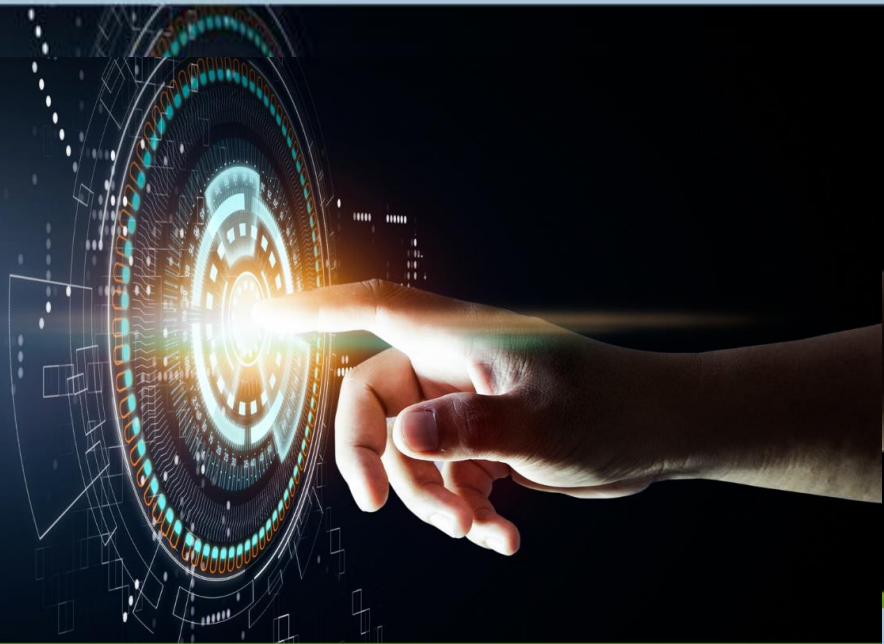


# LHAG Insights



**Special Alert!**

Tax, Customs & Trade



Dato' Nitin Nadkarni  
Consultant  
Tax, Customs & Trade  
E: [nn@lh-ag.com](mailto:nn@lh-ag.com)



Jason Tan Jia Xin  
Partner  
Tax, Customs & Trade  
E: [tjx@lh-ag.com](mailto:tjx@lh-ag.com)



Chris Toh Pei Roo  
Senior Associate  
Tax, Customs & Trade  
E: [tpr@lh-ag.com](mailto:tpr@lh-ag.com)

1 JUNE 2023

## ***High Court issues Grounds of Judgment for Landmark Decision in Transfer Pricing:***

### **Income Tax (Transfer Pricing) Rules 2023: A Knee Jerk Response?**

*Ketua Pengarah Hasil Dalam Negeri v Sandakan Edible Oils Sdn Bhd<sup>1</sup>*

### **Landmark Decision by Kuala Lumpur High Court (KLHC) in Transfer Pricing (TP)**

On 17 May 2022, the Kuala Lumpur High Court (KLHC) dismissed the Director General of Inland Revenue's (DGIR) appeal in ***Sandakan Edible Oils***. This was a landmark decision which vindicated the tax industry's view on various long-standing points of contention with the DGIR.

On 27 May 2022, the Special Commissioners of Income Tax's (SCIT) decision<sup>2</sup> which the KLHC affirmed, was recognised by [Euromoney's Benchmark Litigation Asia-Pacific Awards 2022](#) as *Malaysia's Impact Case of the Year*. The full impact of that decision would become evident a year later.

On 5 April 2023, the KLHC issued its grounds of judgment ([available here](#)) confirming, amongst others, that:

- TP adjustments ought not to be made when a taxpayer's financial results already fall within the interquartile range (IQR).
- The median point is a poor determinant and "arbitrary measure" of arm's length pricing. "The proper approach is that where there is a pattern which shows fluctuating profits between the

<sup>1</sup> *Ketua Pengarah Hasil Dalam Negeri (KPHDN) v Sandakan Edible Oils Sdn Bhd* [2023] 1 LNS 616

<sup>2</sup> *SEO Sdn Bhd v KPHDN* (2021) MSTC 10-129

*companies as one would expect in business, a range rather than a single point should be used to determine arm's length pricing. This is the proper interpretation of the OECD Guidelines*.<sup>3</sup>

- Differences in turnover between a taxpayer and comparables is not a comparability defect. “*Nothing in transfer pricing legislation requires taxpayers to achieve the same turnover as its competitors*”.

### **Erosion of TP Principles by the Income Tax (Transfer Pricing) Rules 2023 (2023 TP Rules)?**

On 29 May 2023, the 2023 TP Rules were gazetted<sup>4</sup> ([available here](#)). The 2023 TP Rules appears at least in part to be a response to recent judicial trend in transfer pricing, including the SCIT's and KLHC's decisions in ***Sandakan Edible Oils***.<sup>5</sup> Amongst others, they purport to:

- Create an unprecedented definition of the arm's length range as a range of figures or a single figure falling between the 37.5th and 62.5th percentile of a data set.<sup>6</sup>
- Empower the DGIR to make adjustments to the median or any other point above the median even when a taxpayer's price is already within the arm's length range, where comparability defects exist.<sup>7</sup>
- Provide that the arm's length price to automatically be taken to be the median where the taxpayer's price fall outside the arm's length range.<sup>8</sup>

### **Divergences in the 2023 TP Rules from the OECD Guidelines?**

These changes are startling, to say the least, particularly insofar as they appear to lead Malaysia ever further away from internationally accepted TP understandings and practices. In particular:

- The IQR (the range between the 25th and 75th percentile) is recognised internationally as a suitable determinant of arm's length pricing. The use of the IQR has been specifically recognised in the OECD Guidelines, and also in other developed countries, including Singapore,<sup>9</sup> the United Kingdom,<sup>10</sup> and the United States.<sup>11</sup>

<sup>3</sup> OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022

<sup>4</sup> P.U(A) 165

<sup>5</sup> See also, amongst others, ***KPHDN v Procter & Gamble (Malaysia) Sdn Bhd (2022) MSTC 30-523 (HC)***; ***CFE Ltd v KPHDN (2022) MSTC 10-152 (SCIT)***

<sup>6</sup> Rule 13(5), 2023 TP Rules

<sup>7</sup> Rule 13(2)(a) & Rule 13(3), 2023 TP Rules

<sup>8</sup> Rule 13(2)(b) TP Rules

<sup>9</sup> **IRAS e-Tax Guide, Transfer Pricing Guidelines (Singapore)**, paragraph 5.112 ([https://www.iras.gov.sg/media/docs/default-source/e-tax/etaxguide\\_cit\\_transfer-pricing-guidelines\\_6th.pdf?sfvrsn=26bfb1a6\\_9](https://www.iras.gov.sg/media/docs/default-source/e-tax/etaxguide_cit_transfer-pricing-guidelines_6th.pdf?sfvrsn=26bfb1a6_9))

<sup>10</sup> International Manual published by HMRC titled “**Transfer pricing operational guidance: Evidence gathering: Searching for comparables: range of results**” [INTM485120] (United Kingdom) (<https://www.gov.uk/hmrc-internal-manuals/international-manual/intm485120>)

<sup>11</sup> Regulations under **Section 482 of the Internal Revenue Code (Title 26) (United States)**; **Practice Unit (akin to Public Ruling)** published by the Internal Revenue

The 37.5th to 62.5th percentile now propounded in the 2023 TP Rules represents a narrowing of what is internationally accepted as the arm's length range in TP.

- Pursuant to paragraph 3.60 of the OECD Guidelines, no adjustments should be made if the taxpayer's results come within the arm's length range.

The 2023 TP Rules however purport to empower the DGIR to make adjustments to the median *even* when a taxpayer's price is *already* within the arm's length range.<sup>12</sup>

- The OECD Guidelines recognise that where adjustments are to be made i.e., where the taxpayer's results fall outside the arm's length range,<sup>13</sup> any point in the range could arguably satisfy the arm's length principle.<sup>14</sup>

Even if there are comparability defects, the OECD Guidelines do not mandate the use of the median but recognises that appropriate measures of central tendency to be used include the median, the mean, weighted averages, or other measures, depending on the specific characteristics of the data set.<sup>15</sup>

In this regard, it remains to be seen whether the act of rigidly prescribing the median as the arm's length price is wisdom or folly. One cannot but help recall the KLHC's observation of the median as a poor determinant and "*arbitrary measure*" of arm's length pricing.

### Potential Areas of Contentions Arising from the 2023 TP Rules

Contentions are also expected to arise between taxpayers with the DGIR on, amongst others, the following matters:

- The impact of the 2023 TP Rules on on-going TP audits and cases under litigation involving YAs before YA 2023.

For instance, it may now be open for a taxpayer to argue that prior to the 2023 TP Rules, there was no express provision whether in the Income Tax Act 1967 (ITA) or the 2012 TP rules which empowered the DGIR to make TP adjustments to the median.

In short, are the additions to the 2023 TP Rules an express recognition of ambiguities in the earlier legal position? If so, it is a trite principle in tax law that any ambiguities ought to be construed in favour of the taxpayer.<sup>16</sup>

- The 2023 TP Rules are made by the Minister pursuant to his powers under Section 154(1)(ed) of the ITA. This provision

---

**Service titled "Large Business & International ("LB&I") International Practice Service Transaction Unit" [ISI/9422.09\_06(2013)] (United States)**

<sup>12</sup> Rule 13(2)(a) & Rule 13(3), 2023 TP Rules

<sup>13</sup> Paragraph 3.61, OECD Guidelines

<sup>14</sup> Paragraph 3.62, OECD Guidelines

<sup>15</sup> Paragraph 3.62, OECD Guidelines

<sup>16</sup> *Exxon Chemical (Malaysia) Sdn Bhd v KPHDN* [2005] 4 CLJ 810



#### Head Office

Level 6, Menara 1 Dutamas  
Solaris Dutamas  
No. 1, Jalan Dutamas 1  
50480 Kuala Lumpur  
Malaysia  
Tel: +603 6208 5888  
Fax: +603 6201 0122

#### Johor Office

Suite 21.01  
21st Floor, Public Bank Tower  
No.19, Jalan Wong Ah Fook  
80000 Johor Bahru, Johor  
Tel: +607 278 3833  
Fax: +607 278 2833

#### Penang Office

51-12-E, Menara BHL Bank,  
Jalan Sultan Ahmad Shah,  
10050  
Penang  
Tel: +604 299 9668  
Fax: +604 299 9628

#### Email

[enquiry@lh-ag.com](mailto:enquiry@lh-ag.com)

#### Website

[www.lh-ag.com](http://www.lh-ag.com)

empowers the Minister to make rules “...implementing and facilitating the operation of section 140A...”.

What is the extent of the Minister’s powers (if any) under this provision? To what extent, if at all, can they diverge from international TP practice and principles, including as encapsulated in the OECD Guidelines?

With a (figurative) stroke of the pen, the Honourable Minister has reduced the arm’s length range from the IQR (25th to 75th percentile) to the range between the 37.5th to 62.5th percentile. If this is permissible, what is to prevent a future version of the TP Rules from providing a further reduction (or even obliteration to a single point) of the arm’s length range?

### Concluding Thoughts

The 2023 TP Rules have only been gazetted for less than a week and its full impact remains to be seen. In next week’s LHAG Insights, our Tax, Customs & Trade Practice will conduct an in-depth analysis and comparison of the 2023 TP Rules vis-à-vis its predecessor (the 2012 TP Rules<sup>17</sup>) and its wider impact on TP matters.

**Chris Toh Pei Roo, Senior Associate** ([tpr@lh-ag.com](mailto:tpr@lh-ag.com))

The taxpayer in **Sandakan Edible Oils** was successfully represented at both the SCIT and the KLHC by Dato’ Nitin Nadkarni, Jason Tan Jia Xin and Chris Toh Pei Roo from Lee Hishammuddin Allen & Gledhill’s Tax, Customs & Trade Practice.

If you have any queries pertaining to the KLHC’s decision in **Sandakan Edible Oils**, the 2023 TP Rules, or transfer pricing matters generally, please contact the author or his team partners, [Dato’ Nitin Nadkarni](mailto:Dato%20Nitin%20Nadkarni), [Jason Tan Jia Xin](mailto:Jason%20Tan%20Jia%20Xin) and [Ivy Ling Yieng Ping](mailto:Ivy%20Ling%20Yieng%20Ping), at [tax@lh-ag.com](mailto:tax@lh-ag.com).