



TRANSFER PRICING AUDITS AND DISPUTE RESOLUTION IN MALAYSIA

Presenters

Becky Nguyen
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Private and Confidential



AGENDA

Part 1

Latest Developments in OECD
Transfer Pricing Guidelines 2022

Part 2

Transfer Pricing planning
opportunities

Part 3

Transfer Pricing Documentation,
Audit prevention

Part 4

Tax and Transfer Pricing Dispute
Resolution Strategies

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Data, Technology and Insights for Risk, Governance and Growth

For nearly 100 years, Kroll has helped clients make confident decisions in the areas of valuation, real estate, taxation and transfer pricing, disputes, M&A advisory and other corporate transactions.

Kroll is the world's premier provider of services and digital products related to **governance, risk and transparency**. We work with clients across diverse sectors in the areas of valuation, expert services, investigations, cyber security, corporate finance, restructuring, legal and business solutions, data analytics and regulatory compliance.

The firm's nearly 5,000 professionals are located in **30 countries and territories** around the world.

~5,000

TOTAL PROFESSIONALS
GLOBALLY

13,400

CLIENTS INCLUDING
NEARLY

48% OF THE
S&P 500

THE
AMERICAS

2,000+

PROFESSIONALS

EUROPE AND
MIDDLE EAST

1,100+

PROFESSIONALS

ASIA
PACIFIC

850+

PROFESSIONALS

Enhancing Value

Our Service Areas



VALUATION ADVISORY

Valuation and consulting for financial reporting, tax, investment and risk management purposes

- Valuation Services
- **Transfer Pricing**
- Alternative Asset Advisory
- Real Estate Advisory
- Tax Services
- Fixed Asset Management and Insurance Solutions



CORPORATE FINANCE

Objective guidance to management teams and stakeholders throughout restructuring, financing and M&A transactions, including independent fairness and solvency opinions

- M&A Advisory
- Fairness and Solvency Opinions
- Transaction Advisory Services
- ESOP and ERISA Advisory
- Private Equity - Financial Sponsors Group
- Distressed M&A and Special Situations
- Private Capital Markets and Debt Advisory



GOVERNANCE, RISK, INVESTIGATIONS AND DISPUTES

Risk management and mitigation, disputes and other advisory services

- Business Intelligence and Investigations
- Compliance and Regulatory Consulting
- Compliance Risk and Diligence
- Cyber Risk
- Disputes Consulting
- Global Restructuring Advisory
- Legal Management Consulting
- Security Risk Management



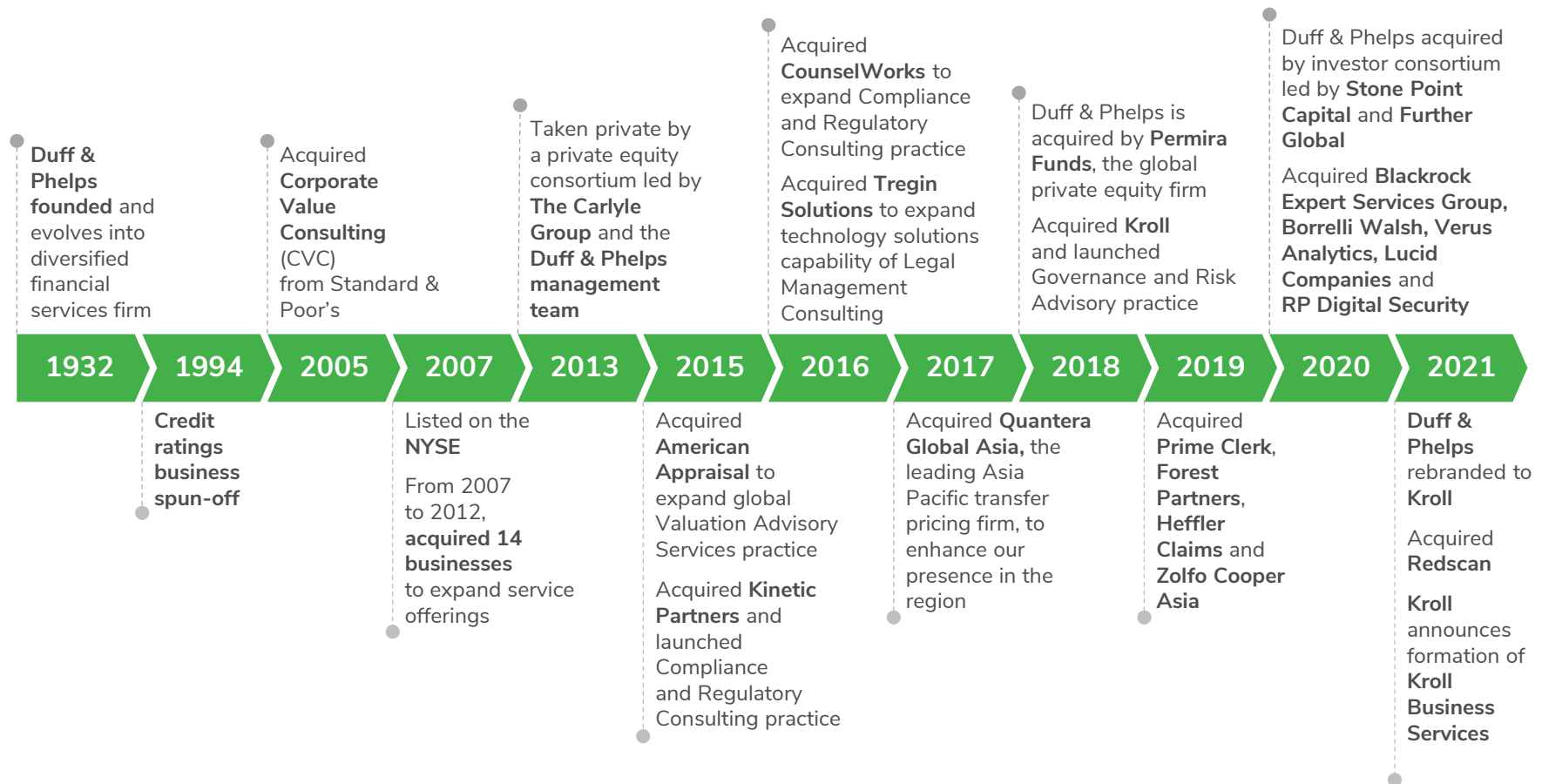
BUSINESS SERVICES

Complex legal and business solutions through our proprietary technology and team of experts

- Prime Clerk Restructuring
- Kroll Corporate Actions
- Lucid Issuer Services
- Lucid Agency and Trustee Services
- Kroll Class Action Administration
- Kroll Mass Tort Administration
- Kroll Notice Media Solutions
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Our Evolution

In Operation for Nearly 100 Years



Global Coverage

One Firm. One Global Team



North and Central America	South America	Europe				Africa		Asia, Australia, and Middle East	
Canada	Argentina	Austria	Georgia	Montenegro	Slovenia	Angola*	Rwanda*	Australia	Mongolia
Costa Rica*	Bolivia*	Belarus*	Germany	North Macedonia	Spain	Cameroon	Senegal	Burma*	New Zealand
Dominican Republic*	Brazil	Belgium*	Greece*	Netherlands	Sweden	Congo	South Africa	Cambodia	Philippines*
El Salvador*	Chile	Bosnia	Hungary	Norway*	Switzerland	Gabon	Tanzania	China	Saudi Arabia
Guatemala*	Colombia	Bulgaria	Iceland	Poland	Ukraine	Ghana	Uganda*	Hong Kong	Singapore
Honduras*	Ecuador*	Croatia	Ireland	Portugal*	United Kingdom	Ivory Coast	Zambia	India*	South Korea*
Mexico	Peru	Czech Republic	Italy	Romania		Malawi	Zimbabwe	Indonesia*	Taiwan
Panama*	Uruguay*	Denmark	Latvia	Russia		Mali		Israel	Thailand
Puerto Rico	Venezuela*	Estonia	Lithuania	Serbia		Mauritius		Japan	Turkey*
United States		France	Luxembourg*	Slovakia		Mozambique		Malaysia	UAE*
			Moldova			Namibia*		Maldives*	Vietnam

* Denotes locations where Kroll provides expertise via strategic alliance partners

Transfer Pricing Services

What We Do

Our Transfer Pricing Services are dedicated to offering practical, effective solutions across the full spectrum of transfer pricing and valuation issues any multinational firm may encounter when setting up and maintaining global operations – spanning design and implementation of transfer pricing systems, preparation and maintenance of compliance documentation to support the integrity of the system, through to defense of the system when faced with challenges by global tax authorities.

OUR SERVICES

- Global and Country Specific Transfer Pricing Documentation
- OECD Policy Analysis and Implementation
- Transfer Pricing Risk Assessment, Strategic Planning and Due Diligence
- Intercompany Finance Policy Development and Support
- IP Structure Planning, Implementation and Defense
- Global Supply Chain Strategies
- Advance Pricing Agreements (APAs)
- Cost Sharing / Cost Contribution Arrangements
- Intangible Migration Strategies
- Expert Services in Litigation and Audit Support

OUR DIFFERENTIATORS

- Globally integrated transfer pricing practice with industry leading tax valuation and transfer pricing capabilities.
- Largest transfer pricing team globally outside the Big 4 accounting firms
- Proven ability to respond quickly to global regulatory changes with distinguished transfer pricing specialists in the Americas, Europe and Asia Pacific.
- Low leverage, partner-led engagements, with a focus on providing high quality practical and strategic transfer pricing advice.
- Complete independence from audit, tax and regulatory restrictions.
- Practical approach with a focus on local nuances and developing defensible global policies.

Transfer Pricing Expertise

What Makes Us Different

Our **independent** and **practical** transfer pricing advisory services help solve complex regulatory issues and bring clarity to your intercompany dealings.



Senior Strategic Advice

Managing directors that stay **actively involved** throughout the lifecycle of our client relationships, providing the strategic advice required to solve complex issues



Unparalleled Independence

Work that is **unimpaired by audit independence restrictions**, allowing us to provide clear advice and team with your other tax, financial, legal and audit advisors



One Global Team

Local, in-house experts from across the Americas, EMEA and APAC regions that work seamlessly and consistently as one **globally coordinated team**

An End-To-End Solution

Our Approach to Transfer Pricing

We support our clients by providing clear strategic advice throughout the transfer pricing lifecycle from design to defence.

Design

We **design and plan robust transfer pricing strategies** through global regulatory impact assessment, tax position analysis, business location selection review, internal policy manual review, digital services tax assessment and intercompany financing design.

Defend

We assist in audit readiness and defence through our **controversy and expert witness** services, performing economic research and analyses for large-scale and multi-jurisdiction dispute resolution, arbitration, APAs, and MAPs, while also providing expert reports and testimonies.



Deploy

We partner with internal finance teams to support the challenging transition from advice to on-the-ground implementation through our **operational transfer pricing** capabilities, with deep experience developing large-scale, complex transfer pricing adjustment models.

Document

We provide strategic **global compliance capabilities**, including master file and OECD-compliant local documentation services, assistance with CbCR compliance and documentation, creation of tax file memoranda and other compliance reporting requirements.

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Part 1: Latest Developments in OECD Transfer Pricing Guidelines 2022

Presenter

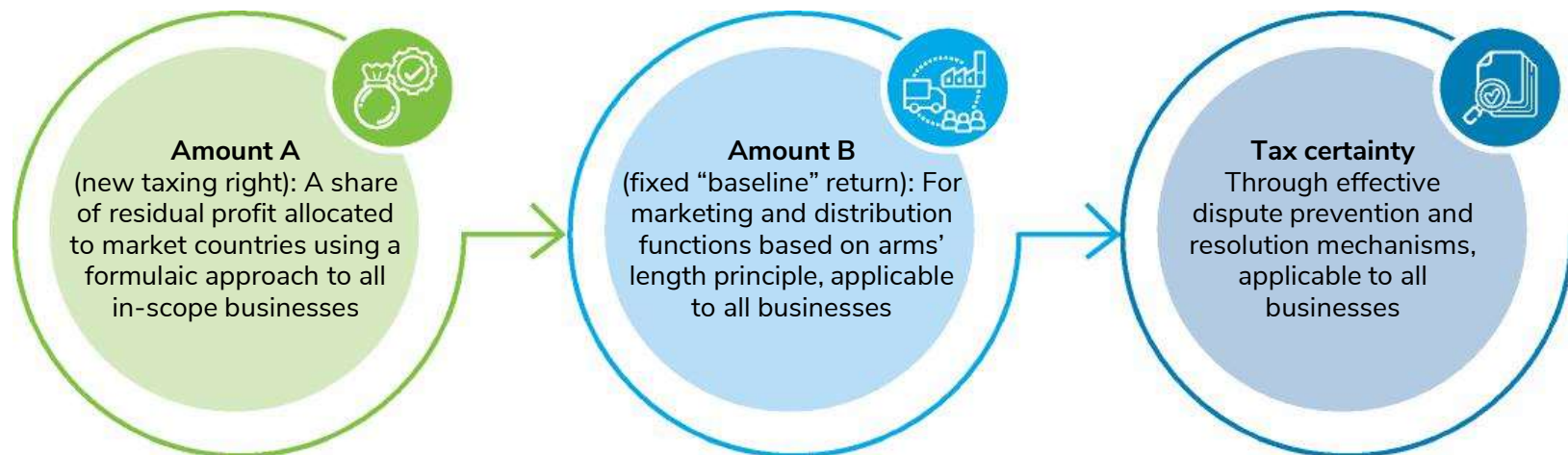
Becky Nguyen

BEPS 2.0 Pillar One and Pillar Two

Pillar One

Pillar One Blueprint: An overview

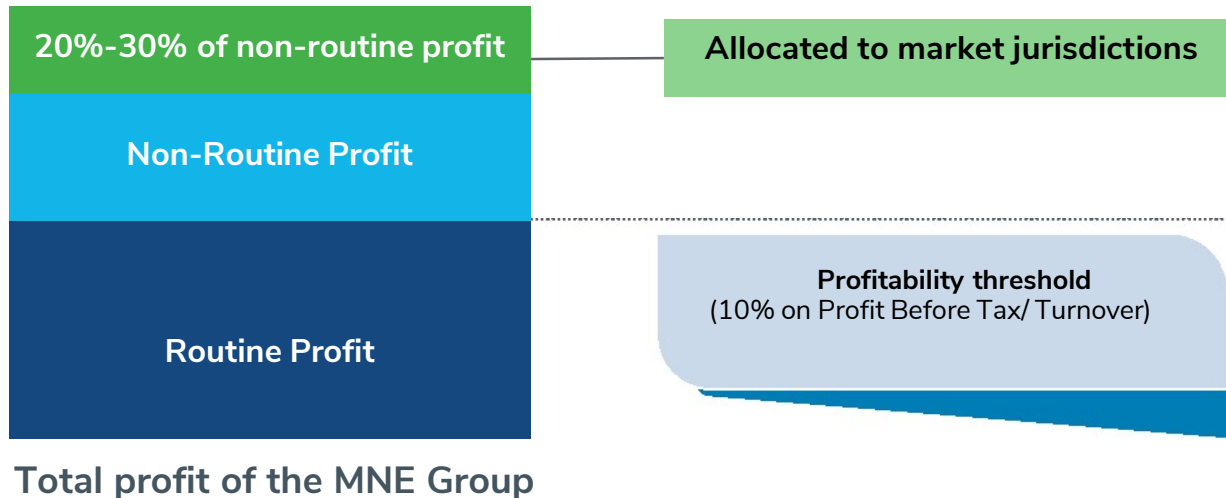
- **New Taxing right:** expand the taxing rights of market jurisdictions where there is an active and sustained participation of a business in the economy of that jurisdiction through activities in, or remotely directed at, that jurisdiction.
- **Scope:** All MNE groups with gross revenue exceeding **€20 billion (~RM90 B)** and **profitability above 10 %** (Profit before tax / revenue) are considered in-scope for Amount A.
- **New rules:** profit allocation and nexus rules applicable to business profits.



BEPS 2.0 Pillar One and Pillar Two

Pillar One

Illustration of Amount A:



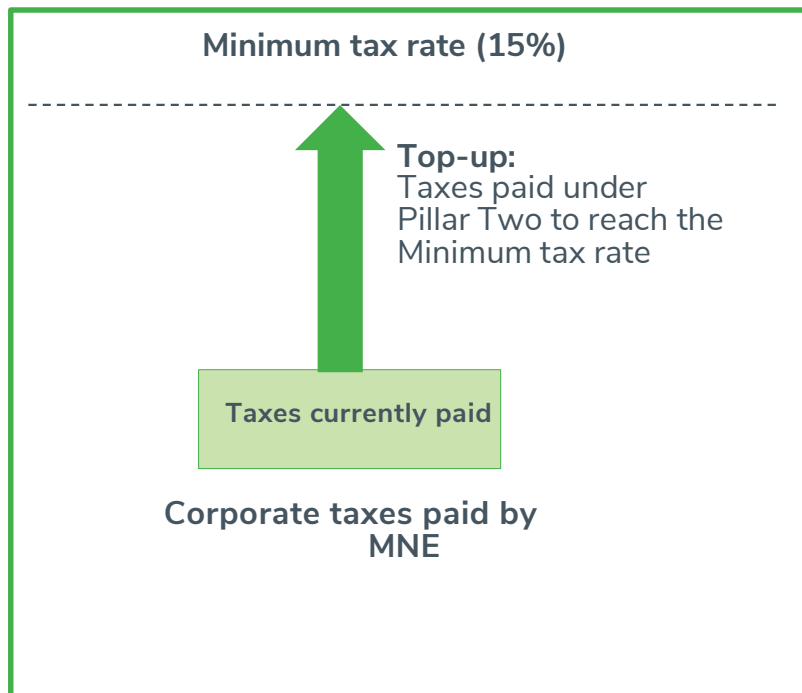
- **Profit allocation:** between 20 and 30 percent of residual profit, defined as profit before tax in excess of 10 percent of revenue, will be allocated to market jurisdictions with nexus, using a revenue-based allocation key.
- **Nexus:** Market revenue thresholds (€1 million (~RM 4M) /€250,000 (~RM 1M) for jurisdictions with GDP lower than €40 billion (~RM 160B) will apply to the in-scope revenue of a group, generated in a market jurisdiction.

BEPS 2.0 Pillar One and Pillar Two

Pillar Two

Pillar Two Blueprint: An overview

- **Scope:** MNE groups with total consolidated group revenue of €750 million (~RM3 B) or above.



- **Minimum tax rate:** large internationally operating businesses should pay **at least 15%** tax in each jurisdiction as well as overall, regardless of where they are headquartered or the jurisdictions in which they operate.

New OECD Guidelines 2022

On 20 January 2022, the OECD published the 2022 edition of the OECD TP Guidelines, by consolidating the changes made to the 2017 edition of the OECD TP Guidelines resulting from 3 reports:



Financial Transactions

- The report Transfer Pricing Guidance on Financial Transactions.
- Published on 11 February 2020.



Intangibles

- The report Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles.
- Published on 21 June 2018.



Profit Split Method

- The report Revised Guidance on the Application of the Transactional Profit Split Method.
- Published on 21 June 2018.

Part 1-A: Financial Transactions

Presenter

Becky Nguyen

POLL QUESTION 1:

HOW SIGNIFICANT WERE THE INTRAGROUP LOAN (PRINCIPAL AMOUNT) FOR YOUR COMPANY FOR FY2021?

A – NONE

B – INSIGNIFICANT (LESS THAN RM 1M)

C – SIGNIFICANT (MORE THAN RM 1M) – With TP Doc

D – SIGNIFICANT (MORE THAN RM 1M) – Without TP Doc

Financial Transactions

Economically relevant characteristics

Comparability factors for Financial transactions

Factors	Considerations
Contractual terms	<ul style="list-style-type: none">• Written agreement• Actual conduct of the parties
Functions, assets and risks	<ul style="list-style-type: none">• Lender: Exercising control over and financial capacity by lender to assume the risks• Borrower: Collateral by borrower
Characteristics of financial instruments	<ul style="list-style-type: none">• Type and purpose• Amount / capital structure• Maturity / repayment• Fixed or floating interest rate• Currency• Seniority / ranking• Collateral• Guarantee
Economic circumstances	<ul style="list-style-type: none">• Geographic location, industry, currency, timing
Business strategies	<ul style="list-style-type: none">• Use of funds for M&A, working capital

Financial Transactions

Treasury

Treasury functions include:

Intra-group Loan

- Lender's and borrower's perspectives;
- Use of credit ratings of the entity, multinational group, or the debt issuance to measure creditworthiness; and
- Transfer pricing approaches to determine arm's length rates: CUP

Cash pooling

- Cash pool leader and cash pool members;
- Allocation of the benefits of cash pooling; and
- Cash pool leader: should be rewarded for coordination or agency function

Hedging

- Where a centralised treasury function arranges a hedging contract that the operating entity enters into, the centralised treasury should be rewarded for provision of services to the operating company

Financial Transactions

Financial guarantees

Financial Guarantees - Overview

- Inter-company guarantees are usually provided by the parent in order to facilitate loans with an independent commercial lender.
- In standard financial guarantees, the guarantor pledges payment of cash liability in the event of a default.
- Key transfer pricing considerations:
 - Accurately delineate the transaction
 - Evaluate the benefits received by the guaranteed entity

Some of possible approaches

Comparable uncontrolled price (CUP)

Yield approach

Expected loss approach

Part 1-B: Hard to Value Intangibles

Presenter

Becky Nguyen

Intangibles

Economically relevant characteristics

Comparability factors for Intangibles

Factor	Considerations
Contractual terms	<ul style="list-style-type: none">• Written contracts, public records• Actual conduct of the parties• Legal ownership to determine the appropriate remuneration
Functions, assets and risks	<ul style="list-style-type: none">• Exercising control over development, enhancement, maintenance, protection, and exploitation (DEMPE) functions• Provide funding and other assets• Assume the risks associated with the intangible
Identification of the transaction whose prices and other conditions	<ul style="list-style-type: none">• Transactions identified by the MNE group in the relevant registrations and contracts
Application of the foregoing principles in fact patterns	<ul style="list-style-type: none">• Associated enterprises must receive arm's length compensation• Factors to evaluate:<ul style="list-style-type: none">(i) Level and nature of activity undertaken(ii) Amount and form of compensation paid

Hard-to-value intangibles (HTVI)

Background and context

- **Hard-to-value intangibles (HTVI):** covers intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises,
 - no reliable comparables exist, and
 - at the time the transaction was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible, are highly uncertain.
- The approach allows tax authorities to use ex-post outcomes (higher/ lower) as rebuttable presumption on the appropriateness of price-setting.

Taxpayer should provide:

- Financial projections used at the time of the transfer to determine the pricing arrangements.
 - Details of how risks were accounted for in calculations to determine the price
 - Explanation of the appropriateness of its consideration of reasonably foreseeable events and other risks, and the probability of occurrence
-
- Reliable evidence of any significant difference between the financial projections and actual outcomes

Part 1-C: Profit Split Method

Presenter

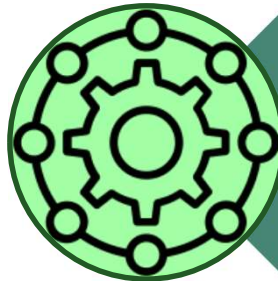
Becky Nguyen

Profit Split Method – When to Apply?



Unique and Valuable

- Contributions which are not comparable to those made by uncontrolled parties
- Significant risks are assumed by parties involved



High Integration of Business Activities

- Complementary activities could lead to the use of PSM when there is proven, visible inter-dependency
- Parties jointly perform functions, use assets and assume risks



Shared Assumption of Risks

- When risks are separately assumed, PSM can still be applied if those risks are closely inter-related or correlated
- Assumption of risk should match contribution to the control of the risk

Profit Split Method – How to Apply?



Contribution Analysis

- Total profits are divided based on the relative value of contributions made by each of the related parties



Residual Analysis

- Profits attributable to routine functions are divided based on TNMM
- Residual profits are divided based on the relative value of contributions



Profit splitting factors

- Assets: operating/ fixed assets
- Capital employed
- Costs: relative spending/ investment

Part 1-D: Potential Impacts to Businesses

Presenter

Becky Nguyen

Potential Impacts to Businesses

1. Financial Transactions



Consider not only the arm's length compensation of a financial transaction but also whether the overall management is consistent with arm's length principle



Avoid recharacterization of debt as equity, or as another debt instrument



Include information concerning characteristics of the debt



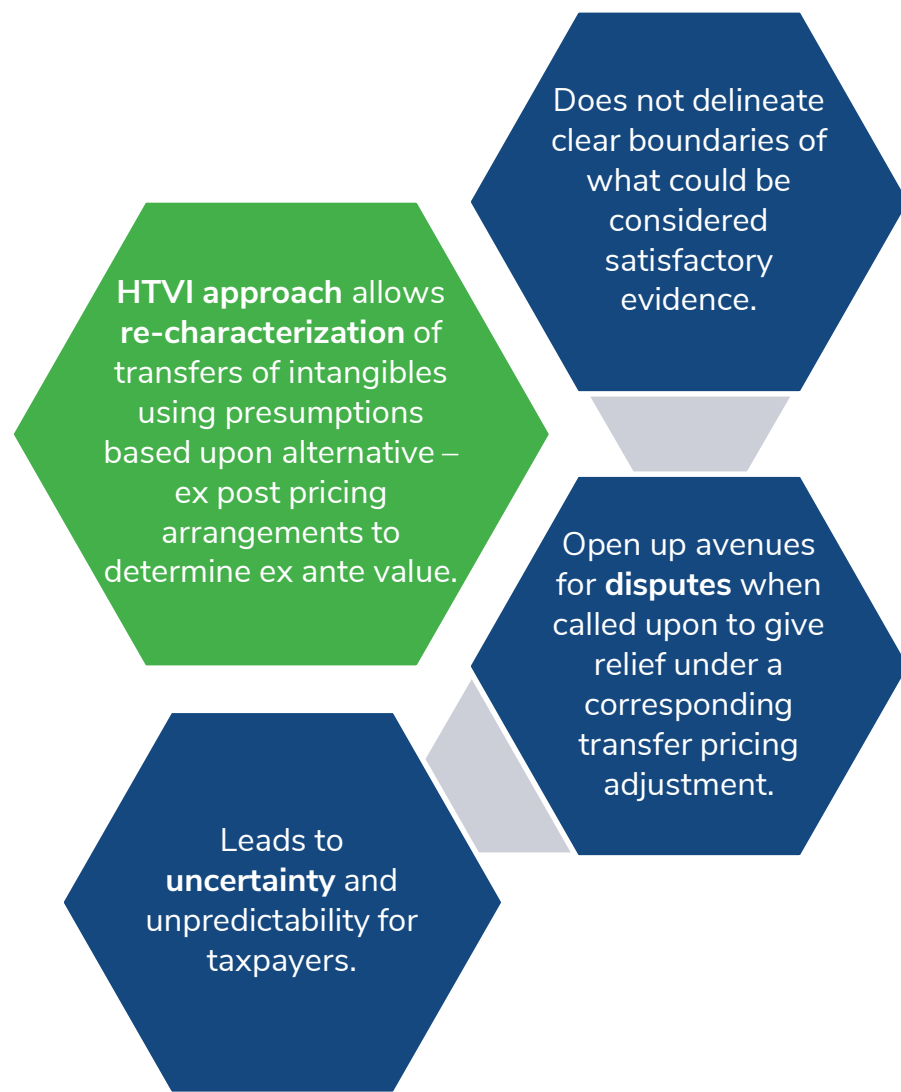
Consider realistically available alternatives to both lender and borrower



Address both lender and borrower's abilities to meet their debt obligations

Potential Impacts to Businesses

2. Intangibles



MNCs should:

- Revisit intangible structures; and
- Adapt them where necessary with supporting economic analysis and documentation.

This may assist **AVOIDING**
Presumptive Evidence Approach.

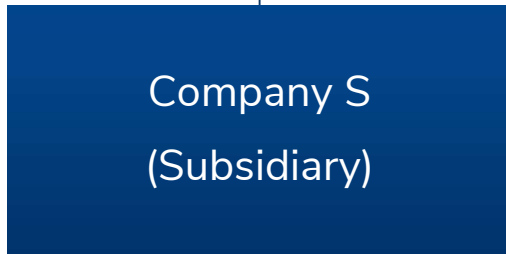
Potential Impacts to Businesses

3. Profit Split method

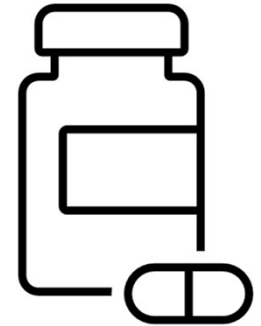


- Own patent for a new pharmaceutical formulation;
- Designed clinical trials;
- Performed R&D functions during development of product;
- Patent granted.

Company A licenses patent rights to Company S



- Conducts subsequent development of the product;
- Performs important enhancement functions;
- Obtains authorization from relevant regulatory body; and
- Product is successful and sold in various markets worldwide.



Accurate delineation of transaction



Unique and valuable contributions of both parties



Transactional Profit Split Method is appropriate!

Potential Impacts to Businesses

3. Profit Split method

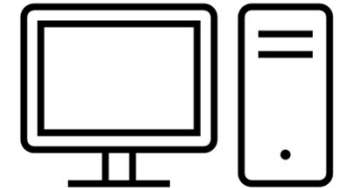
Company A
(Parent of M Group)

- Engaged in manufacturing and distribution of electronic devices; and
- Has exclusive right to sell the devices in all territories.

Company A subcontracts manufacturing of
electronic devices to Company B

Company B
(Another member of
M Group)

- Follows directions of Company A to produce devices;
- Sources and supplies the materials;
- Invested in machinery and tooling;
- Sells the finished goods to Company A, which in turn will market and distribute the product to unrelated customers.



Company B does not
make any unique or
valuable
contributions



Risks assumed by
Company B are not
economically
significant



Company B can be
reliably benchmarked
by reference to
comparable
uncontrolled
transactions - TNMM



Transactional profit
split method is
UNLIKELY to be the
most appropriate!

Part 2: Transfer Pricing planning opportunities

Presenter

Douglas Fone

Transfer Pricing Planning Opportunities

POLL QUESTION 2:

HOW LIKELY IS IT THAT YOU WILL BE CONSIDERING TRANSFER PRICING PLANNING OR SUPPLY CHAIN RESTRUCTURING OPPORTUNITIES IN THE NEXT 12 MONTHS?

A – NO CHANCE

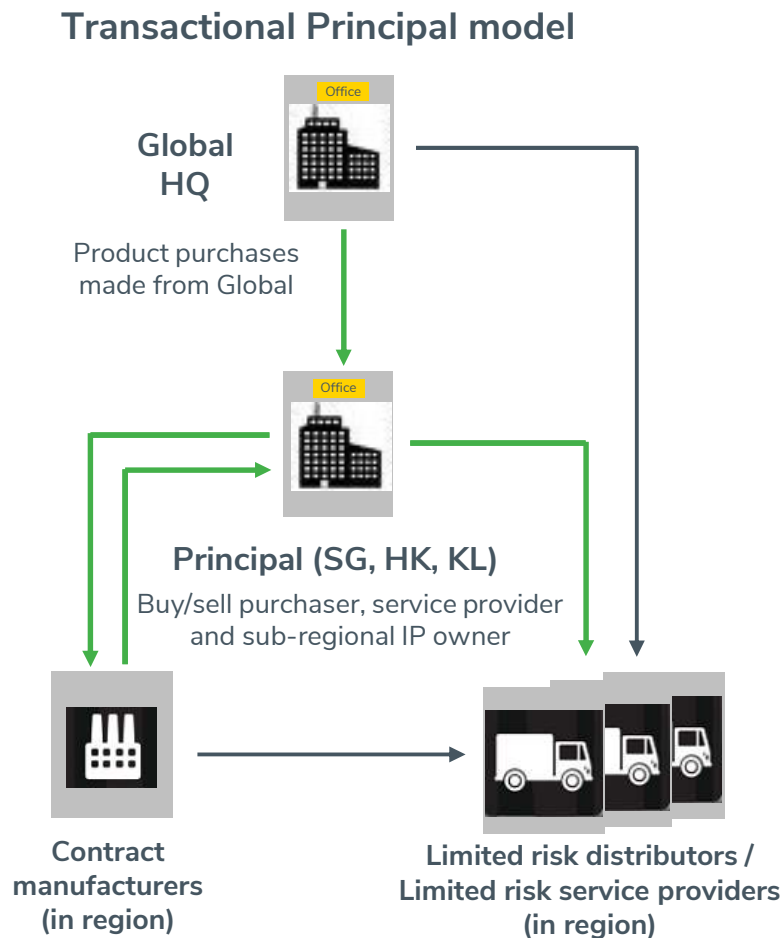
B – UNLIKELY (LESS THAN 25% CHANCE)

C – POSSIBLE / PROBABLE (25% - 75% CHANCE)

D – HIGHLY LIKELY (MORE THAN 75% CHANCE)

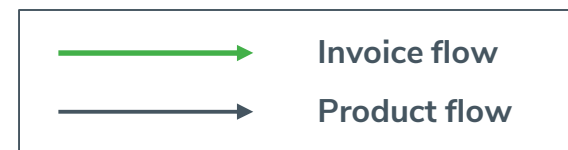
Transfer Pricing Planning Opportunities

Transactional Principal model



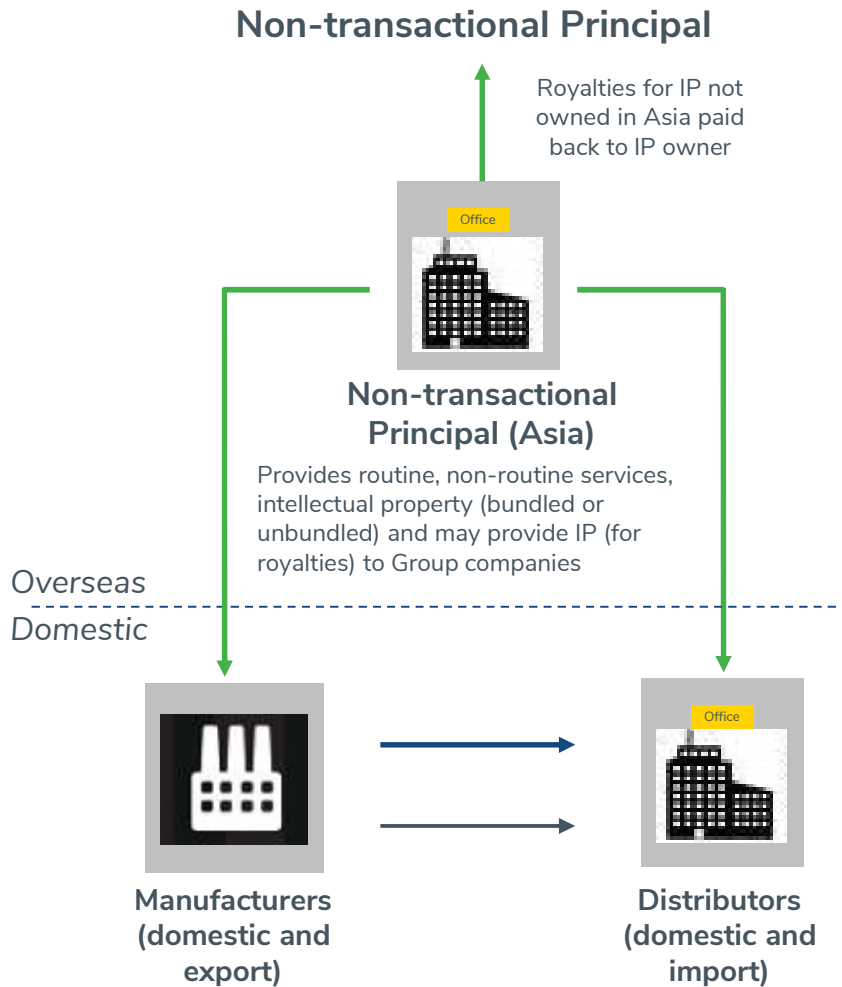
Model description and tax considerations

- A Principal is implemented in key locations (Singapore, Kuala Lumpur and/or Hong Kong) and functions as a sub-regional HQ
- The Principal books revenue and earns a portion of residual profits for regional coordination
- Distributors are converted to Limited Risk Distributors and manufacturers to Contract Manufacturers. They operate on a limited risk basis and earn limited risk returns
- Intellectual Property can be centralized in the Principal, with contract R&D providers being located in the region



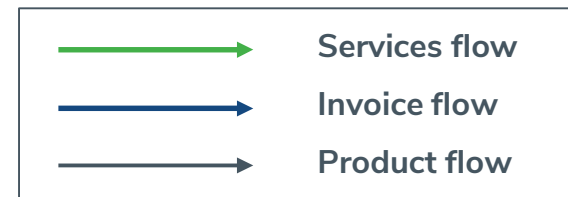
Transfer Pricing Planning Opportunities

Value added services Principal model



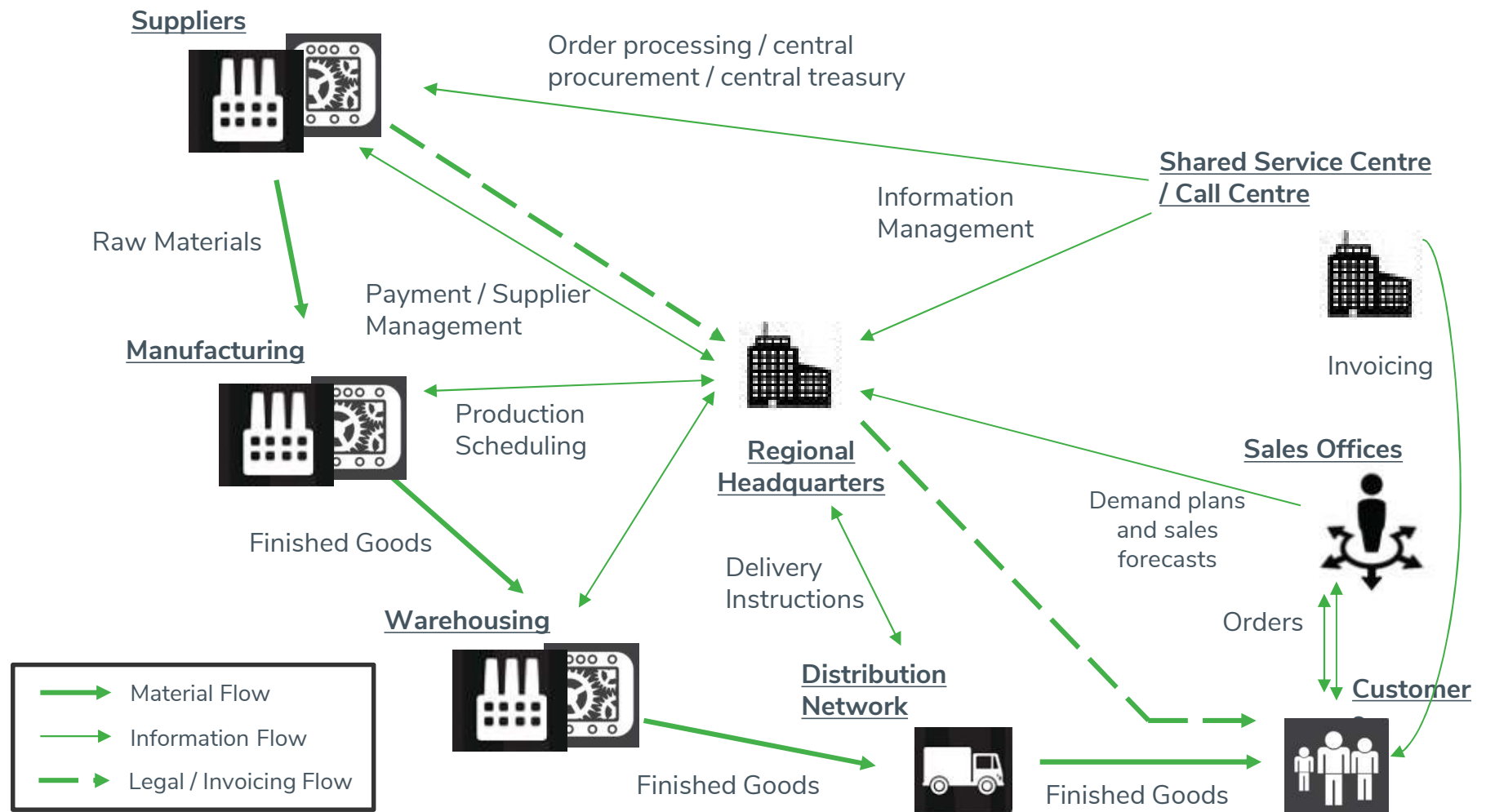
Model description and tax considerations

- The Non-transactional (services) Principal provides value-added services and IP to manufacturers and distributors for value-based service fees and royalties
- The Principal is located in a favorable tax jurisdiction for the company
- Incremental substance added through managing the services and IP transactions may reduce the Effective Tax Rate further
- Important considerations include:
 - Subpart F – ensuring income is not caught as Foreign Base Company Services Income
 - PE and transfer pricing considerations
 - Deductibility of services fees
 - Indirect tax and customs duty concerns
 - Exchange control issues
 - Withholding tax



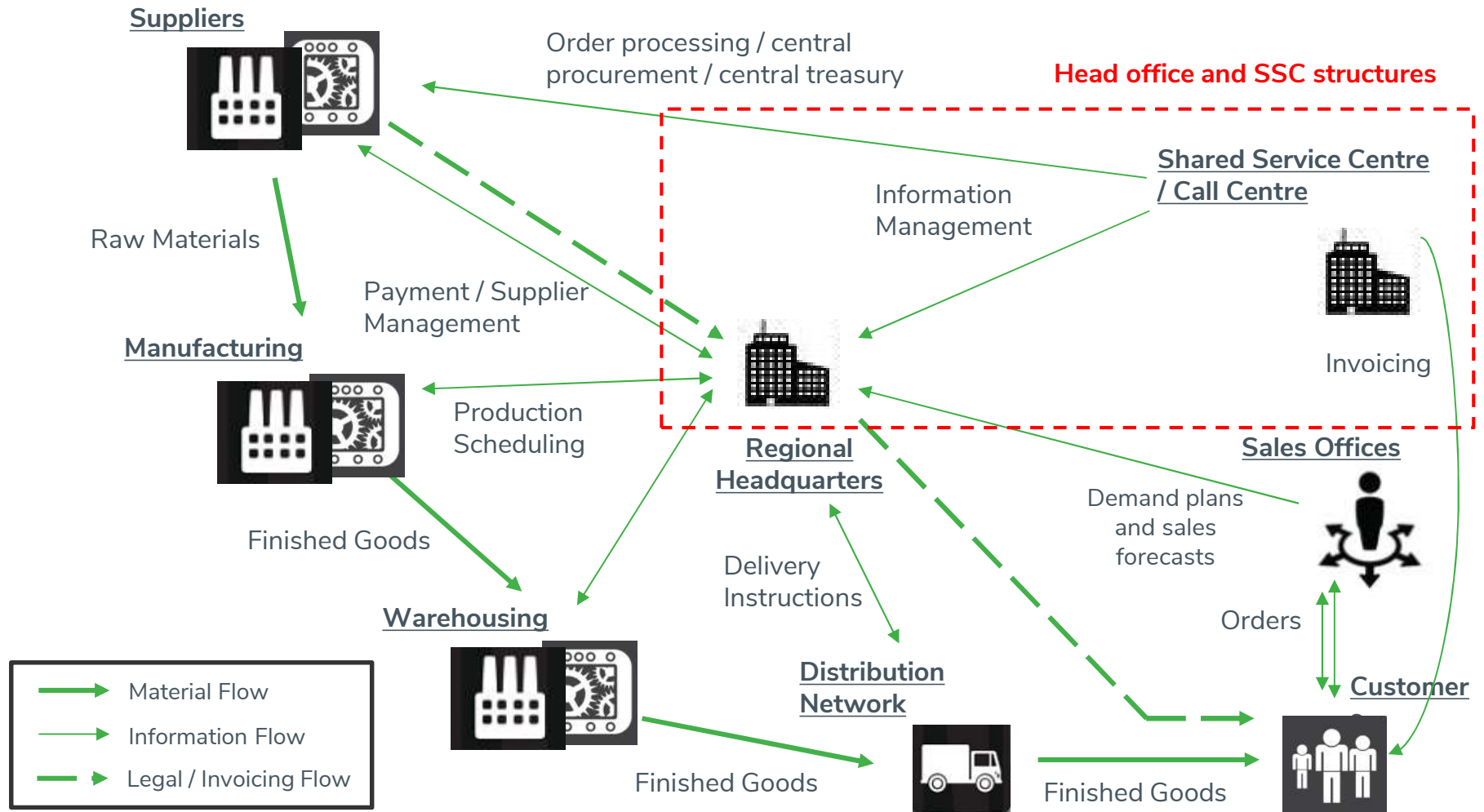
Transfer Pricing Planning Opportunities

Typical regional structure – centralised business model



Transfer Pricing Planning Opportunities

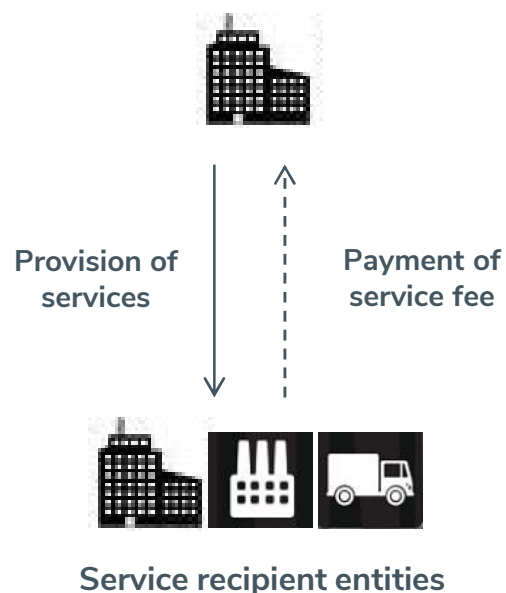
HQ and shared service centre structures



Transfer Pricing Planning Opportunities

HQ and/or shared service centres

Shared Service Centre / Call Centre



Service provider perspective – how to price the service fee?

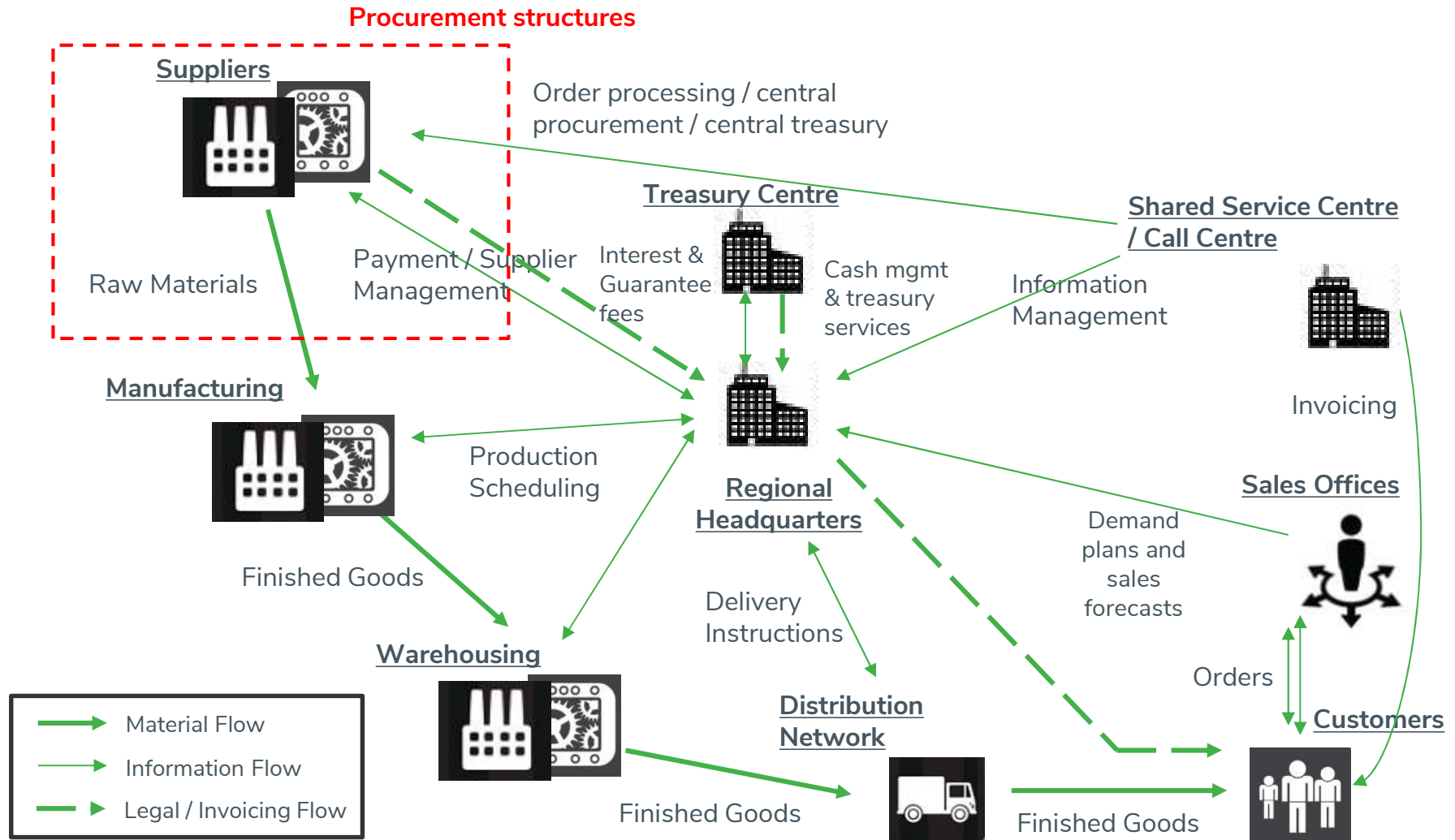
- Allocation of direct service costs to individual service recipient
- Apportionment of indirect service costs on a fair and reasonable basis depending on the nature of the expense, e.g., headcount for HR services, number of IP addresses for IT services – based on a user-pays principle
- Add an arm's length mark-up but only on value-add (non-pass through) costs

Service recipient perspective – how to ensure tax deduction?

- Are valuable benefits received from the services provided?
- Are the benefits received commensurate with the charge made?
- If the services are not received from the SSC, would the service recipients have to source the services from elsewhere or carry out those services in-house?
- Are there any cheaper alternative service providers realistically available?
- Deductibility of service charges for payers
 - Evidence of benefit derived re costs saved or income increased
 - Is charge commensurate with benefit received?
 - Detailed break down of cost base typically required
 - Allocation bases used – not necessarily revenue based
 - Legal agreement and transfer pricing documentation

Transfer Pricing Planning Opportunities

Procurement structures



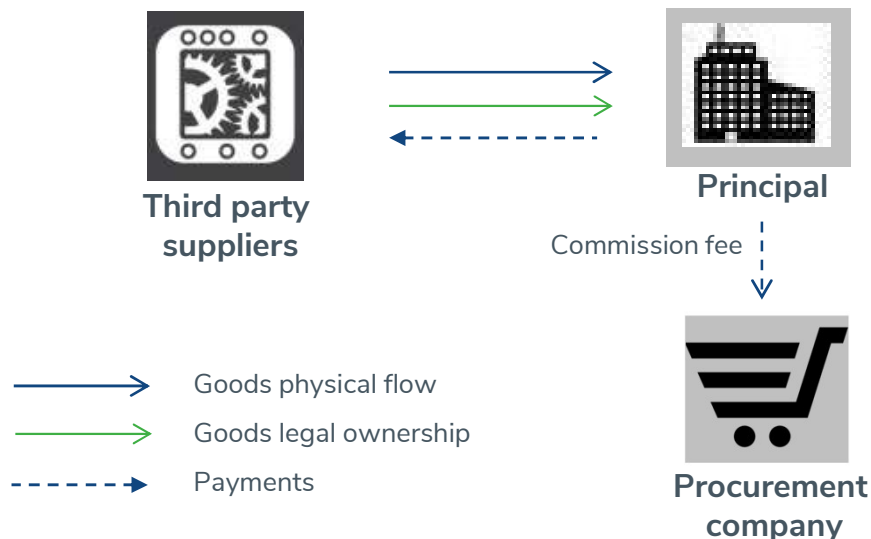
Transfer Pricing Planning Opportunities

Procurement structures



Service model

- Procurement Co performs only coordination and support services
- Does not take ownership of the materials and assumes a low level of risks
- Service fee for Procurement Co is based on cost plus on OPEX only
- Typically, around 7-12%

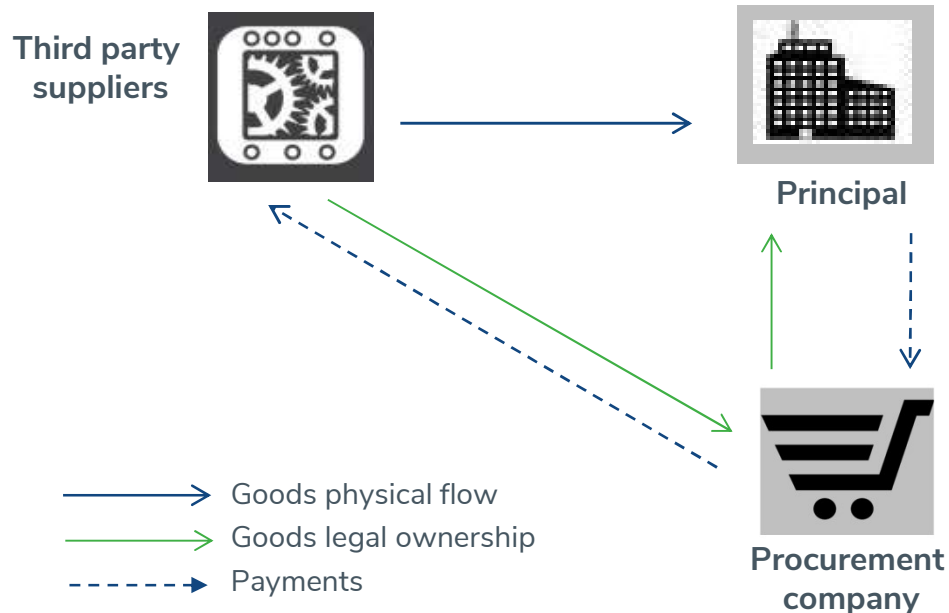


Commission model

- Procurement Co undertakes activities with some value added, generally related to market intelligence
- Procurement Co does not take ownership and risks are low
- The revenue of Procurement Co is based on a commission fee calculated as a percentage of the value of goods procured

Transfer Pricing Planning Opportunities

Procurement structures

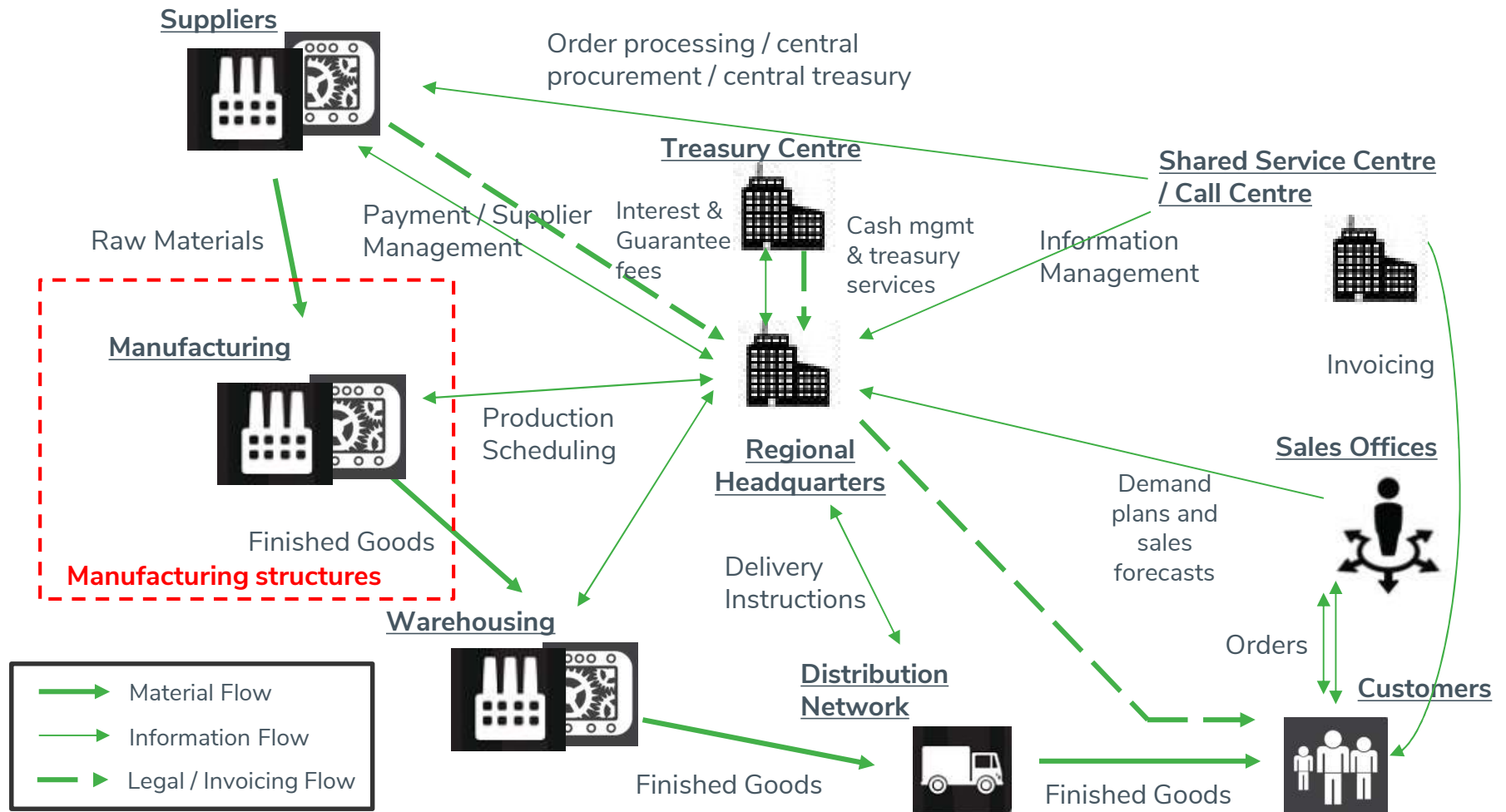


Buy/Sell model

- Procurement Co performs activities with a high added value, such as market intelligence, inventory and manufacturing management, quality control, finance and logistics
- Procurement Co takes ownership of materials purchased and usually assumes inventory, foreign exchange and logistics risks
- The transfer pricing policy is designed with reference to savings achieved and based on operating margin at lower end of distributor spectrum

Transfer Pricing Planning Opportunities

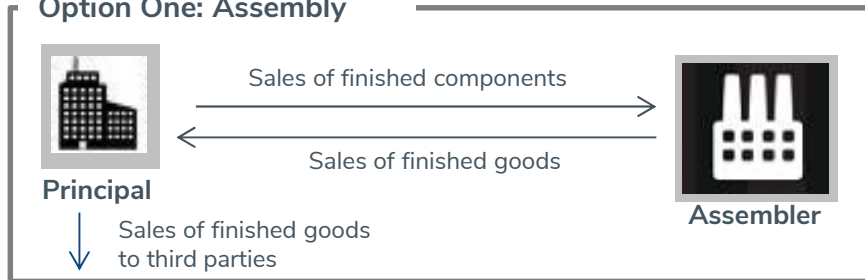
Manufacturing structures



Transfer Pricing Planning Opportunities

Manufacturing in Asia

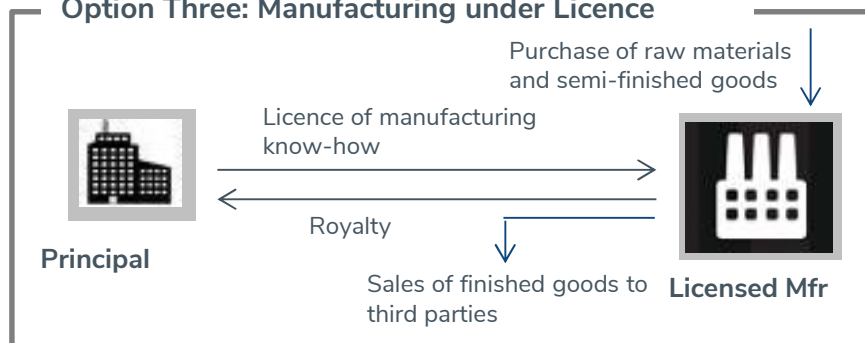
Option One: Assembly



Option Two: Contract Manufacturing



Option Three: Manufacturing under Licence



Assembler

- Routine and low-risk activities – assembling products from components supplied by Principal
- Should earn low but stable profit, tested on basis of TNMM or cost plus

Contract Manufacturer

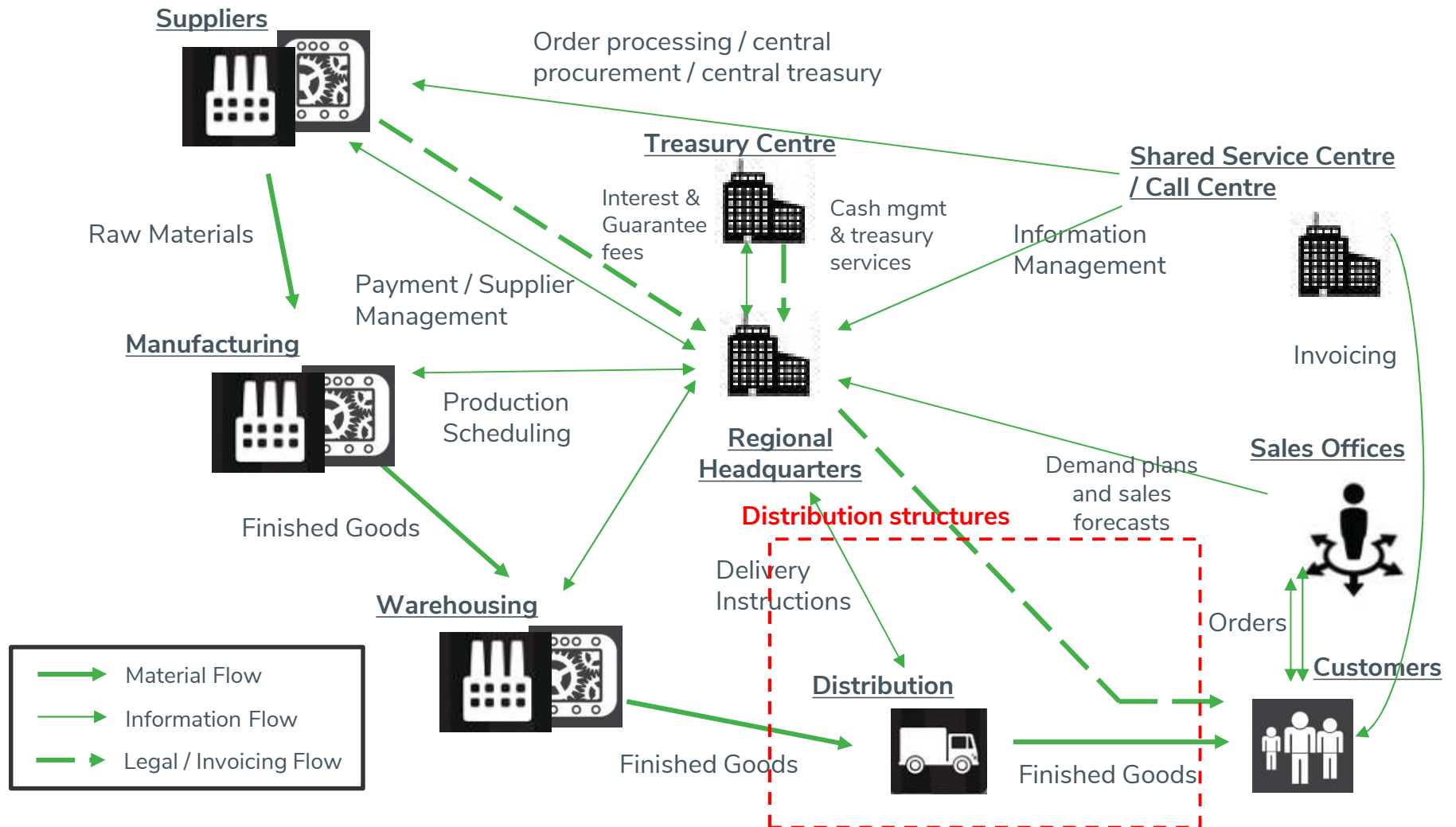
- Processes raw materials and semi-finished goods supplied by Principal and sells the resultant finished goods back to Principal
- Similar to Toll Manufacturer, but takes title to the raw materials and WIP
- Should earn low but stable profit, tested on basis of TNMM or cost plus

Licensed Manufacturer

- Purchases raw materials and other inputs mainly from third parties, processes them potentially under licence of manufacturing know-how from Principal, and sells finished goods mainly to third parties. More complex activities and operates as a Profit Centre, bearing capacity and other risks
- Should earn higher/fluctuating profit, tested on basis of TNMM or cost plus
- Test royalty paid to Principal by way of CUP method

Transfer Pricing Planning Opportunities

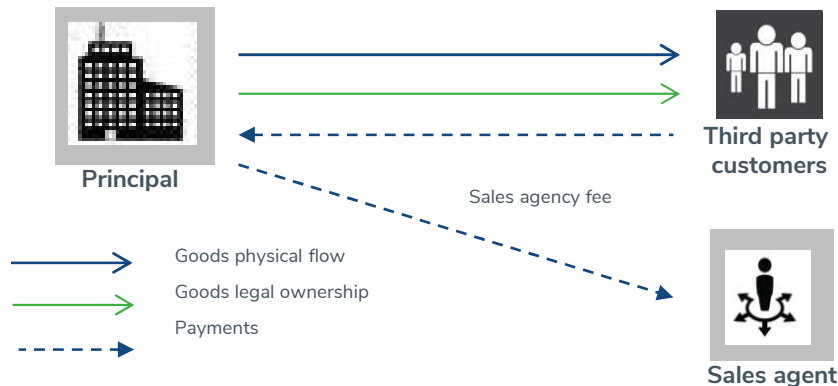
Distribution structures



Transfer Pricing Planning Opportunities

Distribution structures

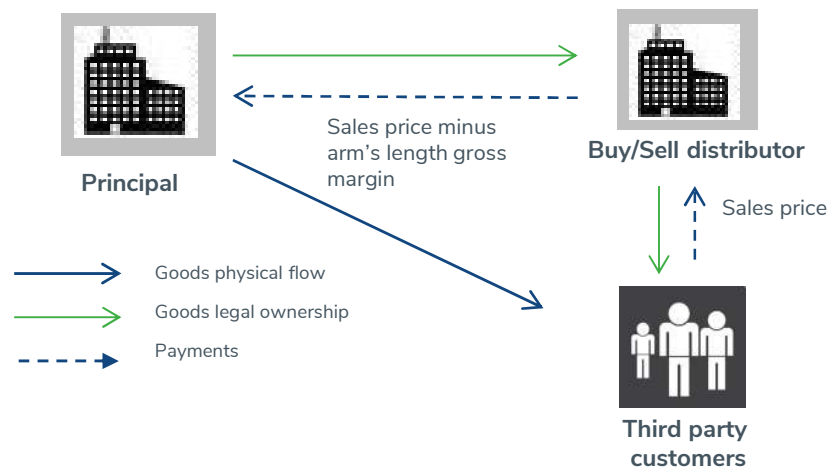
Sales agent model



Sales Agent

- Sales agent does not take title to the goods, but carries out limited sales support activities to facilitate the sales that are made by the Principal to third parties
- Sales agent receives a cost-plus service fee or a commission on sales sufficient for it to earn an arm's length net margin, which should be low but stable
- Check the arm's length nature of the fee by way of cost-plus method, TNMM or potentially CUP method if data can be found

Buy/Sell model



Buy/Sell Distributor

- Buy/sell distributor takes title to the goods, bears significant risks and carries out more functionally intense activities to generate the sales, e.g., marketing, logistics management
- Buy/sell distributor receives a gross margin on the sales made to third party customers, sufficient for it to earn an arm's length net margin, which should fluctuate but should be higher over an economic cycle
- Check the arm's length nature of the gross/net profit, by way of resale price method or TNMM

Transfer Pricing Planning Opportunities

How to ensure benefits are secure?

1. Design transfer pricing systems properly in advance
2. Ensure optimum compliance to reduce risk of scrutiny
3. Avoid common audit red flags
4. Ensure high standards of corporate governance
5. Recognise the risks, take the issues seriously and take action to prevent problems and costs in the future
6. Ensure profitability is in line with “value creation”
7. Consider availability and use of MAP
8. Consider availability and use of APAs

Transfer Pricing Planning Opportunities

How to ensure benefits are secure?

1. Design transfer pricing systems properly in advance

- Should the related parties involved be treated as profit centres, revenue centres, cost centres or ?
- What related party transactions should be introduced?
- What price-setting method should be applied to the related party transactions?
- What should be the physical flow of goods/services, and what should be the contract/invoice flow?
- What should the actual price of goods/services be – apply benchmarking and economic analyses to determine pricing
- Monitor actual results and take corrective action promptly – prospective adjustments rather than post-year end adjustments

Transfer Pricing Planning Opportunities

How to ensure benefits are secure?

2. Ensure optimum compliance to reduce risk of scrutiny

- Tax return disclosures
- Disclosure of transactions in audited accounts
- Importance of specific benchmarking
 - Carefully scrutinised by Tax Offices and Courts
- Transfer pricing documentation should be complete, up-to-date and prepared contemporaneously
- Other important documentation:
 - Legal agreements should be in place and arm's length in nature
 - Evidence of services provided, benefits received
 - Evidence of price negotiation/price-setting
 - Evidence of existence and value of IP

Transfer Pricing Planning Opportunities

How to ensure benefits are secure?

3. Avoid common audit red flags

- Non-compliance with documentation requirements
- Start-up losses for more than two years
- Lower profits or losses for extended period, but expanding operations
- Decision-making by overseas related party
- Low profitability – below inter-quartile range
- Fluctuating profit patterns inconsistent with profile
- Transactions with related parties in tax havens
- High-risk transactions, such as royalties and services
- Significant drops in profit after termination of tax holiday

Transfer Pricing Planning Opportunities

How to ensure benefits are secure?

4. Ensure high standards of corporate governance

- Transfer pricing policy paper
- Maintenance and disclosure manual
- Clear communication of TP model internally
- Protocols for dealing with transfer pricing queries
- Maintain professional relations with Tax Office
- Regular transfer pricing risk reviews/health checks
- Review of variances of actual performance vs. budget
- Prospective price adjustments to achieve targets
- Engage independent experts

Transfer Pricing Planning Opportunities

How to ensure benefits are secure?

5. Recognise the risks, take the issues seriously and take action to prevent problems and costs in the future

6. Ensure profitability is in line with “value creation” – economic reality paramount but ensure legal and accounting realities too

7. Consider availability and use of MAP

- Often not available, practical or affordable

8. Consider availability and use of APAs

- Requirement for provision of additional data and economic analyses
- What are the risks of transfer pricing dispute in the future?
- What is the amount of double taxation at stake?
- Up-front investment required in time and resources
- Long-term benefits - simplified compliance / avoidance of double taxation

Part 3: Transfer Pricing Documentation, Audit prevention and Case Studies

Presenter

Becky Nguyen

Part 3-A: Transfer pricing Documentation

Presenter

Becky Nguyen

Transfer Pricing Documentation

POLL QUESTION 3:

WHAT ARE YOUR KEY CONCERNS WHEN PREPARING TRANSFER PRICING DOCUMENTATION FOR FY2020?

A – HOW TO JUSTIFY LOSSES

B – HOW TO DEAL WITH EXCEPTIONAL COVID COSTS

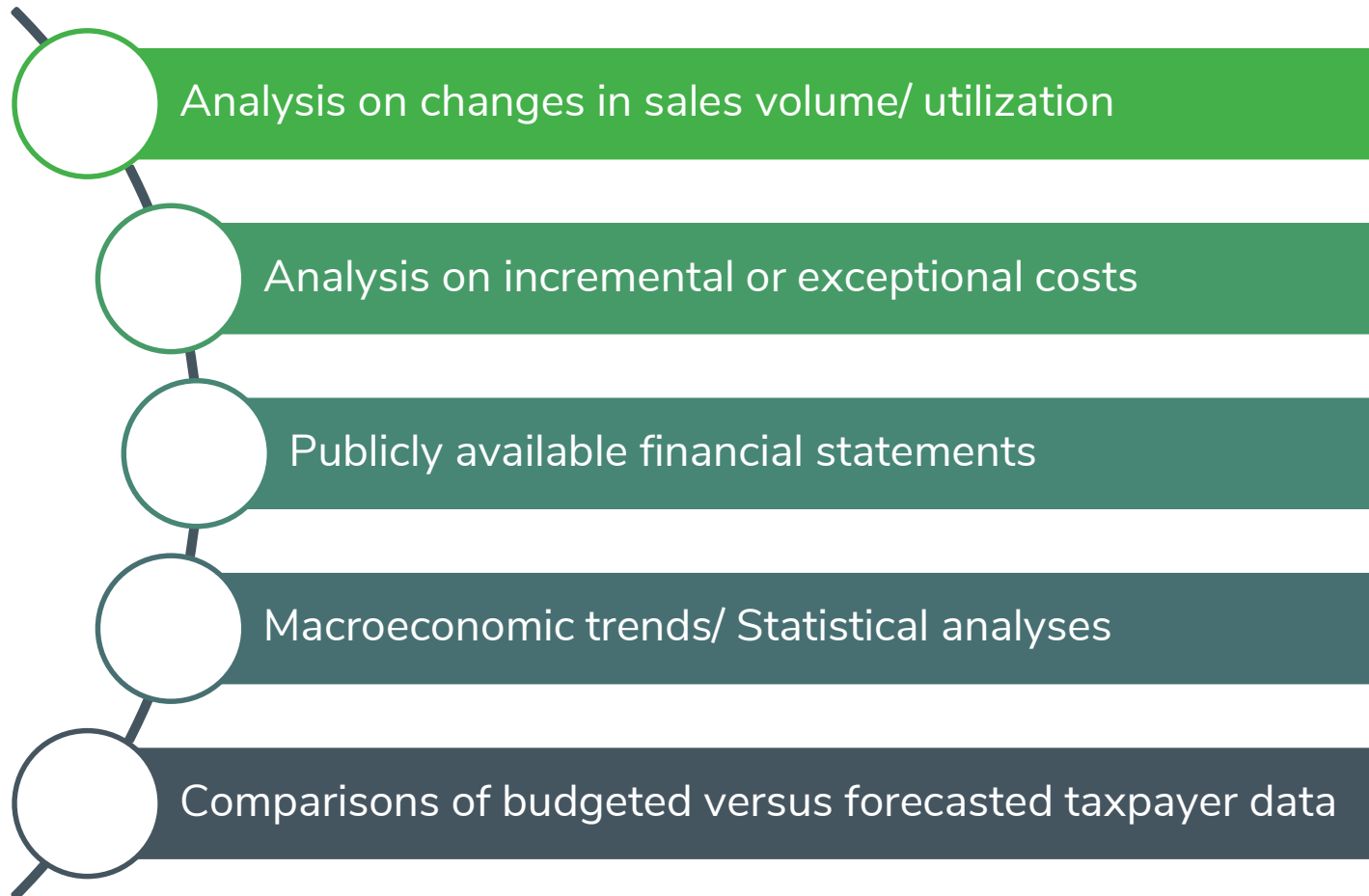
C – HOW TO BENCHMARK SPECIFIC TRANSACTIONS

D – HOW TO MINIMISE RISK OF TAX OFFICE SCRUTINY

Transfer pricing Documentation

1. Comparability Analysis

When performing comparability analysis, companies need to consider:



Transfer pricing Documentation

1. Comparability Analysis

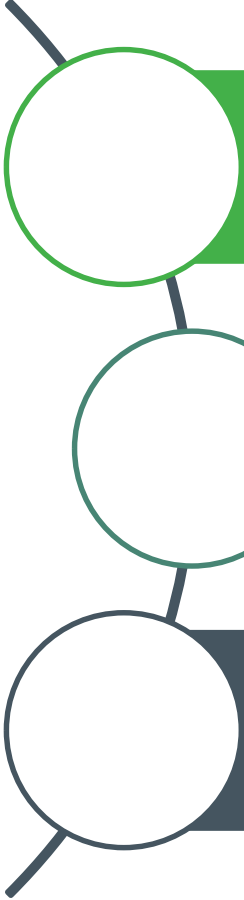
What Practical Approaches May Be Available for Making Financial Adjustments?

- **Option 1:**
 - Adjust the results of the tested party as far as possible to eliminate the impact of COVID-19 for the period in question, likely FY2020 and FY2021
 - Compare the adjusted results of the tested party to the range of the comparable companies' results from a multiple year period before the impact of COVID-19, such as FY2017-2019.
- **Option 2:**
 - Determine the actual impact of COVID-19 on the sales, gross profit and operating expenses of the tested party.
 - Adjust to the same extent the financial data of the comparable companies from the pre-COVID-19 period.
 - This would likely lead to a lower range against which the tested party's actual performance in FY2021 can be compared for the purposes of determining compliance with the arm's-length principle.
- **Option 3:**
 - Carry out the financial analysis of the tested party and comparables over a longer multiple-year period, e.g., five or more years, to even out the relative impact of COVID-19 on FY2021.
 - This more basic approach is not considered the best approach due to the exceptional (once in a century) circumstances of COVID-19.

Transfer pricing Documentation

2. Losses and the Allocation of COVID-19 Specific Costs

When considering the allocation of COVID-19 specific costs or losses between associated entities, companies need to emphasize:



The allocation of risks between related parties to an arrangement affects how profits or losses resulting from the transaction are allocated at arm's length through the pricing to the transaction

It is necessary to consider the allocation of exceptional, nonrecurring operating costs arising as a result of COVID-19 between related parties, and such allocations should be based on an assessment of how independent enterprises allocate costs under comparable circumstances.

Parties to intercompany agreements may consider whether they have the option to apply force majeure clauses, revoke or revise their intercompany agreements

Transfer pricing Documentation

2. Losses and the Allocation of COVID-19 Specific Costs

Special analysis for loss making entities

Considerations

- Companies affected by the Covid-19 pandemic should carry out a special factor analysis where all **legal, commercial rationales and justifications** are in place to establish a defensible position.



Key Takeaways

- A sound transfer pricing position is to be supported by a set of **contemporaneous transfer pricing documentation** setting out the specific business factors, contractual and financial analysis as evidences of the loss-making position.



Contractual analysis

- Review contractual terms,
- Obligations under the contract,
- Document the costs incurred.



Loss factor analysis

- Specific reasons for losses,
- Financial analysis,
- Documentation.



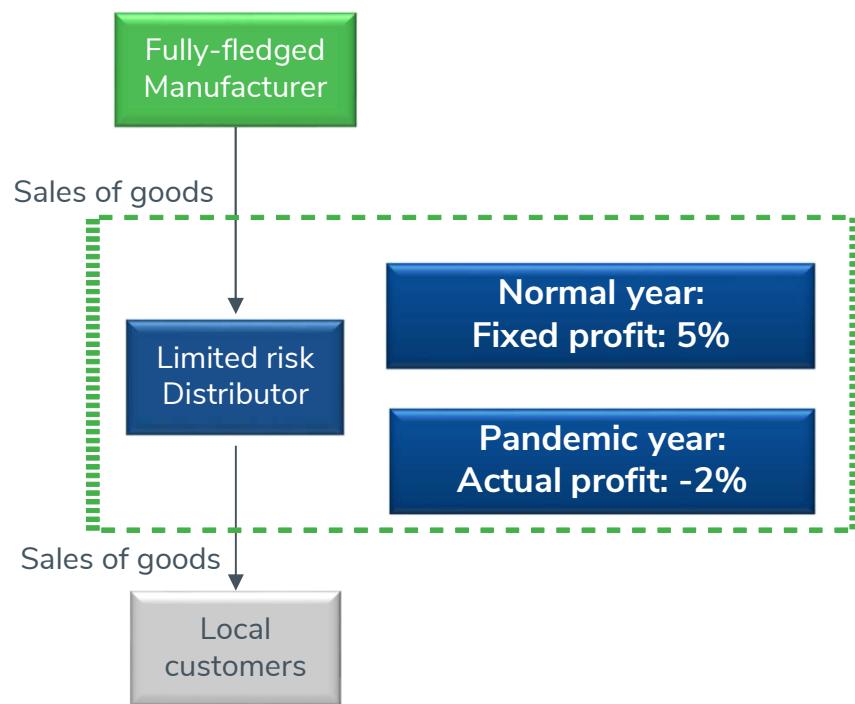
Segregated period analysis

- Covid-19 affected period,
- Transition period,
- Resumption period.

Transfer pricing Documentation

2. Losses and the Allocation of COVID-19 Specific Costs

Special analysis: An Example



Contractual analysis:

- Force majeure clause: compensation due to unforeseen crisis

Loss factor analysis:

- Special factor: significant drop in demand/sales and/or increase in costs

Segregated period analysis:

- Covid-19 affected period: 100% drop in demand
- Transition period: 50% drop in demand
- Resumption period: 10% drop in demand

Transfer pricing Documentation

2. Losses and the Allocation of COVID-19 Specific Costs

Can Loss-making Comparables Be Used?

- Typically, there is a reluctance among Asia Pacific tax authorities to allow the use of loss-making comparables.
- In Malaysia, loss-making comparables can be used on case-by-case basis.
- Certainly, for practical risk management purposes, taxpayers should try to avoid sole reliance on loss-making comparables.
- If this is not possible, then taxpayers can use loss-making comparables and be prepared to argue for their inclusion, relying on the commercial reality that independent parties sometimes make losses without ceasing to be a going concern. Consider whether losses are COVID-related or due to normal fluctuations of business – pay attention to the years of data available.

Transfer pricing Documentation

2. Losses and the Allocation of COVID-19 Specific Costs

Traditionally, IRB may **reject loss-making comparable companies** on grounds of non-comparability.

Comparable Analysis Results	Covid-19 pandemic		
	FY 2018	FY 2019	FY 2020/2021
Comparable Co. A	5%	6%	-5%
Comparable Co. B	4%	3%	-8%
Comparable Co. C	11%	10%	2%
Comparable Co. D	9%	8%	-10%
Comparable Co. E	15%	12%	3%
Upper Quartile	11%	10%	2%
Median	9%	8%	-5%
Lower Quartile	5%	6%	-8%
Taxpayer's results	10%	9%	-3%
Conclusion (at Medium)	Arm's length	Arm's length	?

Will IRB accept loss-making comparable companies?

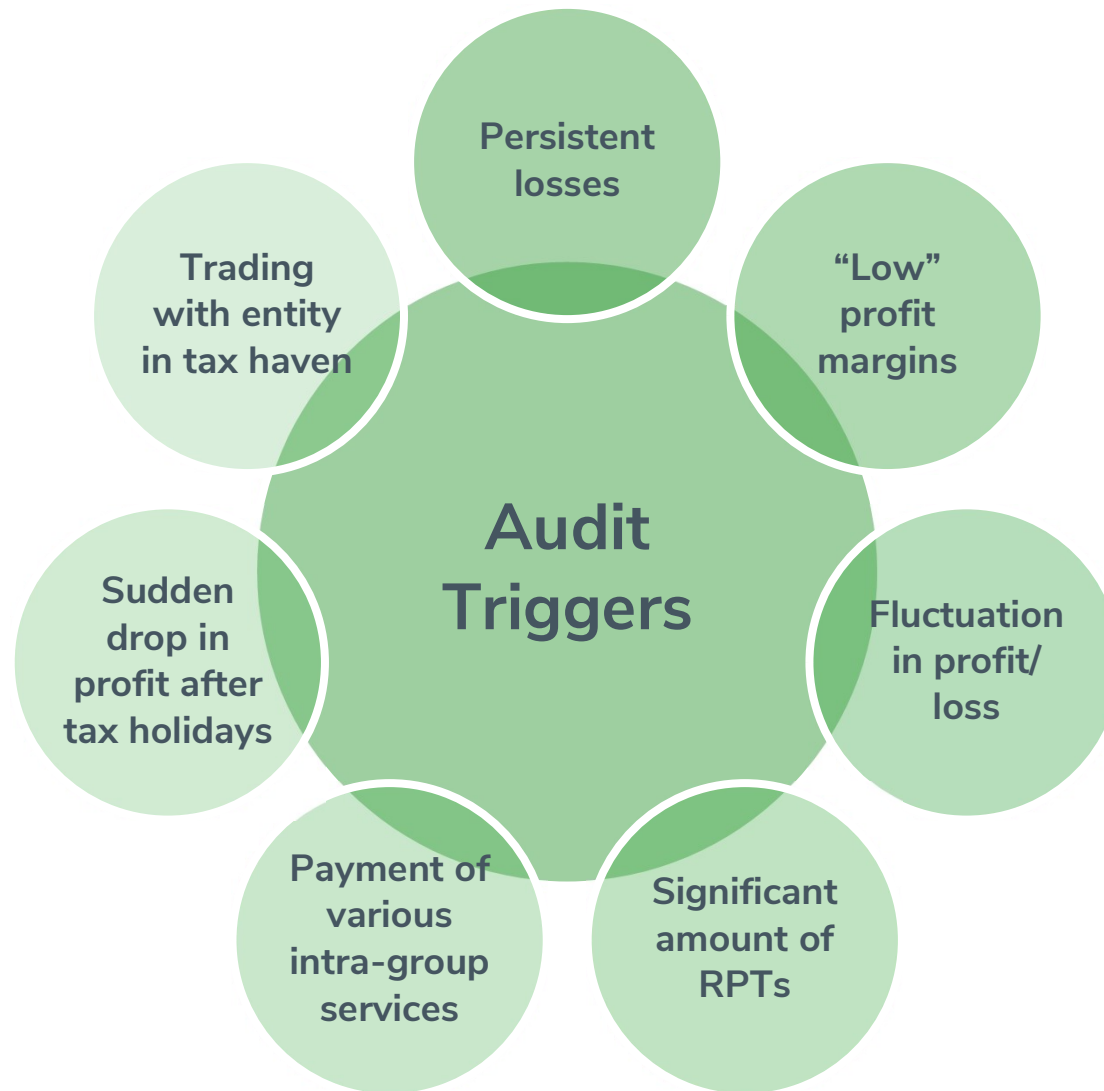
How to support the loss-making position of the Company?

Part 3-B: Audit prevention

Presenter

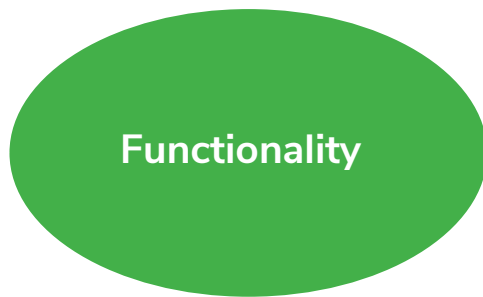
Becky Nguyen

Highlighted Transfer Pricing Audit Triggers



HOT Disputable Areas in Transfer Pricing

1. Functions, Assets & Risks (FAR) Analysis



- Actual conduct **vs** contractual arrangement

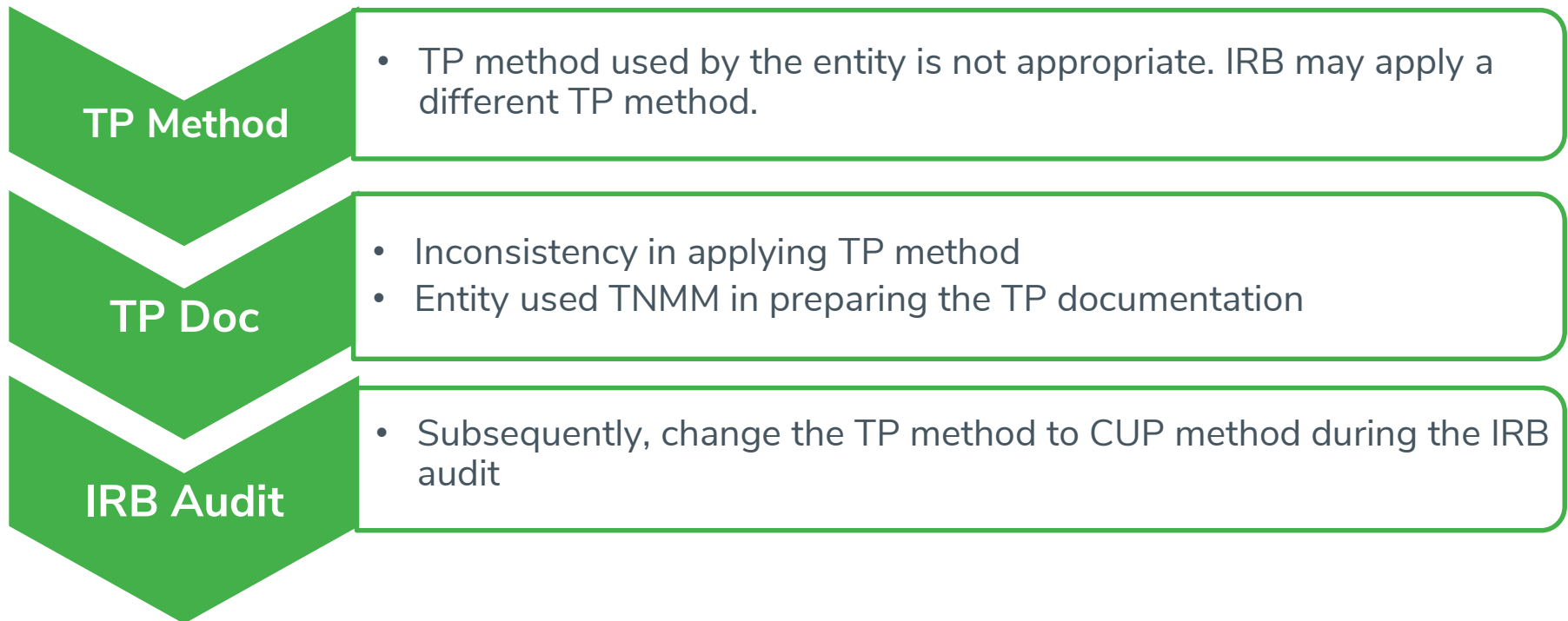


- Entrepreneur – investment/profit centre
- Full Fledged – profit centre
- Limited Risk – cost or revenue centre
- Agent – cost or revenue centre

Largest transfer pricing adjustments arise from a misunderstanding or disagreement by tax authorities re the facts of the case, leading to mis-characterization of the entity

HOT Disputable Areas in Transfer Pricing

2. Transfer Pricing Method



HOT Disputable Areas in Transfer Pricing

3. Benchmarking Analysis

Comparable Companies

- IRB prefers Malaysian comparable companies.
- FAR of the comparable companies.
- “Cherry-picking”

Profit Level Indicators (PLI)

- Ensure the entity used the most appropriate PLI.
- Normally straightforward but can be contentious e.g., OM or Berry ratio for trading house or wholesale distributor of bulk commodities?

HOT Disputable Areas in Transfer Pricing

3. Benchmarking Analysis (Cont'd)

Adjustments for non-operating items

- To adjust the expenses and income that are not part of the course of carrying out its normal operating activities.
- May be disallowed by the IRB.
- E.g. Foreign exchange gain/loss, disposal of assets, extraordinary item, etc.
- Consider working capital adjustments etc

Measure of dispersion

- Inter-quartile range
- Median
- Upper quartile and lower quartile
- Full range
- Weighted average or pooled approach?

HOT Disputable Areas in Transfer Pricing

4. Pricing Policy

- No proper pricing policy in place
- No basis for charging
- Back-to-back arrangement without any mark-up
- No charges for services rendered
- Transfer of tangible / intangible assets for no consideration
- Unreasonable expenses paid to related party
- Special price / discount given to related companies as compared to 3rd parties without justification

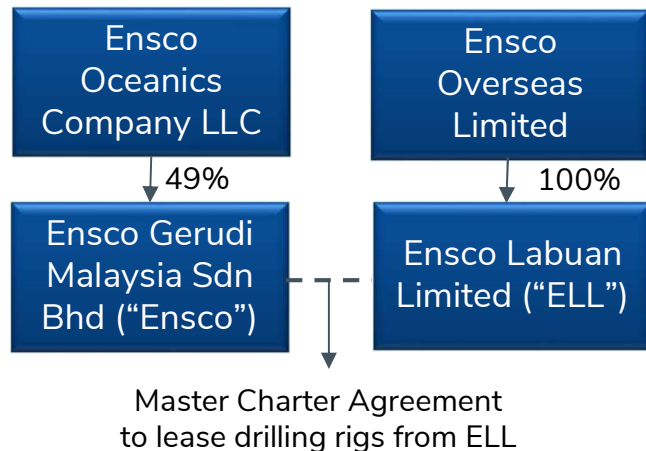
Part 3-C: Case Studies

Presenter

Becky Nguyen
Douglas Fone

Case Study – Malaysia v Enesco Gerudi Malaysia Sdn Bhd

Malaysia v Enesco Gerudi Malaysia Sdn Bhd, July 2021, Juridical Review, High Court, Case No. WA-25-233-08-2020



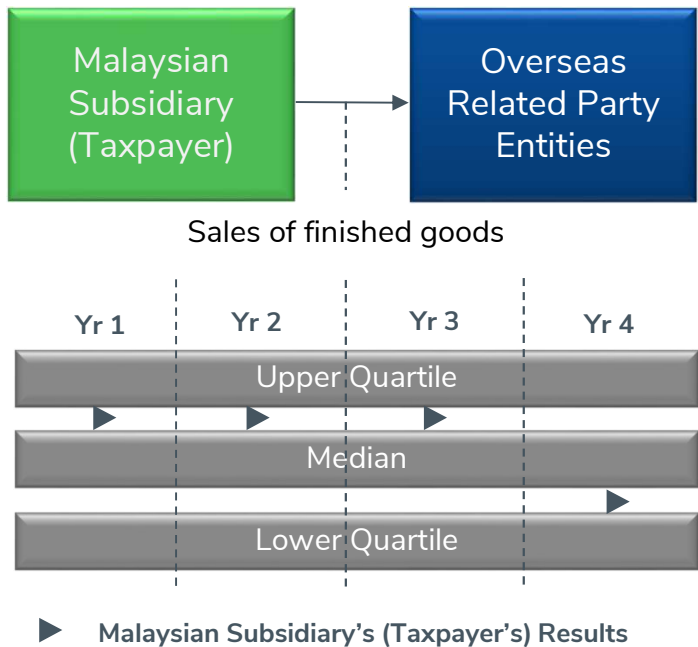
Enesco agrees to pay ELL a percentage of the applicable day rate that Enesco earns from drilling contracts.

Tax authorities proposed that profit earned by ELL should remain with Enesco by reducing cost of the leasing asset by 20% or equivalent to the margin obtained by ELL.

- Enesco in its TP Documentation used TNMM method in which it falls within the inter-quartile range of the comparable companies.
- Tax authority proposed Profit Split Method but Enesco deemed it to be unsuitable because they performed simple functions to the transactions.
- Tax authority rejected this explanation and issued Notices of Additional Assessment for YA2012 to YA2017 collectively amounting to MYR106.8 million.
- **Decision to raise tax assessment illegal?**
- **Are Enesco and ELL controlled by the same third person?:**
 - Section 140A(5A) ITA came into force on 1.1.2019. Relevant YA is before the amendment in which to have control under Section 139 ITA, Enesco has to be at least 51% owned, but it was only 49% owned by Enesco Oceanics.
- **Tax authority breached the duty to give reasons for its decision?:** Enesco's basis and justifications for the pricing of the leasing transactions (supported by TNMM) is in stark contrast to tax authority's failure to provide its own Transfer Pricing Report to Enesco to justify Profit Split Method.

Case Study – S v Ketua Pengarah Hasil Dalam Negeri

S v Ketua Pengarah Hasil Dalam Negeri (2021)



- Taxpayer's results fell within the IQR of the comparable companies **agreed** by the Malaysian IRB for all four years under audit.
 - Results fell above median in 3 out of 4 years
 - Results fell below median in 1 out of 4 years
- Malaysian IRB issued additional assessment for TP adjustment to adjust Taxpayer's results to the median for that one year.
- **Litigation Focuses:**
 - Whether TP adjustment drawn to the median point is reasonable?
 - Whether Malaysian IRB had any basis in justifying an adjustment to be made to the median as the appropriate benchmarking, without any mathematical or reasonable justification?
 - Whether Malaysian IRB had unfettered powers under Section 140A to make the adjustment?
- **Outcome:** The Special Commissioners of the Income Tax Malaysia decided in favor of the Taxpayer in all issues above and the adjustments proposed were **not upheld**.

Case Study: Mineral and metal extraction company (dispute resolution re financing)

Company:

- Client is a leading Belgian mineral and metal extraction company, with production units worldwide including in Australia for the extraction, production and distribution of industrial minerals

Business challenges:

- The company was selected by the Australian Taxation Office (“ATO”) for a comprehensive tax review as part of the ATO’s International Structuring and Profit Shifting (“ISAPS”) project
- The company had intercompany loans in excess of AUD300m and the ATO challenged the arm's length nature of the interest rate applied on those loans



Case Study: Mineral and metal extraction company (dispute resolution re financing)

The solution:

- Our controversy and regulatory services team with deep experience in managing ATO audits and with expertise in dealing with intra-group funding matters helped the company in preparing the necessary economic analysis and transfer pricing documentation and managing the entire audit process. This included making representations before the ATO, responding to the follow-up questions and attending the meetings throughout the audit process

Key benefit areas:

- The ATO walked away without making any adjustments
- This is a remarkable outcome for the company given the heightened audit environment (especially in the light of the Chevron decision) and the increased scrutiny by the media and the public backlash against perceived profit shifting by multinationals

Case Study: Consumer electronics company (dispute resolution in Australia)

Company:

- Client is a leading South Korean consumer electronics company, with wholesale distribution companies worldwide and regional headquarters company in Singapore

Business challenges:

- The company was selected by the Australian Taxation Office (“ATO”) for a client risk review which developed into a full transfer pricing audit
- The company had incurred start-up losses for 2-3 years and then low profits, and the ATO sought to adjust the pricing of purchases of finished goods by the Australian taxpayer from related party suppliers in South Korea, Singapore and elsewhere



Case Study: Consumer electronics company (dispute resolution in Australia)

The solution:

- Strategic audit management and detailed economic analysis, including
 - Assisting the client staff through rigorous interviews by the ATO to avoid misunderstandings of facts by the ATO
 - Preparation of detailed responses to ATO queries and anticipation of arguments to be raised by the ATO
 - Preparation of detailed economic analyses to justify the start-up losses and low profitability, including working capital adjustments to account for the generous inter-company payment terms allowed by the related party suppliers

Key benefit areas:

- The transfer pricing audit was converted by the ATO into a bilateral APA with an agreement on the low profitability of the taxpayer for future years and a relatively small adjustment for brought forward tax losses, resulting in no tax payable for the first 5-year APA period and a very favourable profit level for the client going forward

Part 5: Questions & Answers

Presenters

Becky Nguyen
Douglas Fone

Frequently Asked Questions

1. Does the IRB only accept Malaysian comparable companies?
2. What are TP risks for interest-free intercompany loans?
3. What TP method can be applied to provision of intercompany service transactions?



For more information, please contact:

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Thank You

Transfer Pricing Audits & Dispute Resolution in Malaysia

**Topic: Recent Tax Cases on Transfer
Pricing**

Speaker: Jason Tan (Partner, LHAG)

KPHDN v Sandakan Edible Oils Sdn Bhd

RECENT TAX CASE 2022

Transfer pricing
adjustment –
Whether IRB can
adjust to the
median of
comparables

Facts:

Taxpayer is a manufacturer and part of a large MNC. It sells its finished products primarily to related parties outside Malaysia

Taxpayer submitted TP Report based on CUP method. IRB rejected CUP and requested for TNMM. Parties eventually agreed on 6 comparables

However, IRB still made adjustments on basis that taxpayer's results fell below the median for one of the years of assessment.

Issue: Whether IRB can adjust to median when taxpayer's profits fall within interquartile range

KPHDN v Sandakan Edible Oils Sdn Bhd

RECENT TAX CASE 2022

Transfer pricing
adjustment –
Whether IRB can
adjust to the
median of
comparables

Court: No adjustment to median needed as results fall within IQR per OECD Guidelines.

IQR recognised in TP practice (SG, UK, US), and legal precedents (France, Spain, Italy).

Court looked at contemporaneous evidence, which was preferred.

IRB's allegation of comparability defects not reflected in audit. In any event, these do not justify adjustment to the median

RECENT TAX CASE 2021

Transfer Pricing –
Adjustment on
interest rate for a
loan and
disallowance of
interest expense

WPC Ltd v KPHDN

Facts: The Taxpayer borrowed RM100million from its related company in order to acquire shares in another company. The interest payable on the loan was 3% p/a and the principal amount is to be paid on demand.

IRB's Audit: IRB conducted an audit and concluded that the interest paid by the Taxpayer was not at arm's length and made adjustments under Section 140A and Rule 8(1)(b) and 8(2) of ITTPR.

IRB took the view that the non repayment of principal sum is contrary to Model Tax Convention and substituted the interest rate with 0%.

IRB also disallowed deduction of the interest paid by the Taxpayer by relying on Section 140A.

RECENT TAX CASE 2021

Transfer Pricing –
Adjustment on
interest rate for a
loan and
disallowance of
interest expense

WPC Ltd v KPHDN

Taxpayer's position: The Taxpayer argued that IRB failed to provide an arm's length price and did not prepare a transfer pricing report to justify its findings.

Taxpayer's position: IRB did not show how the loan transaction and interest charged was not at arm's length.

IRB also did not consider the transfer pricing report prepared by the Taxpayer which clearly shows that the interest rate of 3% is at arm's length.

Court's Decision: The Special Commissioners ruled that the assessments are invalid as IRB failed to show that the transaction was not at arm's length.

RECENT TAX CASE 2021

Selection of TP
comparables and
usage of median

KPHDN v P&G (High Court)



Facts: Taxpayer is a Malaysian subsidiary of a MNC. They were appointed as a limited risk distributor to distribute its health care and personal care products in Malaysia.

The price of goods sold to the taxpayer will be set by reference to a margin comparable to that of comparable 3rd party distributors. Taxpayer also prepared TP documentation.

IRB's position: IRB conducted a TP audit and concluded that the Taxpayer was a 'normal distributor', not a limited risk distributor. Based on this, the IRB selected 5 of its own comparables which it deemed to carry similar marketing functions.

IRB's position: Based on the Distribution Agreement between Taxpayer and its related company, Taxpayer could provide input in marketing plans and execute such marketing initiatives.

RECENT TAX CASE 2021

Selection of TP
comparables and
usage of median

KPHDN v P&G (High Court)



Tax Assessment by IRB:

By using its own 5 comparables and the TNMM, IRB adjusted the Taxpayer's profits to the median level of such comparables and raised time-barred assessments.

Court:

3. Use of median is wrong. IRB should adjust it to the interquartile range as per the OECD Guidelines.

4. IRB failed to perform functional/ FAR analysis.

Court:

1. Based on the Taxpayer's TP Report and all evidence, it is a limited risk distributor and the comparables selected by the IRB are not comparable.
2. The comparables also have high working capital levels, unlike the Taxpayer.

Court:

5. IRB failed to give due weight to the assets owned and risks assumed by other entities.

6. The assessments are quashed.

Enesco Gerudi v KPHDN (High Court)

RECENT TAX CASE 2021

Transfer pricing
adjustment –
Whether IRB
needs to give
reasons and
whether Section
140A was correctly
invoked.

Facts:

Taxpayer provides offshore drilling services and entered into an agreement with its indirectly associated party (ELL) to lease drilling rigs.

IRB imposed 5% mark-up on the leasing charges and raised assessments. IRB did not provide any analysis of their adjustment. Taxpayer filed a judicial review application.

IRB's Audit:

IRB conducted TP audit and took the position that the pricing of the leasing is not at arm's length. Taxpayer prepared a TP Report and argued that it has low functional and risk profile.

1st Issue: Whether IRB need to give reasons for TP adjustment?

2nd Issue: Whether taxpayer and ELL are 'associated person' and whether Section 140A was correctly invoked?

Court's decision: IRB needs to give detailed reasons in TP audit. Further, Section 140A was wrongly invoked as they are not associated persons. The assessments were quashed by the Court.

THANK YOU

If you have any queries, please do not hesitate to contact:

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