

As multinational companies search for more efficient ways to compete in global markets, cross-border transactions between related companies are increasing in number and complexity.

Today, it is not uncommon for a finished product to contain parts made by members of a multinational group that are located across several countries. In addition, management and administrative services for an entire organization are often concentrated at the head office location to achieve economies of scale.

Transfer pricing refers to the terms at which goods, services, funds, technology, and intellectual property rights are transferred across borders by related companies. Tax laws and regulations in most market economies require the related parties to conduct such transactions at arm's-length prices – that is, those prices that would have been charged if the parties were unrelated. In many jurisdictions, significant penalties may be imposed if arm's-length practices are not followed.

Singapore Transfer Pricing Requirements

In February 2006, the Inland Revenue Authority of Singapore (IRAS) released the IRAS Circular: Transfer Pricing Guidelines (Main Circular) with detailed guidance on, and documentation requirements for, transfer pricing and advance pricing arrangements (APAs). The guidance in the Main Circular is applicable to all transactions, both local

and cross-border, 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 only applicable to related-party transactions where the transacting entity is resident in a jurisdiction which has a comprehensive double tax agreement with Singapore.

Like its counterparts in most countries, IRAS endorses the arm's-length principle as the standard to guide transfer pricing. This is supported by various provisions such as Section 53(2A) of the Singapore Income Tax Act (SITA). 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 analysis has been performed. When reasonable efforts have been exercised, the transfer prices would be considered, prima facie, as arm's-length. Accordingly, the burden of proof would then reside with IRAS. Adequate and timely documentation will go towards demonstrating a reasonable effort. Indeed, IRAS warns that scant documentation for significant transactions may result in transfer pricing reviews and challenges.

Annex G to the Main Circular 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 may include:

- details on the product transferred;
- the transacting parties and their financial information;
- the functions performed, risks undertaken, and assets used by each related party;
- the rationale for the chosen transfer pricing method and tested party;
- transactions between and/or with third parties or comparables chosen; and
- an arm's-length price range.

Since the introduction of the Main Circular, IRAS has been gradually increasing its focus on transfer pricing. A second circular, Transfer Pricing Consultation Circular (Consultation Circular), was released by IRAS in July 2008, with the aim of fostering taxpayers' transfer pricing awareness and compliance. The initiative also seeks to identify areas in which IRAS may further assist and advise taxpayers on good transfer pricing practices.

IRAS plans to monitor the level of transfer pricing compliance by adopting several steps, including:

- sending questionnaires to selected taxpayers with sizeable related-party transactions or with recurring losses for no apparent reasons;
- assessing if a transfer pricing consultation is warranted; and
- providing the taxpayer with its opinions on the adequacy and timeliness of the taxpayer's documentation.

If the taxpayer's transfer pricing deviates significantly from IRAS' opinion of arm's-length pricing, IRAS may make arrangements with the taxpayer to review the issue further. As of February 2009, IRAS have conducted visits to more than 20 companies and have sent questionnaires to an even greater number. The Consultation Circular concludes by emphasizing the notion contained in the Main Circular – that taxpayers with significant related-party transactions need to have adequate and timely documentation to demonstrate compliance with the arm's-length principle.

With the increasing interest by Singapore taxpayers in APAs, in October 2008, IRAS released additional transfer pricing guidance in the form of a circular providing administrative guidance on APAs. The guidance provides a formal framework to facilitate the application and consideration of APA requests, and specifically highlights the commitment needed from taxpayers in relation to an APA request.

More recently in February 2009, IRAS finalized transfer pricing guidance for related-party loans and related-party services (e-Tax Guide). In this supplementary e-Tax Guide, IRAS reaffirms its endorsement of the arm's-length principle to determine transfer prices but recognizes that embarking on a comprehensive transfer pricing analysis to demonstrate compliance may not always be practical or administratively expedient. Accordingly, in the e-Tax Guide, IRAS will allow

taxpayers some flexibility to vary from the arm's-length principle under certain circumstances, in order to facilitate compliance.

Penalties

Singapore does not have penalties specifically for transfer pricing. However, IRAS has the legislated power to impose penalties from 100 percent of the tax undercharged (for an incorrect return) to 400 percent of the tax undercharged (for serious fraudulent tax evasion). In the event of insufficient or lack of documentation, IRAS may invoke Section 65, 65A, and 65B of the SITA and thereafter enforce penalties for violation of these provisions.

Transfer Pricing Audits

With the release of transfer pricing guidance in Singapore, IRAS has been increasing its focus on related-party arrangements and prices in their tax audits. This is likely due to the fact that many of Singapore's trading partners have toughened their transfer pricing requirements significantly over the past decade. Such developments have caused taxpayers with cross-border transactions to err on the side of caution – by imputing more income into countries with stricter transfer pricing requirements and penalties.

How Companies Are Responding

For many multinationals, devoting staff to accommodate a transfer pricing audit drains resources from productive uses and creates an atmosphere of uncertainty that distracts from planned objectives. As a result, many multinationals have increasingly focused their attention to avoid exposure on their transfer prices.

Astute multinationals test their transfer prices using IRAS-approved methods and seek to achieve and document a favorable set of transfer prices across borders. Such companies also aggressively counter the arguments and evidence of tax authorities who try to redefine transfer prices to their rulings or multilateral APAs with tax authorities to cover future transfer

prices, and sometimes, as a method of resolving historic issues.

How KPMG Can Help

At KPMG, we have assisted many companies in identifying and addressing transfer pricing issues. In the assignments that KPMG in Singapore and other member KPMG firms worldwide have completed, we have assisted multinationals by:

- recommending appropriate arm's-length transfer prices to value transactions for both documentation and planning purposes;
- minimizing the effective tax rate internationally through the use of transfer pricing planning;
- defending against tax authorities' audits of transfer prices;
- preparing documentation and negotiating APAs with tax authorities to cover future transfer prices;
- making presentations on behalf of taxpayers during Transfer Pricing Consultation field visits from IRAS; and
- assisting in the identification and quantification of transfer pricing positions for FIN48 and corporate financial control purposes.

Strategic, efficient transfer pricing can be a reality. Contact KPMG for further details on our global transfer pricing services.

Contact us

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