNMM)**

The TNMM is similar to the cost plus and resale price methods in the sense that it uses the margin approach. This method is useful in instances where it is difficult to compare at gross profit margin such as in situations where different accounting treatments are adopted. The method examines the net profit margin relative to an appropriate base such as costs, sales or assets attained by a MNE from a controlled transaction. As with the cost plus or resale price methods, this margin should preferably be derived from comparable uncontrolled transactions between the same taxpayer and independent parties. If there are no comparable uncontrolled transactions involving that MNE, reference may be made to the net profit margin that

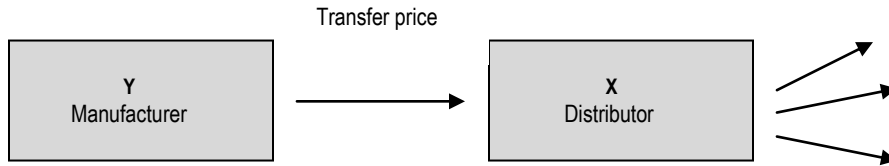
would have been earned in comparable transactions by an independent person. Functional analysis of the associated person as well as the independent person will have to be applied to determine comparability.

**11.5.1 Application of TNMM**

(a) Net margins (unlike gross margins or prices) tend to be significantly influenced by various factors other than products and functions (e.g. competitive position, varying cost structures, differences in cost of capital, etc). Therefore, where possible, the usage of TNMM should be confined to cases where these factors have a high degree of similarity, so as to eliminate the effects of these other conditions.

**Example 15**

X is a Malaysian subsidiary of Y, located overseas. Y manufactures computers, which it sells to X and other associated distributors in different countries. The computers distributed by X bear company Y’s trademark. X also provides technical support to all its customers.



**Trading account for X**

Sales	100,000
Cost of goods sold	90,000
Gross Profit	10,000
Operating expenses	15,000
Net loss	(5000)
Margin (Net Loss)	-5%

Assume that the CUP method is not applied as no reliable adjustments can be made to account for differences with similar products in the market; and the resale price method is not used as no comparable measurement of gross margin can be found due to differences in accounting practices amongst independent distributors. The TNMM is adopted on the basis of net profit return to sales. It was found that the net profit margin to sales earned in a comparable transaction by an independent person is 5%.

Adjustments on X will be as follows :

Net profit of X = 100,000 x 5% = **5,000**

**Adjusted cost of goods sold** = 100,000 – 15,000 – 5,000 = **80,000**

### **Example 16**

Company A manufactures plastic bags in Malaysia and exports them to its holding company overseas. The gross profit mark up with respect to its manufacturing operations is 15% while the cost of freight is reflected as operating cost.

Company B, another manufacturer of plastic bags in Malaysia, exports these plastic bags to independent parties overseas. The gross profit mark ups with respect to the manufacturing operations is 10%. However, unlike Company A, the freight cost is included in the cost of goods sold for B.

The cost plus method would require a comparability adjustment to the gross profit mark-up of company B to provide for accounting consistency. If the freight costs cannot be identified and there are no more reliable comparisons, it is necessary to examine the net margins.



## 11.6 Global Formulary Apportionment

IRBM does not accept methods based on global formulary apportionment on the basis that they are arbitrary and could not reliably approximate arm's length conditions. Global formulary apportionment refers to a method which uses a predetermined and mechanistic formula normally based on a combination of costs, assets, payroll and sales to allocate the global profits of an MNE group among associated enterprises in different countries.

## PART IV COMPARABILITY ANALYSIS

### 12. COMPARABLE PERIOD

12.1 Every taxpayer should endeavour to determine its transfer pricing for tax purposes in accordance with the arm's length principle, based upon information reasonably available at the time of the determination. Hence, the arm's length price should be determined by comparing the results of a controlled transaction with the results of uncontrolled transactions that were undertaken or carried out during the same year as the year of the taxpayer's controlled transaction.

12.2 This requirement is made on the basis that the arm's length principle must be complied with contemporaneously, on a year by year basis. A contemporaneous uncontrolled transaction should provide the most reliable comparable as it is carried out in an economic environment that is the same as or similar to the economic environment of the taxpayer's controlled transaction.

12.3 Depending on the industry concerned and the circumstances of the case, there may be cases where data in a particular financial year does not provide the most reliable comparison. For instance, if a tested party's

accounting period ends at 31 March 2010, data from a company in the same industry with a financial year end at 31 December 2009 is considered a better comparable to another company with financial year end at 31 December 2010. This is because the economic environment for the company with year ending 31 December 2009 would be more relevant to that of the tested party.

### **13. MULTIPLE YEAR DATA**

13.1 The purpose of analyzing multiple year data is to identify whether the outcome of a particular year is influenced by abnormal factors. However, the use of multiple year data does not imply the use of multiple year average.

13.2 In order to obtain a complete understanding of the facts and circumstances surrounding a controlled transaction, it is useful to examine data from both the years after the year under examination and prior years. The use of data from past years will show whether a taxpayer's reported loss on a transaction is part of a history of losses on similar transactions, a result of a particular economic condition in a prior year that caused an increase in cost in the subsequent year, or a reflection of the fact that a product is at the end of its life cycle.

### **14. ARM'S LENGTH RANGE**

14.1 An arm's length range refers to a range of figures that are acceptable in establishing the arm's length nature of a controlled transaction. The range is derived from applying the same transfer pricing method to multiple comparable data. It is established that transfer pricing is not an exact science, and that the application of the most appropriate transfer pricing methodology may produce a range of results. The facts and circumstances of a case are therefore important in determining a range, or the point in a

range, that is the most reliable estimate of an arm's length price or allocation.

14.2 The arm's length range should be constructed using only comparable uncontrolled transactions that have, or have been adjusted to, a high level of reliability in comparison to the controlled transactions. A substantial deviation among points or between the data in the range (e.g. upper quartile and lower quartile) may indicate that comparables used are not reliable, and that material differences exist in terms of FAR which warrant comparability adjustments. In such cases, the reliability of comparable data must be carefully assessed, and adjustments made for the material differences in comparability analysis and the methodology should be reviewed.

14.3 If every effort has been made to exclude data that have a lesser degree of comparability, but some comparability defects remain and cannot be adjusted, it may be appropriate to make transfer pricing adjustments to a value that best reflects the facts and circumstances of transactions between associated persons. This value may be derived from utilising statistical tools depending on the specific characteristic of the data set.

## **15. SEPARATE AND COMBINED TRANSACTIONS**

15.1 To obtain the most precise approximation of an arm's length price or profit allocation, the arm's length principle should ideally be applied on a transaction-by-transaction basis. However, depending on the circumstances of the case, transfer pricing may sometimes need to be dealt with at the level of a product line or business unit rather than at the level of each particular transaction.

15.2 In establishing transfer prices, taxpayers should set prices separately for each transaction they enter into with an associated person. However,

where transactions are so closely linked (or continuous) that they cannot be evaluated adequately on a separate basis, determination of transfer price based on bundled transactions may be considered. This is provided it can be demonstrated that it is the normal industry practice to set one price for a combination of transactions (e.g. goods and the associated intangible property) or where it may not be reasonable to expect to find quality data available to set the price for separate transactions. Lack of reliable data on comparable transactions may be due to the complexity of the dealings or the relationships between the parties. Therefore, the total amount may be on an aggregate basis.

- 15.3 It is generally acceptable to group intangibles associated with the product or service provided if comparable independent transactions also have these various transactions which cannot be disaggregated and are bundled into a package deal with all the associated costs being included in the price of the product.

Other examples include:

**Example 17**

**Aggregation of transaction involving tangible and intangible products that are highly integrated**

A company that licenses manufacturing know-how and supplies vital components that are highly integrated to an associated party may find it more reasonable to assess the arm's length price for these two activities as an item instead of separately.

**Example 18**

**Aggregation of transactions where one product complements the other**

Aggregation of transactions may also be appropriate in situations where a taxpayer is required to carry an unprofitable product or line of products which are auxiliary to the profitable items and where there is sufficient profit

available to provide an adequate return from the complete product range to reward the assets, functions and risks of the enterprise. Common types of bundled products that fall under this category include printers with cartridges, and razors with blades.

### **Example 19**

#### **Disaggregation of transactions where the nature of transactions are substantially different**

Company M was established in Malaysia to handle the distribution, sales, after-sales service, repair and maintenance services of the X group vehicles consisting of trucks, buses and coaches which are 100% imported from its parent company in Country X. Company M is also the regional hub for X in South East Asia, covering markets such as Singapore, Thailand, Vietnam and Indonesia. This regional office also houses the regional training centre where mechanics, technicians, driver trainers and managers from the Asia Pacific region are trained to provide X's group customers in the region.

Ordinarily, in this situation, the various kinds of activities should not be aggregated and Company M is required to prepare segmental accounts as follows, in order to enable the evaluation of the arm's length nature of the controlled transactions on a transactional basis:

- Sales and distribution
- Repair and maintenance services
- Regional services

## **16. RE-CHARACTERIZATION OF TRANSACTIONS**

16.1 Examination of a controlled transaction ordinarily should be based on the transaction actually undertaken by the taxpayer insofar as these are consistent with the methods described in the Guidelines. However, when reviewing an agreement between associated persons, consideration is not

only on the terms of the agreement but also the actual conduct of the parties.

Therefore, in determining an arm's length price, the IRBM may disregard and re-characterize a controlled transaction under the following circumstances:

- (a) where the economic substance of a transaction differs from its form; or
- (b) where the form and substance of a transaction are the same; the arrangements made in relation to the transaction, when viewed in their totality, differ from those which would have been adopted by independent persons behaving in commercially rational manner and this actual structure practically impedes the IRBM from determining an appropriate transfer price.

16.2 The need to re-characterize a transaction is based on the rationale that the character of the transaction is derived from the relationship between the parties and is not determined by normal commercial conditions. The controlled transaction may have been structured by the taxpayer to avoid or minimise tax. This is supported by the fact that -

- (a) associated persons are able to enter into a greater variety of contracts and agreements compared to independent persons because the normal conflict of interest which exist between independent parties is often absent;
- (b) associated persons often conclude arrangements of a specific nature that are not, or very rarely, encountered between independent persons; and
- (c) contracts under a controlled transaction are quite easily altered, suspended, extended, or terminated according to the overall

strategies of the multinational group as a whole and such alteration may even be made retroactively.

16.3 The above principle can be demonstrated in the following examples extracted from the OECD Guidelines:

**Example 20**

An investment in an associated enterprise in the form of interest-bearing debt would not be expected to be structured in the same way had it been conducted at arm's length, given the economic circumstances of the borrowing company. In this case, it might be appropriate for a tax administration to characterize the investment in accordance with its economic substance where the loan may be treated as subscription of capital.

**Example 21**

A sale under a long term contract, for a lump sum payment, gives unlimited entitlement to the intellectual property rights arising as a result of future research for the term of the contract. While it may be proper to respect the transaction as a transfer of commercial property it would nevertheless be appropriate for a tax administration to conform the terms of that transfer in its entirety to that which might reasonably have been expected between independent persons. Thus, in the case described above, it might be appropriate for the tax administration, for example, to adjust the conditions of the agreement in a commercially rational manner as a continuing research agreement.

## **17. TRANSFER PRICING ADJUSTMENT**

Where the DGIR has found that a price in a controlled transaction is not at arm's length, he may make an adjustment to reflect the arm's length price or interest rate for that transaction by substituting or imputing the price, or interest, as the

case may be. In such instances, the adjustment will also be reflected by a corresponding adjustment upon request of the other party of the controlled transaction. Adjustments will be made where:

- (a) For the supply of property or services, the consideration is less than the consideration that would have been received or receivable in an arm's length arrangement;
- (b) For the acquisition of property or services, the consideration is more than the consideration that would have been given or agreed to be given in an arm's length arrangement; or
- (c) No consideration has been charged to the associated person for the supply of property or services.

## **18. LOSSES**

18.1 Enterprises incur losses for a variety of economic and business reasons such as start up losses, market penetration strategies, and research and development failure. However, an independent enterprise would not endure continuous losses without taking appropriate measures to correct the situation within reasonable time, as it would contradict fundamental business objectives of making profits. The fact that an associated enterprise continuously suffers losses may be an indication that it is not being compensated fairly.

18.2 In determining whether the losses are acceptable, it is important to ensure that the controlled transaction entered into is commercially realistic and make economic sense. A taxpayer needs to also establish that the losses are commercial in nature within the context of its characterization. In this regard, a taxpayer is expected to maintain



contemporaneous documentation which outlines the non-transfer pricing factors that have contributed to the losses.

- 18.3 A contract or toll manufacturer that only carries out production as ordered by a related party, without performing functions such as operational strategy setting, product R&D and sales, is expected to maintain a consistent level of profitability. Should the manufacturer suffer from losses, it must prove that these losses are not a result of its transactions with a related party.

## **PART V BUSINESS RESTRUCTURING**

19. Business restructuring within a multinational group often result in a change of business characterization and reduction of profitability of a local entity. Such reduction of profits is acceptable only with reduced functions performed, assets employed and risks assumed. As long as these functions, assets and risks are actually transferred, it is viewed as commercially rational for a multinational group to restructure in order to obtain tax savings. However, if it is found that the local entity continues to perform the same functions, and bear the same risks, IRBM will make the necessary adjustments. In an arm's length situation, an independent party would not restructure its business if it results negatively for it, where it has the option realistically available not to do so.

## **PART VI SPECIFIC TRANSACTIONS**

### **20. INTRAGROUP SERVICES**

- 20.1 Intragroup services are services provided by one or more members of a multinational group for the benefit of the other members within the group. In general, the types of services that members of a multinational group

can provide to each other include, but are not limited to, management services, administrative services, technical and support services, purchasing, marketing and distribution services and other commercial services that typically can be provided with regard to the nature of the group's business. The costs of such services, initially borne by the parent or other service companies within the multinational group, are eventually recovered from other associated persons through intragroup arrangements.

20.2 In general, no intra-group service should be found for the following activities:

(a) **Shareholder activities**

Shareholder activity refers to an activity that one group member (usually the parent company) performs solely because of its responsibility as a shareholder due to its ownership interest in one or more members of the group.

Examples of non-chargeable shareholder activities include:

- Costs pertaining to the juridical structure of the parent company such as meetings of shareholders of the parent company, issuing of shares in the parent company and costs of the supervisory board;
- Costs relating to the reporting and legal requirements of the parent company such as producing consolidated accounts or other reports for shareholders, filing of prospectuses; and
- Costs of raising funds for the acquisition of new companies to be held by the parent company (distinct from fund raising on behalf of its existing subsidiaries).

(b) **Duplicative services**

- (i) Duplicative services are services performed by a group member that merely duplicates a service that another group member is already performing in-house, or that is being performed by a third party. In such instances, any duplicative claim will be automatically disallowed. The ability of a group member to independently perform the service (for instance in terms of qualification, expertise and availability of personnel) shall be taken into account when evaluating the duplication of services performed.

**Example 22**

A subsidiary has qualified personnel to analyse its capital and operational budget. This analysis is then reviewed by the parent company's financial personnel. The review by the parent company is considered duplicative.

- (ii) However, there are exceptions in which duplication of services can be charged such as:
- Special circumstances where duplication is only temporary. For example in implementing a new system, a company may simultaneously continue to operate an existing system for a short period, in order to deal with any unforeseen circumstances that may arise during the initial implementation; or
  - To reduce the risk of a wrong business decision such as by getting a second legal opinion on a particular project.

(c) **Services that provide incidental/passive association benefits**

This refers to services performed by one member of a multinational group, such as a shareholder or coordinating centre, which relates only to specific group members but incidentally provides a benefit to other members of the group. Incidental benefit may also arise as a consequence of an associated person being part of a larger concern and not because of a service that has actually been provided. Such incidental benefits would not warrant a charge to the incidental recipient because the perceived benefit is so indirect, and remote, that an independent person would not be willing to pay for the activities giving rise to the benefit and therefore should not be considered as intragroup service to the incidental recipient.

**Example 23**

An enterprise that had obtained a higher credit rating due to it being a member of a multinational group should not be charged for its mere association with the group. However, if the higher credit rating is due to a guarantee provided by another group member, then an intragroup service can be considered to have been rendered.

(d) **On-call services**

An on-call service is where a parent company or a group service centre is on-hand to provide services such as financial, managerial, technical, legal or tax advice to members of the group at any time.

- (i) This service is considered non-chargeable under the following circumstances:
- Service is easily and promptly available even without any standby arrangement;
  - The potential need for such service is remote;
  - Where there is no/negligible benefits derived from the service.
- (ii) If there are exceptional circumstances which require on-call services to be considered as chargeable services, it must be proven that an independent person in comparable circumstances would incur such charges to ensure availability of the services when the need for them arises.

20.3 Other services that are commonly found between associated persons include –

- (a) activities performed by one member of a multinational group to meet the identifiable needs of its associated person;
- (b) activities that are centralized in the parent company or regional headquarters companies or group service centre; and
- (c) ancillary or subsidiary services which are services rendered in connection with other transactions such as the transfer of a property (e.g. intangible asset) or the commencement of the effective use of a property. IRBM requires that charges for the services are shown separately or can be shown separately should the need arise.

The following table summarizes the types of services that may be chargeable and that which are non-chargeable:

Type of service	May be Chargeable	Non Chargeable	Exceptions
Services that provide specific benefits	✓		
Centralized services	✓		
Ancillary services	✓		
Shareholder activities		✓	
Duplicative services		✓	<ul style="list-style-type: none"> <li>• Temporary duplications e.g. maintaining use of existing system during early stages of implementation of a new system</li> <li>• To reduce risk of a wrong business decision e.g. obtain a second legal opinion on a project</li> </ul>
Services that provide incidental benefits		✓	
Passive association benefit (benefit from being part of larger concern)		✓	
On-call services (standby charges)		✓	<ul style="list-style-type: none"> <li>• Where it can be proven that an independent person is willing to incur such standby charges.</li> </ul>

#### 20.4 Application of arm's length principle for intragroup services

- (a) In applying the arm's length principle to intragroup services, taxpayers should consider:
- (i) Whether services have been provided; and
  - (ii) If so, whether the charge for these services are at arm's length prices.
- (b) The following factors should serve as a guide in determining whether services have been provided:
- (i) Whether the service recipient receives benefits that are of economic or commercial value; and
  - (ii) Whether an independent enterprise in comparable circumstances is willing to pay for the services or perform such services in-house.

A benefit is of economic or commercial value if it -

- enhances the recipient's return or profitability by improving its production efficiencies; or
  - results in cost savings or a decrease in the recipient's operating expenses for example by decreasing production time.
- (c) Charges for intragroup services must be consistent with the relative benefits intended from the services, based on the facts known at the time the services were provided, and at arm's length. Where anticipated benefits are not realised, taxpayer needs to justify that an independent party would be willing to pay for the services.

## **20.5 Methods of charging for provision of services**

20.5.1 In charging for the provision of services, a service provider could adopt a direct charge method or an indirect charge method. The direct charge method is preferred because it facilitates the determination of whether the charge is consistent with the arm's length principal, and evidence for direct charge is usually readily available.

### **20.5.2 Direct Charge Method**

- (a) The direct charge method is applicable for a specific service where the service, the beneficiary of the service, the cost incurred and the basis of charge can be clearly identified. Hence, the cost can be allocated directly to the recipient.
- (b) Direct charge method must also be applied when the specific service forms part of the main business activity of the service provider, and is provided to both associated persons and independent parties.

### 20.5.3 Indirect Charge Method

- (a) The indirect charge method is applicable where the direct charge method is impractical or if the arrangements for the services provided are not readily identifiable i.e. where the costs are attributable to several related enterprises and cannot be specifically assigned to the recipients of services. IRBM does not encourage the use of indirect charge method, thus the service recipients must be prepared to support their claims via indirect charge method, especially if this forms a significant amount of total claims.

#### **Example 24**

Circumstances when the indirect charge method may be applicable:

- Where sales promotion activities carried out centrally at international fairs or in global advertising campaigns benefit the group members as a whole and is reflected in increased quantity of goods produced or sold by members of the group;
  - The provision of information technology services like management information system which involves development, implementation and maintenance of inter-company electronic data such as transmission of marketing data, production and scheduling forecast, accounting data, etc.
  - Provision of accounting services to all members of the multinational group.
- (b) The method is based upon cost allocation and apportionment by reference to an allocation key which must be appropriate to the nature and purpose of service provided. For example, the provision of payroll services may be more related to number of staff than turnover, while the allocation of usage of networking



infrastructure could be allocated according to the number of computer users.

- (c) The arm's length principle requires that the amount allocated to a respective member of a group is in proportion to the individual member benefit or expected benefit from the services or reflects the share of the total benefits of the service attributable to that particular recipient. Taxpayers are expected to document the analysis undertaken in arriving at the choice of allocation key.
- (d) IRBM does not accept allocation key based on sales unless the taxpayer can justify the correlation between sales and costs incurred.

## **20.6 Determination of arm's length charge for intragroup services**

20.6.1 In applying the arm's length principle to intragroup services, it is necessary to consider from the perspective of both the provider and the recipient of the service. The service must be of value to the recipient and the price must be one that an independent party would be prepared to pay.

In determining arm's length prices for intragroup services the service recipient may apply external CUP together with a benefit test. For the service provider, both, the CUP and the cost plus method may be applied.

20.6.2 In determining the arm's length price charged for an intragroup service, the following factors should be taken into consideration:

- (a) Nature of the service;
- (b) Value / extent of the benefit of the service to the recipient;
- (c) The costs incurred by the service provider in providing the service;
- (d) The functions involved in providing the service;

- (e) The amount an independent recipient would be prepared to pay for that service in comparable circumstances. Service recipients must show benefits commensurate with the amount charged by the service provider;
- (f) Other options realistically available to the recipients.

## 20.7 Profit Mark-up

20.7.1 It is vital to consider whether mark-up on a cost base is justifiable since in an uncontrolled transaction an independent person would normally seek to earn a profit from providing services, rather than merely charging them out at cost. Therefore, it is necessary to understand the nature of activity, the significance of the activity to the group, the relative efficiency of the service supplier and any advantage that the activity creates for the group.

20.7.2 The nature of service and the expected value to a recipient influence the arm's length price of the service provider. Specialised services, such as engineering services in the oil and gas industry, warrant a higher mark-up than general services such as repair and maintenance.

20.7.3 When applying the cost-plus method to an associated enterprise which assumes the role of an agent or intermediary to obtain services from independent enterprises on behalf of its group members, it must be ensured that the arm's length return is limited to rewarding the agency/intermediary function only. It is not appropriate to charge a service fee based on mark-up on cost of the services obtained from independent enterprises.

20.7.4 If a tested party is the service recipient in Malaysia, a mark-up by an overseas affiliate service provider which has fulfilled an arm's length test in that service provider's country of residence need not automatically be deemed arm's length in Malaysia. A benefit test

from the perspective of the service recipient must still be demonstrated.

## **21. COST CONTRIBUTION ARRANGEMENT (CCA)**

### **21.1 Concept of a CCA**

A CCA is a framework (in the form of contractual agreement) agreed among business enterprises to share the costs and risks of developing, producing or obtaining assets, services or rights, and to determine the nature and extent of the interests of each participant in those assets, services or rights. Each participant's proportionate share of the overall contributions to the arrangement will be consistent with the participant's proportionate share of the overall expected benefits to be received under the arrangement. The participant would be entitled to exploit its interest in the CCA separately as an effective owner, not as a licensee. Where a taxpayer enters into a CCA with its associated persons, the arrangement should reflect that of an arm's length arrangement.

### **21.2 Types of CCA**

There are two major types of CCA most commonly encountered in practice:

(i) **Arrangement for the joint development of intangible property**

In this arrangement each participant contributes different assets, resources and expertise, and receives a share of rights in the developed property based on the contribution.

(ii) **Service Arrangement**

CCA could exist for any joint funding or sharing of costs and risks, for developing or acquiring property or for obtaining services such as pooling resources for the development of advertising campaigns

common to the participants' market. However, if a service arrangement does not result in any property being produced, developed or acquired, the principles for dealing with intragroup services will apply to that arrangement whether it is described as CCA or not.

### **Example 25**

Three members of a multinational group, marketing a product in the same regional market where consumers have similar preferences, want to enter a CCA to develop a joint advertising campaign. A fourth member of the group helps develop the advertising campaign but does not itself market the product. This fourth member is not a participant in the CCA because it does not have any beneficial interest in the services subject to the CCA activity and would not, in any case, have a reasonable expectation of being able to exploit any interest. The three participants in the CCA would, therefore, compensate the fourth member by way of an arm's length payment for the advertising services provided to the CCA.

## **21.3 Applying the arm's length principle**

21.3.1 To demonstrate whether a CCA accords with an arm's length arrangement in comparable circumstances, the following matters should be addressed:

- (a) CCA should be entered into with prudent and practical business judgment with a reasonable expectation of its benefits. An independent party would not enter a CCA where the value of the contribution exceeds the expected benefit. Estimation of the expected benefit to be derived from the arrangement can be computed in the following manner:

- (i) Based on the anticipated additional income that will be generated or the expected cost savings; or
  - (ii) The use of an appropriate allocation key, perhaps based on sales, units used, produced or sold, gross or operating profits, numbers of employees, capital invested, or alternative keys.
- (b) Terms of the arrangement should be agreed upon up-front and in accordance with economic substance, judged by reference to circumstances known or reasonably foreseeable at the time of entry into the arrangement.

21.3.2 Consideration for the entry, withdrawal and termination of a CCA should be dealt with at arm's length, as follows:

- (a) Where a participant's contribution is not consistent with its expected share of benefits from the CCA, a balancing payment may be required between the participants to adjust their respective contributions;
- (b) Where a participant transfers its pre-existing rights of a prior CCA to a new participant, the exiting participant must be compensated based upon an arm's length value for the transferred interest (buy-in payment). The amount of the buy-in payment shall be determined based on the price an independent party would have paid for the rights obtained by the new participant, taking into account the proportionate share of the overall expected benefit to be received from the CCA;

- (c) Where a participant disposes off part or all of its interest, he should be compensated with an arm's length payment (buy-out payment).

## **22. INTANGIBLE PROPERTIES**

22.1 Intangible properties are unique products valued for their intellectual or intangible contents which can be legally or not legally protected. Intangible properties can be categorised into two broad types:

- (a) Trade intangibles such as patents created through risky and costly R&D, know-how, designs and models that are used in producing a product or in providing a service; and
- (b) Marketing intangibles i.e. trademarks and trade name that are used in the exploitation of the products, customer lists, distribution channel and so forth.

### **22.2 Existence of Intangible Properties**

In considering the issue of intangible properties, it is essential to first determine the existence of such property i.e. by the benefit derived from the intangible. When a company demonstrates a higher than average rate of return on assets or higher than average profits for a given level of physical assets over a period of time, it indicates the likely presence of intangibles. Intangible for the purpose of these guidelines is intended to address something which is not a physical asset or a financial asset and which is capable of being owned or controlled for use in commercial activities. Intangibles that are important to consider for transfer pricing purposes are not always recognised as intangible assets for accounting purposes. For example, costs associated with developing intangibles internally through expenditures such as research and development and advertising are sometimes expensed rather than capitalized for accounting purposes and

the intangibles resulting from such expenditures therefore are not always reflected on the balance sheet. Such intangibles may carry significant economic value and may need to be considered for transfer pricing purposes.

### **22.3 Parties entitled to Intangible related returns**

22.3.1 The parties entitled to intangible related returns must be identified once the existence of the intangible has been determined. Legal registration and contractual arrangements are the starting points for determining which members of an MNE group are entitled to intangible related returns. Where no written contracts exist, the contractual relationships of the parties must be deduced from their conduct and the economic principles that generally govern relationships between independent enterprises.

22.3.2 Where the legal ownership of an intangible property does not vest with the party that has developed the property, the developer of the intangible property would be expected to have received an arm's length consideration for its development services. This consideration may come in the form of:

- (a) a cost reimbursement (with an appropriate profit element), if the developer is a contract developer (effectively a service provider), or
- (b) a lump-sum compensation (with the intangible related return), if the developer bore all of the expenses and risks of development.

22.3.3 If the owner of an intangible property chooses to transfer some or all of the rights to exploit the property, an arm's length charge should be imposed for the transfer of those rights. The person to whom the

rights are transferred will then be entitled to the income attributable to the intangible property rights that are transferred.

22.3.4 The terms of agreement between a transferor and a transferee of an intangible property must be evaluated. The agreement will normally indicate:

- Whether the transfer is an outright sale or licensing agreement for royalties to be paid;
- If royalty is to be paid, the basis of payment;
- Whether the price of product transferred has included compensation for use of the intangible property; and if so, whether other payments such as royalties or payment for provision of technology are made in relation to the same product;
- If it involves a marketing intangible where a party that is not the legal owner undertakes marketing activities: how the marketer is compensated.

#### **22.4 Payment for the transfer of intangible property**

Payment in respect of the transfer of intangibles between associated persons may be by way of:

- (a) an outright sale (lump sum payment); or
- (b) a licensing agreement for royalties to be paid.

#### **22.5 Marketing Intangibles**

The value of marketing intangibles depends on many factors including the reputation and credibility of the trade name or trademark fostered by the quality of the goods or services provided under the trade name or trademark in the past, the distribution and availability of the goods or services being



marketed and the extent or success of the promotional expenditures incurred in order to familiarize potential customers with the goods or services.

Where a distributor actually bears the cost of its marketing activities, and where those costs and risks incurred as well as functions performed exceeded those that an independent distributor under similar circumstances might incur or perform for the benefit of its own distribution activities, the distributor will be expected to obtain a share of the intangible related returns from the owner of the trademark or related intangibles.

## **22.6 Application of Arm's Length Principle**

22.6.1 Arm's length pricing for the transfer of intangible property shall take into account the perspective of both the transferor/licensor and the transferee/licensee. A transferor shall recover the costs associated with developing an intangible and earn a reasonable return. The value of an intangible to the transferee shall be the expected benefits (additional profits) that the intangible would generate, which is usually the key consideration in determining the transfer price of an intangible for both parties.

22.6.2 Understanding the type and the characteristics of intangible properties helps in applying the arm's length principle as it helps in identifying the factors that contribute to an intangible's value. It also helps to identify the types of comparables needed for comparability.

22.6.3 When determining the relative value of contribution by each party, or comparability of the transactions, it is necessary to examine the amount, nature and costs incurred in developing, or maintaining the intangible property. Other factors to consider include:

- (a) Expected benefits and usefulness of the intangible property;

- (b) Prevailing industry rates;
- (c) Terms of the agreement including geographic limitations, duration of the license, any termination or negotiation rights and exclusivity rights;
- (d) Benefits to the licensor, arising from sharing of information on the experience of the licensee contributing towards further developments of the property;
- (e) Possibility of sub-licensing;
- (f) The extent of any capital investment, start-up expenses or development work required;
- (g) Rights to receive update, revisions or modifications of the intangibles; or
- (h) Technical assistance, trademarks and know-how provided along with access to any patent.

#### **22.6.4 Transfer Pricing Methodologies for Intangible Property**

- (a) The Rules specify the CUP method can be used in benchmarking transactions involving intangible properties. When difficulties arise in identifying reliable comparables due to the uniqueness of the intangible, the residual profit split method or any other methods that can provide the highest degree of comparability can be applied where both parties to the transaction own highly valuable intangibles.
- (b) In determining the arm's length consideration for transfer of intangibles, a person who is the licensee or the buyer of the intangible property may consider the following:
  - (i) Perform a functional analysis which covers:
    - (a) the type of intangible involved;
    - (b) the value of the intangible;

- (c) the opinion of industry experts on the value of the intangible, if necessary;
  - (d) the duration that the intangible is expected to maintain its value.
- (ii) Determine the rate of return that commensurate with the amount of royalty paid by performing a financial analysis;
  - (iii) Ensure that the amount of consideration paid make economic sense and the person is better off with utilising an associated person's intangible property.

## **23. INTRAGROUP FINANCING**

### **23.1 Financial assistance between associated persons**

Intragroup financing is another form of service between associated persons, which falls under subsection 140A(2), in the form of financial assistance that include loans, interest bearing trade credits, advance or debt and the provision of any security or guarantee. The financial assistance arrangements between associated persons can arise from the following situations:

- (a) Where a taxpayer, directly or indirectly, acquires from or supplies to an associated person financial assistance for a consideration;  
or
- (b) Where a taxpayer supplies financial assistance directly or indirectly to an associated person without consideration.

In both situations, the taxpayer should charge or pay the associated person interest at a rate which is consistent with the rate that would have been charged in a similar transaction between independent persons dealing at arm's length.

## 23.2 Substitution and Imputation of Arm's length Interest

As provided under the Rules, where the interest rate imposed or would have been imposed on a controlled financial assistance is not at arm's length, the DGIR may make an adjustment to reflect the arm's length interest rate or impute interest on the controlled financial assistance. Adjustments will be made where:

- (a) For the supply of financial assistance, the consideration is less than the consideration that would have been received or receivable in an arm's length arrangement;
- (b) For the acquisition of financial assistance, the consideration is more than the consideration that would have been given or agreed to be given in an arm's length arrangement; or
- (c) No consideration has been charged to the associated person for the supply of the financial assistance.

### **Example 26**

#### **Substitution of non arm's length interest**

Company A has obtained a fixed-rate 10%, medium term loan from an associated person which embeds an option to repay the loan prematurely without penalty. In the third year the market interest rate began to decline to 5%, a rate lower than the fixed-rate agreed upon with the associated person. In an arm's length situation, Company A would execute its option to repay the loan as it would not make sense to continue paying the high interest rate of 10%. However, Company A did not exercise the option and continued to pay at the higher interest rate.

In this case, the IRBM may substitute the financial assistance arrangement with an interest rate that reflects the current market situation as if Company

A had exercised the option at an appropriate time and entered into similar arrangement at a lower rate.

### **23.3 Determination of Arm's Length Interest**

An arm's length interest rate is an interest rate charged, or would have been charged, at the time the financial assistance was granted in uncontrolled transactions with or between independent persons.

In determining an arm's length interest rate for financial assistance, the comparable uncontrolled price (CUP) method is considered to provide the most reliable measure. In this context, the CUP method determines an arm's length interest rate by reference to interest rates between independent parties on loan with highly similar terms and conditions. Where differences exist, adjustments should be done to eliminate these differences.

### **23.4 Comparability Factors**

Comparability factors to consider when searching for and analyzing financial transactions and the determination of arm's length interest rate include:

- (a) the nature and purpose of the financial assistance;
- (b) the amount, duration and terms of the financial assistance;
- (c) the type of interest rate (eg: fixed or floating interest rate);
- (d) embedded options;
- (e) guarantees involved in the financial assistance;
- (f) collateral for the financial assistance;
- (g) creditworthiness of the borrower;
- (h) location of the lender and borrower.

When ascertaining the arm's length interest rate, appropriate indices such as Kuala Lumpur Inter Bank Offered Rate (KLIBOR), prime rates offered by

bank and/or specific rates quoted by banks for comparable loans can be used as a reference point. Adjustments are then made on the rates used as reference point based on the outcome of comparability analysis to arrive at the arm's length interest rate.

### **23.5 Documenting Financial Assistance Pricing Policy**

Taxpayers are required to substantiate and document that the terms of an intercompany financial assistance, specifically the interest rate applied, are arm's length. This encompasses preparation of an analysis on the setting of the correct level of underlying interest and documentation on other factors of comparability such as loan structure, etc. Taxpayers also need to review existing inter-company agreement on a periodic basis to ensure that all the terms and conditions of the loan remain at arm's length.

## **PART VII DOCUMENTATION**

### **24. RETENTION OF RECORDS**

Taxpayers are required to keep sufficient records for a period of seven years from the end of the year to which income from the business relates, as provided under paragraph 82(1)(a) of the Act, to enable the DGIR to ascertain income or loss from the business. Subsection 82(8) further provides that all records relating to any business in Malaysia must be kept and retained in Malaysia. 'Records' under subsection 82(9) include books of accounts, invoices, vouchers, receipts and other documents necessary to verify entries in any books of accounts.

For transfer pricing purposes, a taxpayer who has entered into a transaction with an associated person in the basis year for a year of assessment is required to not only maintain the above records, but also prepare and keep contemporaneous documentations. Notwithstanding the exclusions under

paragraph 3 of the Guidelines, the taxpayer is encouraged to maintain contemporaneous documentation to assist in demonstrating whether the taxpayer's transfer pricing policy is appropriate for tax purposes. At the same time, this alleviates the risk of transfer pricing adjustment and has relevance to penalty consideration during a transfer pricing audit. Paragraph 25 addresses this issue in more detail.

## **25. TRANSFER PRICING DOCUMENTATION**

### **25.1 Contemporaneous Transfer Pricing Documentation**

- (a) A documentation is deemed "contemporaneous" if it is prepared:
  - (i) at the point when the taxpayer is developing or implementing any arrangement or transfer pricing policy with its associated person; and
  - (ii) if there are material changes, when reviewing these arrangements prior to, or at the time of, preparing the relevant tax return of his income for the basis year for a year of assessment.
  
- (b) In preparing the documentation, the arm's length transfer price must be determined before pricing is established based upon the most current reliable data that is reasonably available at the time of determination. However, taxpayers should review the price based on data available at the end of the relevant year of assessment and update the documentation accordingly.

### **25.2 Duty to prepare Transfer Pricing Documentation**

- 25.2.1 As previously mentioned in paragraph 24, taxpayers who are involved in controlled transactions are generally required to maintain a contemporaneous transfer pricing documentation. This includes

taxpayers involved in domestic controlled transactions where at least one party enjoys tax incentives or suffers from continual losses, or is taxed at a different rate, such that the effect of that transaction would result in adjustments that alter the total tax payable.

25.2.2 For a person that is not assessable and chargeable to tax in Malaysia due to a tax incentive, or losses; or is transacting with a related party that is not assessable and chargeable to tax in Malaysia due to the same factors, that person is encouraged to prepare Transfer Pricing Documentation if the criteria in paragraph 3.1 is fulfilled.

25.2.3 Types of controlled transactions may involve:

- a. Sales or purchases of raw materials, stock in trade or other tangible assets;
- b. Royalties / license fees / other types of considerations in connection with use of intangible assets;
- c. Management fees including charges for financial, administrative, marketing and training services;
- d. Research and development;
- e. Any other services not previously mentioned;
- f. Rents / lease of assets;
- g. Interests; or
- h. Guarantee fees.

### **25.3 Submission of Transfer Pricing Documentation**

Transfer pricing documentation is not required to be submitted with the annual Return Forms. However, the documentation should be made available to the IRBM within 30 days upon request.



## 25.4 List of Documentation

A transfer pricing documentation may consist of the following:  
(Documentations for specific transactions are listed in Appendix A.)

### (a) **Organizational Structure**

- (i) Taxpayer's worldwide organizational and ownership structure (including global organization chart and significant changes in the relationship, if any), covering all associated persons whose transactions directly or indirectly affect the pricing of the documented transactions.
- (ii) Company organization chart.

### (b) **Group financial report**

TP documentation should include the group financial report, equivalent to an annual report, for the most recent accounting period.

### (c) **Nature of the business/industry and market conditions**

- (i) Outline of the taxpayer's business including relevant recent history, the industries operated in, analysis of the general economic and legal issues affecting the business and industry, the taxpayer's business lines and the property or services in the controlled transactions;
- (ii) The corporate business plans to the extent of providing an insight into the nature and purpose of the relevant transactions between the associated persons;
- (iii) A description of the structure, intensity and dynamics of the relevant competitive environment(s).

(d) **Controlled transactions**

- (i) Description of details of the property or services to which the international/domestic transaction relates; any intangible rights or property attached thereto, the participants, the scope, timing, frequency, type and value of the controlled transactions (including all relevant related party dealings in relevant geographic markets);
- (ii) Names and addresses of all associated persons, with details of the relationship with each such associated person;
- (iii) The nature, terms (including prices) and conditions of international transactions (where applicable) entered into with each associated person and the quantum and value of each transaction;
- (iv) An overview description of the business, as well as a functional analysis of all associated persons with whom the taxpayer has transacted;
- (v) All commercial agreements setting forth the terms and conditions of transactions with associated persons as well as with third parties;
- (vi) A record of any forecasts, budgets or any other financial estimates prepared by the person for the business as a whole and for each division or product separately.

- (e) **Pricing policies.**
- (f) **Assumption, strategies and information regarding factors that influenced the setting of pricing policies**
  - (i) Relevant information regarding business strategies and special circumstances at issue, for example, intentional set-off transactions, market share strategies, distribution channel selection and management strategies that influenced the determination of transfer prices;
  - (ii) Assumptions and information regarding factors that influenced the setting of prices or the establishment of any pricing policies for the taxpayer and the related party group as a whole;
  - (iii) Documentation to support material factors that could affect prices or profits in arm's length dealings.
- (g) **Comparability, functional and risk analysis**
  - (i) A description of the characteristics of the property or service transferred, functions performed, assets employed, risks assumed, terms and conditions of the contract, business strategies pursued, economic circumstances and any other special circumstances.
  - (ii) Information on functions performed (taking into account assets used and risks assumed) of the related party involved in the controlled transaction as well as a description of FAR of group of companies to the extent that they affect or are affected by the controlled transactions carried out by the taxpayer.

- (iii) Details of comparables, as mentioned in paragraph 9 including for tangible property: its physical features, quality and availability; for services: the nature and extent of the services; and for intangible property: the form of the transaction, the type of intangible, the rights to use the intangible that are assigned and the anticipated benefits from its use.
  - (iv) The data collected and the analysis performed to evaluate comparability of uncontrolled transactions with the relevant controlled transactions.
  - (v) Criteria used in the selection of comparables including database screens and economic considerations.
  - (vi) Identification of any internal comparables.
  - (vii) Adjustments (details and reasons for those adjustments) made to the comparables.
  - (viii) Aggregation analysis (grouping of transactions for comparability) where paragraph 15 applies.
- (h) **Selection of the transfer pricing method**
- (i) Description of data and methods considered, the analysis performed to determine the arm's length price and the rationale for the selection of this methodology including reasons for its use in preference to other transfer pricing methodologies.
  - (ii) Documentation of the process involved in the selection of particular methodologies.

- (i) **Application of the transfer pricing method**
  - (i) Documentation of assumptions and judgments made in the course of determining an arm's length outcome (refer to the Comparability, Functional and Risk analysis section above);
  - (ii) Documentation of all calculations made in applying the selected method, and of any adjustment factors, in respect of both the tested party and the comparable;
  - (iii) Appropriate updates of prior year documentation relied upon in the current year to reflect adjustments for any material changes in the relevant facts and circumstances.
- (j) A list of advance pricing arrangements entered into by members of the group with respect to transactions to which the taxpayer is a party.
- (k) Documents that provide the foundation for or otherwise support, or were referred to, in the development of the transfer pricing analysis.
- (l) Taxpayers should keep readily available documents and information that were used in preparing the transfer pricing documentation as they are necessary to support the transfer pricing analysis. This may include:
  - (i) Official publications, reports, studies and databases;
  - (ii) Reports of market research studies carried out by recognized institutions;
  - (iii) Technical publications brought out by recognized institutions;

- (iv) Agreements and contracts entered into with associated persons or with unrelated persons, which may be of relevance to the international transactions;
- (v) Letters and other correspondence documenting any terms negotiated between the person and the associated person;
- (vi) Supporting documents for the economically significant activities and functions undertaken by the taxpayer. For example, where skilled and experience staff constitute human resource assets for the taxpayer, documentation pertaining to these staff which may be relevant here include:
  - Details of experience;
  - Educational qualifications;
  - Areas of particular expertise;
  - Job description and duties;
  - Remuneration;
  - Written statements provided by key staff and used by taxpayer in determining the functions, risks and asset of the company;
- (vii) Other relevant documents.

## **25.5 The extent of relevant and adequate contemporaneous documentation**

In complying with subsection 140A(2) of the Act, taxpayers should take into account the size and complexity of their business and transactions in determining the nature and extend of documentation appropriate to their particular circumstances. In view that the nature and amount of documentation depends on facts and circumstances of a particular transaction, every taxpayer should evaluate the significance of its

transactions in reference to their own business and the additional administrative costs of preparing such documentation.

In general, it is advantageous for a taxpayer to maintain proper documentations on controlled transactions that are applicable to his circumstances and be prepared to provide additional information or documentation not listed in the Guidelines, but which may be relevant for the determination of arm's length price.

## 25.6 Acceptability of Documentation

To ensure the acceptability of the contemporaneous transfer pricing documentation, reasonable efforts should be given to:

- (a) Undertake a transfer pricing analysis to ascertain that transfer prices comply with the arm's length principle and reflect commercially realistic outcomes for all controlled transactions.
- (b) Maintain documents that are applicable to the circumstances and be prepared to provide additional information or documentation not contained above, but which may be relevant for the determination of the arm's length price.
- (c) Prepare the documentation in accordance to the Rules and The Guidelines.
- (d) Implement and review the arm's length transfer pricing policies and redesign the transfer pricing policy to accommodate any changes in the business environment.
- (e) Prevent from providing vague, useless or inadequately founded information.

- (f) Apply a coherent and transparent approach in identifying uncontrolled transactions.
- (g) Provide detailed analysis of functions, assets, risks, market conditions and business strategies.
- (h) Apply a transfer pricing method in accordance to the Rules.
- (i) Ensure that the factual, economic and empirical representations in transfer pricing documentation are company, product and market specific.
- (j) Ensure that the transfer pricing documentation is accurate and precise, and matches the accounting, financial and benchmarked data/comparables.
- (k) Highlight and document any specific event that may have hindered the MNE's performance so that appropriate fact-based adjustments can be considered.
- (l) Prevent from preparing documentation which is of relatively limited use, incomplete and does not properly support the transactions.
- (m) Maintain adequate background documents and full records containing particulars about the factual assumptions and relevant factors that have been taken into account in working out the arm's length price.



## 26. PENALTY

26.1 Tax adjustments as a result of a transfer pricing audit are subject to penalty under subsection 113(2) with the following penalty rates applicable:

<b>1</b>	<b>No Contemporaneous Transfer Pricing Documentation.</b>	<b>35%</b>
<b>2</b>	<b>Transfer Pricing Documentation prepared not according to requirements in the Guidelines.</b>	<b>25%</b>

26.2 Taxpayers who do not fall under the scope of paragraph 3, and have not prepared a contemporaneous Transfer Pricing Documentation, may be subjected to 25% penalty on adjustments due to transactions not conducted at arm's length.

26.3 The rate of penalty shall be increased by 20% as compared to the last penalty rate imposed for the previous offence but limited to a sum not exceeding 100% of the amount of tax undercharged, where -

- (a) the taxpayer obstructs or interferes with a transfer pricing audit;
- or
- (b) the taxpayer fails to comply with the arm's length principle after previous transfer pricing audits.

**APPENDIX A****Documentation on specific transactions**

In addition to the documentation requirements in paragraph 25, a taxpayer engaged in the provision or acquisition of intragroup services, transfer of intangible property or participate in cost sharing arrangement is also required to prepare documentation that contain information as listed below:

**(i) Documentation pertaining to Intragroup Services**

- (a) A detailed description of the relevant service transactions. All aspects of the transactions must be analyzed and documented including:
- Who is doing what and for whom,
  - Where are they doing it,
  - Why are they doing it,
  - How are they doing it, and
  - What property is being used or transferred in connection therewith.
  - A written binding service contract between payer and payee companies i.e the charter which illustrates policies adopted, services provided, costs included and excluded, etc.
  - The contract should at the minimum set out:
    - Details of the group companies which will be providing and receiving management services under the contract;
    - Details of the nature and extend of services to be provided;
    - The basis for determining the fees to be charged;
    - The basis for periodic rate increases (if applicable);
    - The dates at which invoices will be issued;
    - The time for payment of fee invoices; and
    - The charges for late payment of invoices and outstanding accounts.

- (b) Documents (e.g. meeting notes and draft agreements) which show that the contract was concluded only after bona fide (bilateral) negotiations regarding its terms.
- (c) Proof of the provision of intragroup service (in order to demonstrate that the service recipient has benefited therefrom). A comprehensive and complete description of those benefits may consist of the following:
- Detailed description of the benefits provided by each business unit, the costs of which are being allocated;
  - Documentation (e.g. correspondence, memoranda, manuals and directives) indicating a benefit to the recipient of the intragroup services;
  - Job descriptions of the staffs of both the service provider and the recipient, so as to prove that there is no duplication of services;
  - Documentation demonstrating that the recipient's operations have not been made to absorb a disproportionate share of the total regional/global costs of administration and management.
- (d) Documentation of each of the functions, such as marketing, legal or technical functions, as the case may be;
- (e) Documentation that the service provider undertakes to supply in justification of the fee for the services rendered e.g. copies of time sheets or cost centre reports. Documentation could also include letters, manuals, instructions, proof of visits, written advice, periodic activity reports and any other documents or data which tend to confirm that the service have been rendered for the benefit of the recipient and are justifiable on an arm's length basis;

- (f) Where a fixed key is used under the indirect charge method, the justification for the allocation key and method adopted shall be demonstrated;
- (g) In the determination of cost base for the application of cost method, it is important to document all issues considered in the calculation of the cost base including:
  - nature/type of cost which have been included in the cost base;
  - method of allocation of costs between associated persons;
  - the basis of allocation or apportionment of all indirect costs included in the cost base.

**(ii) Documentation pertaining to Intangible Property**

- (a) Description of the intangible property, potential market application and advantages the intangible property provides in the particular market.
- (b) The prevailing industry royalty rates.
- (c) The terms of the license including geographic limitations, time limitations and exclusivity rights.
- (d) The singularity of the invention and the period for which it is likely to remain unique.
- (e) Technical assistance, trademarks and know-how provided along with access to a patent.
- (f) Profits anticipated by the licensee; and benefits to the licensor arising from sharing information on the experience of the licensee.
- (g) In relation to marketing activities, an agreement to indicate the arrangement between the entities in terms of bearing the risks/expenses for the marketing activities to be undertaken; the nature

of the marketing expenses incurred and the proposed treatment, in particular of the non-routine expenses.

**(iii) Documentation pertaining to Intragroup Financial Assistance**

- (a) Loan agreement.
- (b) Document supporting all items covered under paragraph 23.4 (a) – (h).
- (c) Currency of loan.
- (d) A copy of the accounts of the borrower (where Malaysian entity is the lender).

**(iv) Documentation pertaining to Cost Contribution Arrangement**

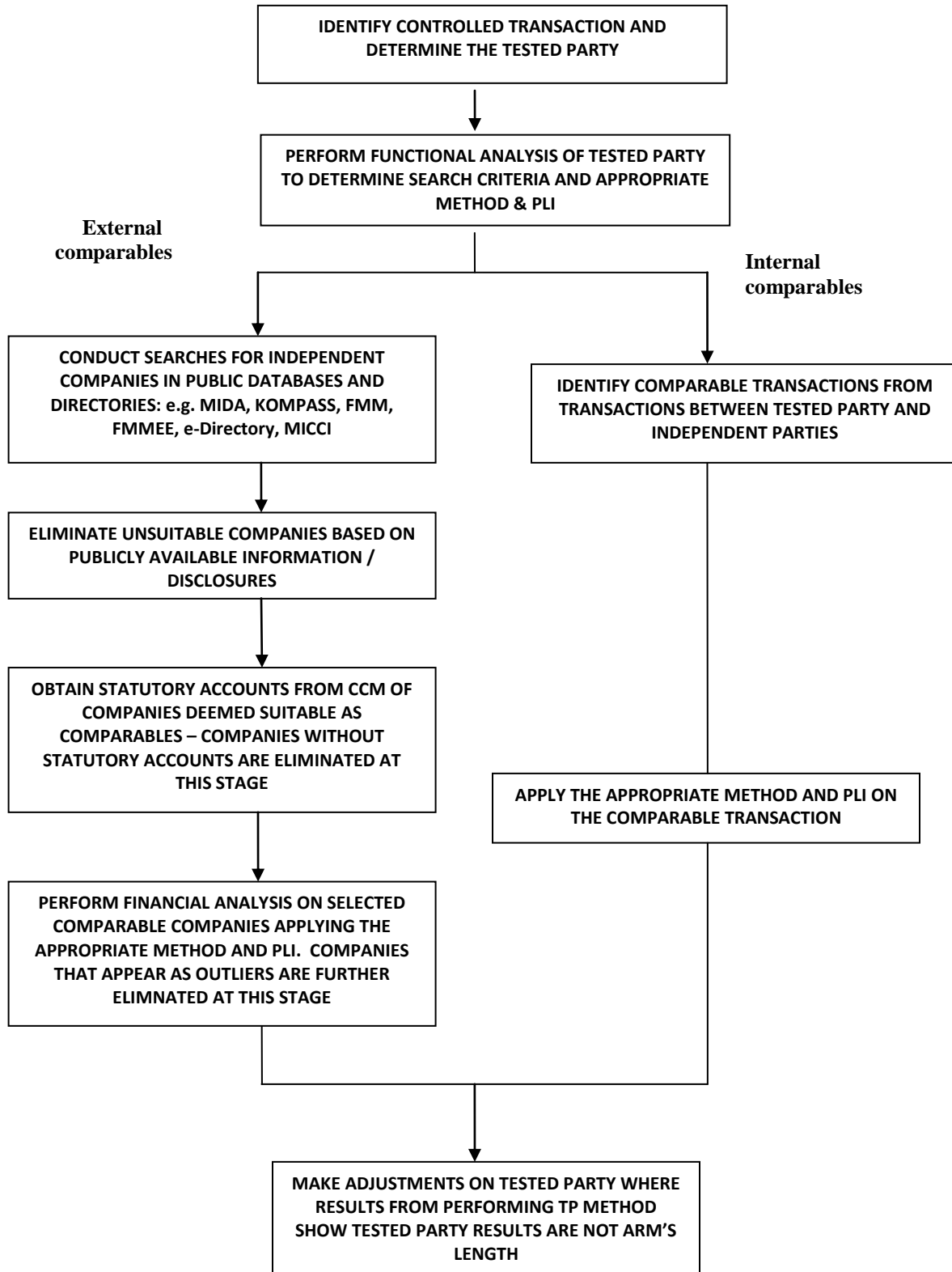
The documentations pertaining to a cost contribution arrangement should include:

- (a) A copy of the CCA agreement that is contemporaneous with its formation (and any revision) and any other agreements relating to the application of the CCA between the CCA participants;
- (b) The identity of participants in the CCA and any other associated persons that will benefit from the CCA;
- (c) The scope of the activities covered by the arrangement, including any intangible or class of intangibles in existence or intended to be developed;
- (d) The duration of the arrangement;
- (e) The total amount of contributions incurred pursuant to the arrangement;

- (f) The allocation of tasks and responsibilities;
- (g) The form and value of each participant's initial contributions (including research) with a description of how the value of initial and ongoing contributions is determined and how accounting principles are applied;
- (h) A description of the method used to determine each participant's share of the contributions including projections used to estimate benefits, any rationale and assumptions underlying the projections and an explanation of why that method was selected;
- (i) The nature and extent of each participant's effective ownership interest in the results of the CCA activities;
- (j) The manner or basis on which proportionate shares of the expected benefits are to be measured;
- (k) The rationale and any assumptions underlying the projections of expected benefits;
- (l) The procedures for entering or withdrawing from the arrangement and the consequences thereof;
- (m) The policies and procedures governing balancing payments;
- (n) Where material differences arise between projected benefits and actual benefits realized, the assumptions made to project future benefits need to be amended for future years and the revised assumptions documented;
- (o) The extent of the use of CCA property by associated persons who are not CCA participants, including the amounts of consideration paid or payable by these non-participants for use of the CCA property; and
- (p) All material changes to the arrangement.

**APPENDIX B**

**COMPARABILITY ANALYSIS**



## **GLOSSARY**

### **Arm's length price**

An amount that would have been the transfer price of a transaction had the persons in the transaction dealt with each other at arm's length.

### **Balancing payment**

A payment, normally from one or more participants to a cost contribution agreement (CCA) to another, to adjust participants' proportionate shares of contributions, that increases the value of the contributions of the payer and decreases the value of the contributions of the payee by the amount of the payment.

### **Buy-in payment**

A payment made by a new entrant to an already active CCA for obtaining an interest in any results of prior CCA activity.

### **Buy-out payment**

Compensation that a participant who withdraws from an already active CCA may receive from the remaining participants for an effective transfer of its interests in the results of past CCA activities.

### **Contemporaneous transfer pricing documentation**

Transfer pricing documentation which is brought into existence –

- (a) when the person is developing or implementing any controlled transaction; and
- (b) where in the basis period for a year of assessment the controlled transaction is reviewed and there is material changes, the documentation shall be updated prior to the date for furnishing a return for that basis period for a year of assessment;



**Controlled transaction**

Transaction for acquisition or supply of property or services between –

- (a) persons one of whom has control over the other;
- (b) individuals who are relatives of each other; or
- (c) persons both of whom are controlled by some other person;

**Economic owner**

One who is not registered as an owner but is considered to own the intangible/tangible asset by virtue of bearing the costs and risks relating to the intangible/tangible asset, as is often the case in CCAs.

**Financial assistance**

Includes a loan, interest bearing trade credit, advance or debt and the provision of any security or guarantee.

**Financial institution**

Includes a bank or a finance company or a banking and finance company licensed or deemed to be licensed under the Banking and Financial Institutions Act 1989 [Act 372] or Islamic Banking Act 1983 [Act 276] or an institution prescribed under the Development Financial Institutions Act 2002 [Act 618] or the Lembaga Tabung Haji established under the Tabung Haji Act 1995 [Act 535] or the Malaysian Building Society Berhad incorporated under the Companies Act [Act 125] or the Borneo Housing Mortgage Finance Berhad incorporated under the Companies Act 1965 or a co-operative society registered under the Co-operative Societies Act 1993 [Act 502].

**Functional analysis**

A method of finding and organizing facts about a business in terms of its functions, assets (including intangible property) and risks. It aims to identify how these are divided between the parties involved in the transaction under review.

**Intangible property**

Includes patents, inventions, formulae, processes, designs, models, plans, trade secrets or know-how.

**Intentional set-off**

A benefit provided by one associated enterprise to another associated enterprise within the group that is deliberately balanced to some degree by different benefits received from that enterprise in return.

**Interest**

Includes finance charge, discount, premium or other considerations.

**Intragroup services**

Services rendered between companies in the same group.

**Legal owner**

The registered owner of an intangible/asset.

**Marketing intangible**

Includes an intangible that is concerned with marketing activities, which aids in the commercial exploitation of the property or has an important promotional value for the property concerned.

**Permanent establishment**

Subject to the meaning assigned to it in the arrangement made under section 132 of the Act, a fixed place of business of a particular person through which the business of the person is wholly or partly carried on or a fixed place of business of another person, through which the particular person makes supplies, in which case the permanent establishment shall be treated as a distinct and separate enterprise from its head office and related branches.

**Person**

Includes a company, a body of persons and a corporation sole.

**Property**

Includes any goods, movable or immovable thing, intangible property and beneficially owned property.

**Related party**

Refers to associated persons as described in 5.2.

**Relative**

**Within the meaning of controlled transaction, means** a parent, a child (including a stepchild and a child adopted in accordance with any law), a brother, a sister, an uncle, an aunt, a nephew, a niece, a cousin, an ancestor or a lineal descendant.

**Service**

Any rights, benefits, privileges or facilities that are, or to be, provided, granted or conferred under an arrangement for or in relation to any work and assistance including financial assistance.

**Tested party**

The participants in a [controlled transaction](#) that is the party by reference to whom a particular [transfer pricing method](#) is applied.

**Traditional transactional method**

The comparable uncontrolled price method or the resale price method or the cost plus method.

**Transaction**

Any trust, grant, covenant, agreement, arrangement or other disposition or transaction made or entered into orally or in writing (whether before or after the commencement of the Income Tax Act, 1967), and includes a transaction entered into by two or more persons with another person or persons.

**Transactional profit method**

The profit split method or the transactional net margin method.

**Transfer price**

An amount paid or payable or an amount received or receivable, as the case may be, by a person in a transaction for the acquisition or supply of property or services.

**Uncontrolled transactions**

Transactions carried on by independent persons dealing with one another at arm's length.

**LEMBAGA HASIL DALAM NEGERI MALAYSIA**

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