

Client Alert

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Proposed Transfer Pricing Changes

The Finance Bill 2018 ("**Bill**") introduces proposed changes to the Malaysian transfer pricing rules, which will potentially have some wide-ranging effects to taxpayers. This alert aims to summarise some of the key proposed changes by the Malaysian Inland Revenue Board ("**MIRB**") and advise on appropriate courses of action.

Proposed Changes To Transfer Pricing

Changes to the Control Test

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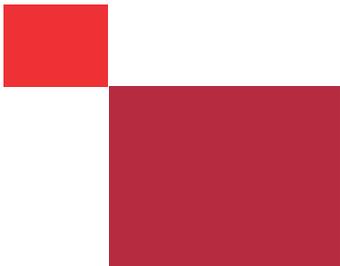
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The Malaysian Income Tax Act ("**MITA**") mandates that transactions between associated persons must be on an arm's length basis. Transactions between associated persons include transactions between persons one of whom has control over the other, or persons both of whom are controlled by some other person.

The existing provisions were broad-based but lacked a specific definition of control; however, the Bill seeks to clarify the parameters on which the control test is measured for the purpose of determining associated persons and potentially broadens the requirements relative to how they previously may have been interpreted. The proposed amendment is set out in the summary below:

Current Position	Proposed Amendment under Bill
<p>No specific definition of "control" for the purpose of transactions between associated persons.</p> <p>The control test is provided under the provision for controlled companies and refers to an ability to exercise or acquire direct or indirect control over the company's affairs if he possesses or is entitled to acquire the greater part of the share capital / voting power in the company.</p>	<p>A company will satisfy the control test where it meets:</p> <ul style="list-style-type: none">a) the shareholding test of 20% or more; andb) <u>one</u> of the following conditions:<ul style="list-style-type: none">i. business operations of the company depend on the proprietary rights provided by the related party;ii. business operation of the company are specified by the related party and prices and other conditions in relation to the supply are influenced by the related party; oriii. one or more directors or members of the board of directors of the company are





Current Position	Proposed Amendment under Bill
	<p>appointed by the related party.</p> <p>The term "controlled transaction" shall be construed as financial assistance:</p> <ul style="list-style-type: none"> i. between persons one of whom has control over the other; or ii. between persons both of whom are controlled by some other person (i.e. a third person).

Introduction of Restriction on Deductibility of Interest

The Bill has also proposed the implementation of anti "earning stripping" rules in the form of a new section, which seeks to restrict the deduction in respect of interest expenses in connection with or on any financial assistance in a controlled transaction up to a certain maximum amount which may be determined by rules made under the MITA. At present, the amount for the restriction has not been determined and will likely be announced in the form of a subsidiary legislation.

Under the Bill, the term financial assistance is defined to include loans, interest-bearing credit, advances, debt or the provision of any security or guarantee. Interest expense means interest on all forms of debt or any payments economically equivalent to interest but excludes expenses incurred in connection with the raising of finance.

Release of Updated Guidance by the MIRB

The MIRB has released new guidance on its website on 1 November 2018. Notably, it has released an Appendix A which increases the documentation burden in relation to specific transactions. These include transactions involving intragroup services, intangible property, financial assistance and cost contribution arrangements.

What should Businesses Do?

The proposed amendments and updated guidance signals a reinforced focus by the MIRB on transfer pricing. With the lower shareholding test for the purpose of determining control, it is possible that transfer pricing rules now apply to a wider range of transactions and transactions between associated persons which fulfil the new control test must comply with the arm's length requirements effective 1 January 2019 onwards should the Bill be passed in its current form.

With the implementation of the anti earning stripping rules, along with the added documentation burden on transactions pertaining to intragroup financial assistance, it is important that businesses review the sufficiency of the support for the arm's length nature (including documentation) of such financing arrangements.

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