

## **Authors Boost Clarity**

### **The Logic and Practice of Transfer Pricing**

*Amidst great changes, it would be wise to look back and take stock before progressing.*

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Accredited Tax Advisor (Income Tax) Sam Sim, author of *The Logic and Practice of Transfer Pricing*, provided the audience with a different perspective of transfer pricing.

**I**n recent times, transfer pricing (TP) has been at the forefront of the Organisation for Economic Cooperation and Development (OECD)/G20's Base Erosion and Profit Shifting (BEPS) Project. This can be seen in Actions 8, 9, 10 and 13, which are transfer pricing recommendations, and the frequent references made to TP in the other Actions.

Against this backdrop, the Singapore Institute of Accredited Tax Professionals and LexisNexis organised a technical session titled "The Logic and Practice of Transfer Pricing", designed specially to provide accredited tax professionals with workable practical tips and insights so that they can be a head above the whirlwind of developments in this area.

Putting things in an Asian perspective was Sam Sim, author of LexisNexis' book *The Logic and Practice of Transfer Pricing*. In a lively evening discourse with Luis Coronado, TP Leader for Singapore and ASEAN, EY Singapore, and Associate Professor Darren Koh, Head of the Master of Taxation Programme at SIM University, interesting observations were made. One of these was that while the OECD BEPS recommendations, particularly the changes to the OECD TP Guidelines, are meant to be global in nature, the reality of there being only four countries in the Asia-Pacific region that are currently members of the OECD is that the translation of the BEPS recommendation through the OECD guidelines may not be uniformly adopted or interpreted across the Asia-Pacific countries.

#### **Action 13's Three Pillars of TP Documentation**

Zooming in on BEP's Action 13, which focuses on TP documentation, there is a country-by-country (CbC) reporting (CbCR) template which is maintained at the headquarters level, while the master and local files are required of the various subsidiaries across the world. More effort will now be required of taxpayers to document and explain what is done throughout the value chain of the Multinational Enterprise (MNE) Group rather than the focus on specific transactions or entities in the past.

A taxpayer's TP position and risk assessment by a tax administrator can only be fully determined with a review of all three documents mentioned above. OECD does not recommend drawing a conclusion based on any one document and imposing tax on a formulaic basis. It has also been a concern amongst taxpayers who responded to the OECD consultations that the draft CbC template published by OECD mainly reflects numbers such as revenue, profits, tax payable and headcount, with a lack of provision for explanation on substance, strategy or justification of the different profiles from different industries.

To illustrate, if a corporation has a manufacturing plant in Country A with many workers and a large revenue, and research and development facilities with far fewer employees in Country B, and Country B has a lower tax rate, a CbCR interpretation based on numeric headcount information may not reflect the substance or reality sufficiently to form a basis for applying transfer pricing policies.

It should also be noted that CbCR is akin to an aggregated spreadsheet. The reporting MNE can but the OECD does not insist that consolidated financials be used and each constituent entity will need to be accounted for.

Companies would find relief in noting that Singapore's new TP rules do not require the CbCR and documentation in the 'Master-Local' file format for certain transactions that do not exceed the set annual thresholds and certain scenarios such as in cases where the taxpayer applies the safe harbour 5% cost mark-up for routine services.

In the revised guidelines, one of the new rules is the requirement of TP documentation to be kept contemporaneously and made available to the Inland Revenue Authority of Singapore (IRAS) within 30 days upon request.

A note of comfort for taxpayers is that annual updates of the TP benchmarking are generally not required as long as the operating conditions remain unchanged. Taxpayers are however encouraged to update their TP documentation at least once every three years.

### **TP Queries By Tax Authorities**

TP queries may be the result of a review of the taxpayers' annual tax returns, or they may arise during the TP consultation process. Some of the queries raised have been centred on sales and purchases, the provision or receipt of services, and use of intangible property.

In the area of sales and purchases, taxpayers may be asked to show the existence of a transfer pricing policy and the reasons for recurring losses. For services, taxpayers should be prepared to provide information on the components of the cost base, the basis of charge and methodology or how the services benefit the Singapore taxpayer (if the Singapore taxpayer is the recipient of the service), among others.

Queries on royalty rates and nature of charge might be some of the queries that may arise in the use of intangible property or sole distribution rights.

### **Practical Steps To Take**

With these insights, one key initial step is to take stock. A holistic collation and assessment of the tax profile and data on matters such as identifying related party transactions, the corresponding parties and the functions, assets and risks performed by or assumed by such parties should be done.

The various types of transactions and the exceptions should be identified. Thresholds should be noted and transactions that may exceed these thresholds in the following year should be highlighted and preparatory work done accordingly.

Another area to be analysed is the tax incentive(s) a company may be enjoying in the various countries and the alignment to substance. These have increasingly become the areas of focus of tax authorities.

For greater efficiency, it is best to review what has been done in the various subsidiaries and put in place processes and templates to achieve consistency. With a TP strategy in place, taxpayers should then monitor the TP results periodically and not wait till the end of the year. It would be wise to put in place a monthly or quarterly monitoring mechanism and ensure that resources are committed to sustain the level of monitoring.

Relevant documentation should then be prepared to complement the periodic monitoring practice. TP documentation should always be dated and in the case of Singapore, it should be prepared prior to November 30 of the year following the financial year-end for calendar year taxpayers. These can then be readily submitted to IRAS upon request.

With group level documentation and the need to ensure a consistent strategy is communicated across various tax jurisdictions, it is critical for corporate headquarters to take a hands-on leadership approach in this matter. A centralised rather than a decentralised approach is likely the trend forward. Nevertheless, it is also essential that the local tax team knows and more importantly, understands the strategy, and is in a position to be able to set the right tone to the authorities – even if it includes an explanation of the industry in general.

While some companies have dedicated TP inhouse specialists, this is often not the case. Having an inhouse TP team may also not solve the issue as most of the information is in the domain of the finance function or the business and operations teams. The buy-in and support of the Chief Financial Officer, Financial Controller and finance team are key to a successful implementation of TP.

BEPS is here to stay. More countries will be adopting OECD's guidelines in various degrees. Tax specialists are advised to develop a strong grasp of their business and be ready with all the necessary documentations. And when one is unsure, the words of a game show host hold true here: "Call a friend." Sometimes, speaking with a friend in the same industry who has more experience with implementing TP, and hearing various perspectives, helps. Of course, this friend should preferably be an accredited tax professional.

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### **About SIATP's Technical Discussions**

SIATP's technical discussions have continually been very well received by accredited tax professionals. Unlike the run-of-mill Continuing Professional Educational courses which typically cover tax fundamentals, SIATP's interactive technical discussions are designed to cover tax issues that do not have clear-cut solutions or situations that may have different interpretations. Over time, these discussions contribute in boosting the overall tax standards in Singapore.

### **About Mr Luis Coronado**



***Partner & Singapore and ASEAN Transfer Pricing Leader,  
EY Singapore***

Luis has over 20 years of experience in international tax and transfer pricing issues and has worked in Asia since 2005. He has advised companies on the negotiation of bilateral advance pricing agreements in Mexico, Korea, China, Canada, Singapore, Japan, the United States and Australia. He frequently advises the Inter-American Development Bank and World Bank on tax policy issues, especially in the area of transfer pricing legislation. Luis is a frequent speaker at tax seminars and universities in the America, Asia and Europe, lectures at IBFD and has taught at the Yangzhou Taxation Institute of China's State Administration of Taxation.

### **About Mr Sam Sim**



***Accredited Tax Advisor (Income Tax)  
Board member and Vice-Chair,  
Tax Committee of Tax Executive Institute (Asia)  
Transfer Pricing GEO Leader, Asia-Pac & Japan  
Fortune 100 U.S. Technology MNC***

Sam was previously Deputy Head, Global Transfer Pricing for a FTSE 100 financial institution where he led a global team of professionals covering TP pricing across the institutional and retail banking businesses. Sam has also lectured at the IBFD international tax academy and the Masters of Tax program at UniSIM. He holds an LL.M. (tax) from New York University and is a Chartered Accountant (Singapore) as well as a qualified attorney of both the New York and Singapore Bars.

## About A/P Darren N T Koh



***Associate Professor, Head of the Master of Taxation Programme  
SIM University***

Darren has a keen interest in international taxation, particularly in the field of transfer pricing and tax efficient supply-chain structuring. After being called to the Bar, he started his career at PricewaterhouseCoopers, London moving to KPMG, Hong Kong and next to Procter & Gamble (P&G). He then spent two years with the United Nations Compensation Commission, a branch of the United Nations Security Council, advising Commissioners on the verification and valuation of war reparation claims filed against Iraq after the first Gulf War. He returned to P&G after his stint at the UN, and later left P&G as Associate Director for the ASEAN/Australasia/India region to pursue a career in academia.

This technical event commentary is written by SIATP's Assistant Director, Joanna Wong and Tax Manager, Felix Wong. This article is based on SIATP's Authors Boost Clarity session facilitated by Sam Sim, Accredited Tax Advisor (Income Tax) and author; Luis Coronado, TP Leader for Singapore and ASEAN, EY Singapore, and A/P Darren Koh, Head of the Master of Taxation Programme, SIM University. For more tax insights, please visit [www.siatp.org.sg](http://www.siatp.org.sg).