

Transfer Pricing e-Alert

26 SEPTEMBER 2019

Transfer Pricing Dispute Successfully Resolved

In *FSB v Ketua Pengarah Hasil Dalam Negeri*, a recent transfer pricing appeal before the Special Commissioners of Income Tax (**SCIT**), the Director General of Inland Revenue (**DGIR**) made transfer pricing adjustments on the premise that services provided by the holding company were duplicative of the activities carried out by the taxpayer. The DGIR invoked Section 140(1) of the Income Tax Act 1967 and applied the general tax avoidance provision to perform transfer pricing adjustments. Tax assessments were raised and the taxpayer appealed against the assessments to the SCIT.

After the hearing commenced, the DGIR reached an amicable settlement with the taxpayer, who was represented by our Tax, SST & Customs partners, Datuk D P Naban and S Saravana Kumar, together with associate, Keith Lim.

Brief Facts

The taxpayer is a Malaysian company, which, among others, provides technical support services to the construction industry and is held by an overseas holding company known as FF Ltd. FF provided a number of services, including management, advisory and training support, to the taxpayer. The taxpayer paid for the services rendered and deducted these as a business expenditure for income tax purposes.

DGIR's Assessments

The DGIR conducted a transfer pricing audit and raised a number of issues on the following services:

- Mark-up of management fees and technical fees;
- Human resources services;
- Finance and audit advisory services;
- Information technology (**IT**) services.

First, the DGIR disallowed the payments incurred by the taxpayer in respect of the human resources services on the basis that those services were irrelevant to the taxpayer. The

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DGIR also alleged that the human resources services were geared towards monitoring activities carried out by FF as the taxpayer already had a managing director and a management team who were capable of providing human resources services.

Second, the DGIR disallowed the payments incurred for the finance and audit advisory services on the basis that those services rendered by FF were duplicative since the taxpayer had employees performing similar functions.

Third, the DGIR disallowed the payments for the **IT** services as those services were seen as a form of shareholder activity provided by FF.

The summary of the determination of the arm's length price by the DGIR was as follows:

Methodology	Transactional Net Margin Method
Comparables	DGIR rejected the comparable companies proposed by the taxpayer due to unavailability of financial data
Profit level indicator	DGIR referred to the mark-up margin of the services provided by the taxpayer in conducting the benchmark analysis
Arm's length range	DGIR adjusted the mark-up of the taxpayer's services by taking the median quartile as the arm's length by using the year-on-year results. DGIR refused to apply the interquartile range on multi-year basis (i.e. weighted average over a period of years).

Taxpayer's Contention

The taxpayer argued that there was no duplicity of services for these reasons:

- The taxpayer employed only one human resources personnel. Given the limited resources, the services rendered by FF were essential to ensure the proper management of staff, assistance relating to personal evaluation and development, formulating human resource policies and managing succession planning process.

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- The finance and audit advisory services included personnel salary costs, outsourced consultancy & professional fees, and travel costs. Supporting documents established that the services provided cost savings for the taxpayer in the form of proper management of key financial indicator, effective cost-control measures and ensuring financial personnel are fully updated on the latest accounting standards to ensure competency.
- According to the OECD Transfer Pricing Guidelines, “shareholder activities” refer to activities performed by a group entity solely because of the ownership interest in other group companies even though the other group entities may not require these activities.

In the present matter, there was ample evidence that the IT services were needed to enhance the taxpayer’s business operations in Malaysia. The services resulted in cost savings through group purchase of software licence with group discount. Further, the group service developed more efficient and effective IT systems for the taxpayer through the use of a secure and stable internet platform. It increases efficiency within the taxpayer’s company and its business interactions with the group due to a common IT system in place which standardises processes and procedures.

Additionally, the taxpayer also argued that the DGIR’s transfer pricing audit was invalid as Section 140(1) cannot be invoked to raise transfer pricing assessment as Parliament had specifically enacted the section for that purpose. The transfer pricing adjustments by the DGIR were based on the Transfer Pricing Guidelines issued in 2003, which the High Court and the SCIT held in the *Maersk Malaysia* case to be not legally enforceable.

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Meanwhile, the additional assessments for the years 2003 to 2006 were time-barred as they have exceeded the timeline prescribed under the law.

Conclusion

In light of the evidence and the legal arguments put forward on behalf of the taxpayer during the hearing, the DGIR reviewed his position and negotiated an out-of-court settlement that was acceptable to the taxpayer.

Recent trends suggest an increase in transfer pricing audits by the DGIR. Hence, it is important that transactions between inter-related companies and the corresponding transfer price policy are well documented with sound commercial justification. Further, where there are intra-group services being received, taxpayers must have the necessary documentary evidence to demonstrate that the payment for such services is at arm's length in addition to establishing that they were:

- indeed rendered and not fictitious;
- necessary in the course of the taxpayer's business; and
- not duplicative in nature.

Our Tax, SST & Customs partners also successfully represented the taxpayer in *Maersk Malaysia*, which is the first transfer pricing dispute to be reported in Malaysia.

If you have any queries pertaining to transfer pricing disputes, please contact **Datuk D P Naban** or **S Saravana Kumar** at tax@lh-ag.com

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