

# Singapore's recent initiatives to foster compliance

Following its 2006 circular on transfer pricing, Inland Revenue Authority of Singapore (IRAS) recently announced another initiative to foster transfer pricing compliance. This is detailed in IRAS Circular: Transfer Pricing Consultation. Under the new initiative, based on the outcome of individual transfer pricing consultations, taxpayers may be selected for an in-depth field visit and further IRAS examination should their transfer pricing practices be found inappropriate. This article highlights both the 2006 and 2008 transfer pricing circulars as well as the developments in between.

## 2006 Singapore Transfer Pricing Guidelines

On February 23, 2006, IRAS Circular: Transfer Pricing Guidelines (Transfer Pricing Guidelines) was released. The document contains detailed guidance on, and documentation requirements for, transfer pricing and advance pricing arrangements (APAs). The transfer pricing guidance therein is applicable to all transactions, solely within Singapore or across borders, between a Singapore taxpayer and its related parties (be it a legal entity or permanent establishment). The guidance on mutual agreement procedures and APAs is applicable to related-party transactions where at least one party is resident in Singapore or a jurisdiction with which Singapore has a comprehensive double tax agreement.

### Arm's-Length Principle as the Standard

Like its counterparts in many countries, IRAS endorses the arm's-length principle as the standard to guide transfer pricing. This is supported by various provisions such as Sections 32 and 53(2A) of the Singapore Income

Tax Act. In addition, the Transfer Pricing Guidelines has many similarities to Organization for Economic Co-operation and Development (OECD) viewpoints – on items such as comparability, transfer pricing methods, administrative procedures, and documentation requirements. However, the IRAS guidance also somewhat echoes U.S. concepts such as the Best Method Rule and the acceptance of the interquartile range.

### Reasonable Efforts

IRAS is of the opinion that taxpayers should exert reasonable efforts to undertake a sound transfer pricing analysis, to ascertain an arm's-length price, as well as demonstrate that such an analysis has been performed. When reasonable efforts have been exercised, the transfer prices determined would be considered, prima facie, as arm's-length. Adequate and timely documentation will go towards demonstrating a reasonable effort. On the other hand, IRAS cautions that scant documentation for significant transactions may result in transfer pricing reviews and challenges. Taking a pragmatic approach, the IRAS guidance states that the extent of the

documentation effort should be balanced between the need to show that the arm's-length principle has been complied with, and the costs of compliance.

### Documentation Requirements

Annex G to the Transfer Pricing Guidelines provides a non-exhaustive list of items that taxpayers should include in their documentation to demonstrate that reasonable efforts have been expended in determining arm's-length transfer prices. Depending on the type and significance of the transaction involved, these items include (but are not limited to):

- details on the transacting related parties and their financial information;
- functions performed by each related party;
- risks undertaken by each related party; assets employed by each related party;
- details on the related-party transactions;
- rationale for the chosen transfer pricing method and tested party;
- details on the comparables chosen; and
- reasons to support the arm's-length range so determined.

## Developments Since 2006

Since the introduction of the Transfer Pricing Guidelines, IRAS has been gradually increasing scrutiny on related-party transactions. Observations point to IRAS' interest in the following areas:

- fees for intra-group services charged out or received by the many regional headquarters in Singapore, with the focus towards the cost incurred in provision of the services, the method of allocation to different recipients, and the mark-up levied; and
- whether adequate compensation has been received for the trading of goods and the distribution function, given the level of functions performed, risks undertaken, and assets used.

Away from the audit front, IRAS has also been actively involved in raising the awareness of transfer pricing issues. To this end, IRAS has been involved in organizing seminars for taxpayers to gain a better understanding of transfer pricing.

## 2008 Transfer Pricing Consultation Initiative

In July 2008, IRAS released IRAS Circular: Transfer Pricing Consultation (TPC Circular), with the aim of examining taxpayers' compliance with the Transfer Pricing Guidelines. The initiative also seeks to identify areas where IRAS may further assist and advise taxpayers on good transfer pricing practices as well as actively reinforce IRAS' expectation for taxpayers to adhere to the arm's-length principle. To ensure this, IRAS has decided to conduct compliance activities, including audits.

IRAS plans to monitor the level of transfer pricing compliance by adopting the following steps:

- IRAS will send questionnaires to selected taxpayers with sizeable related-party transactions, especially with overseas parties, or with recurring losses for no apparent reasons. A sample of the questionnaire is attached as Annex 1 to the TPC Circular. IRAS also indicated that the questionnaire may be customized for specific taxpayers.

In the questionnaire, the taxpayer is required to provide detailed information on its related-party transactions, whether there has been any transfer pricing audit challenges outside of Singapore, and the extent documentation has been maintained in accordance with IRAS guidance.

- Based on the response, IRAS will assess if a transfer pricing consultation is warranted. A transfer pricing consultation entails a field visit to the taxpayer's location to better understand the taxpayer's business and, if necessary, a physical review of the taxpayer's documentation. The taxpayer is expected to make available personnel and related documents for the IRAS field officer's perusal.
- Based on findings from the field visit, IRAS will provide the taxpayer with its opinion with respect to items such as the adequacy and timeliness of the taxpayer's documentation, its reservations (if any) on the transfer pricing methodology adopted, the taxpayer's transfer pricing risk, and how the documentation or methodology may be improved.
- If the taxpayer's transfer pricing "deviates significantly" from IRAS' opinion of appropriate arm's-length pricing, IRAS will express its position and make arrangements with the taxpayer to review the issue at an appropriate time.

The TPC Circular concludes by emphasizing the notion contained in the Transfer Pricing Guidelines that taxpayers with significant related-party transactions need to determine whether they have adequate and timely documentation to demonstrate compliance with the arm's-length principle. Once again, taxpayers are referred to Annex G to the Transfer Pricing Guidelines for details of IRAS' requirements.

## Observations and Outlook

Between 2006 and 2008, IRAS seems to have been gradually increasing its focus on transfer pricing. The Transfer

Pricing Consultation initiative may be viewed as a signal that IRAS is placing greater emphasis on transfer pricing compliance. Beyond this, with the increasing interest by Singapore taxpayers in APAs, IRAS has also released additional transfer pricing guidance in the form of a circular providing administrative guidance on APAs. More recently, IRAS has also finalized transfer pricing guidance for related-party loans and services.

In the TPC Circular, the approach adopted by IRAS to assess compliance includes elements of targeting selected taxpayers for a detailed examination and possible field visit. As of February 2009, IRAS have conducted visits to more than 20 companies and have sent questionnaires to an even greater number. Like a somewhat parallel program already in place for goods and services tax compliance assurance, taxpayers who deviate from IRAS' expectations may end up being subject to a more in-depth review and possibly, even upward adjustments to income. It would indeed be prudent for taxpayers with complex and significant related-party transactions to have adequate contemporaneous documentation, before that day comes.

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